These notes refer to the Energy Act 2008 (c.32)
which received Royal Assent on 26 November 2008

ENERGY ACT 2008

EXPLANATORY NOTES

Part 2: Electricity from Renewable Sources

The Renewables Obligation

Summary and Background

104. This Part of the Act deals with the changes proposed to the Renewables Obligation. The Renewables Obligation (RO) was introduced in 2002 to stimulate growth of electricity generation from renewable sources. The support currently provided under the RO does not differentiate between renewable technologies. It is the main policy measure for supporting the development of renewable electricity across Great Britain and Northern Ireland. In Great Britain the RO operates under the Electricity Act 1989 (c.29) with separate orders in England and Wales (the Renewables Obligation Order 2006 (SI No 2006/1004), as amended by the Renewables Obligation (Amendment) Order 2007 (SI No 2007/1078)), and in Scotland (the Renewables Obligation (Scotland) Order 2007 (Scottish SI No 2007/267)). These, together with a parallel measure in Northern Ireland (the Renewables Obligation Order (Northern Ireland) 2007 (S.R.2007/104), made under Articles 52 to 56 of the Energy (Northern Ireland) Order 2003 (S.I. 2003/419 (N.I.6))) provide for consistent Obligations in all three jurisdictions.

105. Under the existing regime, licensed electricity suppliers in the relevant part of Great Britain have a "renewables obligation" to produce to the Gas and Electricity Markets Authority ("the Authority"), before a specified day, certain evidence regarding the supply to customers in Great Britain of electricity generated by using renewable sources. The evidence required is in the form of renewables obligation certificates ("ROCs") currently issued by the Authority to renewable electricity generators on the basis of 1ROC/MWh of renewable electricity. The generator can then sell these ROCs to suppliers with the electricity or separately. The Renewables Obligation Order in England and Wales and the one in Scotland set out the proportion of the electricity supplied by an electricity supplier that must be sourced from renewable sources.

106. As an alternative to providing ROCs, electricity suppliers may discharge their renewables obligations (either fully or partially) by making buy-out payments to the Authority. Payments made into the buy-out fund are redistributed at the end of the obligation period to suppliers who have produced ROCs, on a pro-rata basis. The obligation level has been deliberately set higher than the expected amount of renewables generation to be deployed in order to ensure there is a market for ROCs. This will mean some suppliers pay the buyout price for at least some of their obligation. The redistribution of the buyout fund in this way is intended further to promote competition between suppliers in supplying more electricity from renewables sources, and therefore to promote further investment in renewables generation.

107. The existing legislation also provides for suppliers who do not comply with the RO by the specified day to be treated as having subsequently discharged the RO if they make late buyout payments, together with escalating interest into a late payments fund.

108. It also makes provision for requiring suppliers to make payments to the Authority to cover some or all of an un-recovered shortfall in the buy-out fund caused, for example, by the insolvency of a supplier with an obligation who cannot make payments into the buyout fund. Where this occurs, additional sums are then required from the remaining electricity suppliers to cover the amounts that would have been paid by the insolvent supplier. This process is known as mutualisation.

109. As already mentioned, Northern Ireland has enacted legislation which is analogous to the provisions of the Electricity Act 1989 creating the RO. That legislation requires Northern Ireland suppliers to produce, as evidence, Northern Ireland Renewables Obligation Certificates ("NIROCs") issued by the Northern Ireland equivalent of the Authority, the Northern Ireland Authority for Utility Regulation. ROCs issued in Northern Ireland are also recognised in Great Britain and can be used by GB suppliers to discharge their obligations. Similarly ROCs issued under the two GB orders can be used by suppliers to fulfil the Northern Ireland RO.

110. The Government's proposed reform of the RO in Great Britain in the Act is designed to bring forward more renewables generation by increasing the effectiveness of the RO. The proposals enable the Secretary of State to increase support to some forms of renewable generation, while reducing subsidy to others.

111. The proposals will:

- Allow the Renewables Obligation to be banded to provide different levels of support for different technologies based on their cost and other considerations specified in the Act.
- Change the obligation to one in which suppliers must present a specified number of renewables obligation certificates (ROC), rather than supply a specified percentage of their electricity from renewable sources.
- Maintain the rights of most existing generating stations to claim 1ROC/1MWh once banding is introduced.
- Provide for the bands to be reviewed periodically or where a specified condition triggers a review.
- Provide for a mechanism to prevent a price crash in the event of an anticipated oversupply of ROCs.
- Require biomass operators to provide information to the Authority on the source of biomass fuels and what steps they have taken to ensure its sustainability.
- Allow generating stations using both fossil fuel and renewable sources (e.g. energy from waste plants) to claim ROCs only for the proportion of electricity generated by the renewable source.
- Enable the Authority to recover the costs of administering the RO from the buyout fund.

112. The Act transfers the functions of the Secretary of State under section 37 to the Scottish Ministers. In the past, the RO has been executively devolved to the Scottish Ministers by an Order in Council under section 63 of the Scotland Act 1998. In order to maintain the current devolution settlement, the new powers taken in relation to the RO need to be transferred to Scottish Ministers in so far as they apply to Scotland. This transfer of functions on the face of the Act has the same effect as if the powers had been transferred to the Scottish Ministers by an Order under section 63 of the Scotland Act 1998.

113. The detail of the changes will be covered in secondary legislation made under the new sections 32 to 32M of the Electricity Act 1989. The orders will be subject to a statutory consultation process.

114. Since the RO was first introduced in 2002, there have been a number of subsequent changes to the primary legislation (made by the Energy Act 2004 and the Climate Change and Sustainable Energy Act 2006) intended to improve the way that the RO works. However as has been indicated by the Committee of Public Accounts[1] and by the Government Review of the RO[2] there is scope for further increases in efficiency of the RO as a mechanism. The reforms proposed in this Act are intended to restructure the way the RO works while maintaining its overall aims. In practice there will continue to be an obligation on suppliers to present certificates to the Authority or to pay a penalty. The buy-out fund will continue to be recycled in order to promote competition in the renewables market. As there have been a number of previous changes to the primary legislation, the Government has also taken the opportunity through the Act to recast the existing legislation so that it is easier for the reader to follow.

Commentary on Sections

Section 37: The Renewables Obligation

115. Section 37 substitutes sections 32 to 32M in the Electricity Act 1989 in place of sections 32 to 32C. The new sections incorporate all amendments made to the Renewables Obligation (RO) in primary legislation since 2002, as well as the further additions and amendments proposed by this Act.

New section 32

116. New section 32 defines the RO and provides a power for the Secretary of State and the Scottish Ministers to make a renewables obligation order detailing how the RO will operate in practice. The process for Parliamentary approval in the Westminster and Scottish Parliaments of the order by affirmative resolution is set out in sections 32L(2) and (3).

117. *Subsection(6)* sets out the new obligation which may be imposed on electricity suppliers in the relevant part of Great Britain. The existing obligation requires specified electricity suppliers to provide evidence of the supply of a certain *quantity of electricity* from renewable sources. The new obligation requires electricity suppliers to submit a certain *number of ROCs* during a specified period. The number of ROCs to be submitted will be calculated in respect of the total amount of electricity of any kind (i.e. renewable or non-renewable) supplied by a given supplier in that period.

New section 32A

118. New section 32A enables an order to specify how the level of the obligation is to be set. In particular, the order will:

- specify how the number of ROCs which an electricity supplier must produce to the Authority for a given period is to be calculated;
- allow scope to provide that ROCs issued in respect of electricity generated from different renewable sources or different types of generating station can only be used to discharge the obligation up to a certain number or a certain proportion of a supplier's obligation (this allows for a cap on the contribution made by particular technologies such as co-firing of biomass by coal-fired power stations);
- determine how the amount of electricity supplied by electricity suppliers to customers is to be calculated. The size of a supplier's individual obligation is generally based on its electricity sales.

119. *Subsection (3)* provides that suppliers cannot produce the same ROC more than once as evidence of complying with the obligation.

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1 http://www.parliament.the-stationery-office.co.uk/pa/cm200506/cmselect/cmpubacc/413/413.pdf
2 http://www.dti.gov.uk/energy/sources/renewables/policy/renewables-obligation/key-stages/2005-6-review/page18365.html

120. *Subsection (6)* provides, among other things, for the order to enable suppliers to 'bank' a specified number of ROCs acquired during a current obligation period which can then be presented to the Authority in a later obligation period. This power is to allow suppliers to hold over ROCs where, for example, for business process reasons they do not manage to present ROCs by the due date or if they have more ROCs than they need to meet their obligation for a given period. The order can specify the proportion or numbers of ROCs that may be held back for any period.

New section 32B

121. New section 32B provides for the issue of ROCs by the Authority. It enables the order to set out the criteria for their issue. Section 32B also sets out what ROCs are to certify. *Subsection (3)* provides for a ROC to certify that the amount of electricity stated in the certificate is from a renewable source and that it has been supplied to customers in Great Britain or the part of Great Britain stated in the certificate. It also sets out a number of alternative matters which ROCs may be required to certify.

122. *Subsections (5), (6)* and *(8)* provide for ROCs to be issued in respect of total quantities of renewable electricity generated by more than one generator, which facilitates the issue of ROCs to agents acting for small generators.

123. *Subsections (7)* and *(8)* allow ROCs to be issued where renewable electricity has been generated but not sold through a licensed supplier in accordance with 32B(3) so long as that electricity has been used in a *permitted way*.

124. *Subsections (9)* and *(10)* set out what is meant by *permitted way*. This is where (i) the electricity which has been generated has been used by the operator of the generating station; (ii) where electricity is provided through a private wire network to customers (for example where a generator supplies electricity to customers on a neighbouring industrial estate); (iii) where the electricity has been provided to an electricity network in circumstances where its supply to customers cannot be demonstrated (for example, where a small generator produces excess electricity which it is unable to consume and the electricity automatically "spills" onto an electricity network). The definition of a private wire network is set out in *subsection (11)*.

New section 32C

125. New section 32C allows the order to exclude specified renewable sources or descriptions of generating stations from eligibility for ROCs, or to confine such eligibility to a proportion of electricity from specified sources. For example, large hydroelectric plants that have been running for over fifty years can compete in the wholesale electricity market without any additional incentive from the RO.

126. *Subsection (4)* provides for generating stations using both fossil fuel and renewable sources to be able to claim ROCs only for the proportion of electricity generated by the renewable source. The order will specify how the proportion is to be calculated, and the consequences for issuing ROCs to a generating station where it uses more than a certain proportion of fossil fuel during a period.

127. *Subsection (8)* replicates provisions in the existing legislation for the RO. It requires the order to preclude the issue of ROCs in certain circumstances where the Northern Ireland Authority is not satisfied that the electricity has been supplied to customers in Northern Ireland.

New section 32D

128. New section 32D creates a new power to enable the Secretary of State, through the order, to set bands. Changing the obligation in this way will enable different levels of support to be provided to different technologies and, in particular, will enable the

order to provide higher levels of support for less mature, emerging technologies, such as offshore wind and biomass.

129. *Subsection (1)* provides that the order may specify how much electricity each ROC is to certify as having been supplied. In particular, (as *subsection (2)* explains) the amount may vary as between different types of renewable sources or technologies. So a ROC issued in respect of "Source A" could certify a different amount of electricity from a ROC issued in respect of "Source B", based on the band in which that particular technology or renewable source is placed

130. This banding power will thus allow for different technologies and renewable sources to be awarded ROCs for either greater or lesser amounts of electricity. For example, the Secretary of State and the Scottish Ministers may decide that a generating station using a certain renewable source or technology will have to generate 0.5 MWh of electricity to get 1 ROC. Equally the Secretary of State and the Scottish Ministers may decide that other generating stations using another renewable source or technology will have to generate 4 MWh of electricity in order to qualify for 1 ROC.

131. *Subsection (4)* sets out the matters to which the Secretary of State and the Scottish Ministers must have regard before setting bands in the order, namely:

a) the costs associated with generating electricity from renewable sources and the cost of transmitting or distributing that electricity;

b) the income that generators using renewable sources receive from generating electricity or from activities associated with the generation of electricity;

c) the impact of the exemption from the Climate Change Levy for those generators;

d) the likely impact of the proposed banding in securing the growth and development of renewables generation and associated industries;

e) the likely effect of the proposed banding on the number of ROCs issued by the Authority and the impact on the ROC market and on consumers;

f) the potential contribution of electricity generated from each of the various renewable sources to the attainment of any target relating to the generation of energy generally, or of electricity in particular, which arises from a target imposed by, for example, an EU Directive.

132. *Subsections (7)* and *(8)* provide that after the first order with banding provision is made, any subsequent order with banding provision cannot be made except where a review of banding is carried out in accordance with the terms of the order.

133. The purpose of allowing the bands to be reviewed is to ensure that they can be amended to reflect changes in the costs of technologies in the marketplace as markets mature. *Subsection (8)* provides that the order can authorise the Secretary of State and the Scottish Ministers to review the bands at: (a) intervals set out in the order or (b) where one or more specified conditions are met. This could, for example, enable the Secretary of State and the Scottish Ministers to review the bands on an "emergency" basis. An emergency review may be triggered if there is an unforeseen significant change, for example, in the marketplace (for example, to grid connection costs); a new support scheme is introduced; a new technology comes forward, or there is over-compliance with the obligation.

New section 32E

134. New section 32E introduces a power to make transitional provisions in relation to existing projects once a renewables obligation order containing banding provision is introduced. For example, it may be desirable to protect existing investments by enabling most existing generating stations which have been financed under the Renewable Obligation Order 2006 to continue to be awarded 1ROC/1MWh once banding is

introduced. *Subsections (1)* to *(3)* provide that transitional provision may be made either when banding is first introduced or when it is revised.

135. *Subsections (4) (5)and (6)* provide that, for generating stations which are in receipt of statutory grants and are specified in the order, the banding provisions may be made conditional on giving up any entitlement to grant (and repaying sums paid under it). Provision might be made, for example, whereby the operator would have a choice between keeping the grant and continuing to receive 1 ROC/MWh for its generation or returning the grant and receiving more ROCs per MWh once banding is introduced. *Subsection (9)* defines the meaning of statutory grant.

New section 32F

136. New section 32F provides for an electricity supplier to be able to discharge its renewables obligation (to the extent provided for by the order) by presenting Northern Ireland Renewable Obligation Certificates which are issued by the Northern Ireland Authority for Utility Regulation ("the Northern Ireland authority"). The Northern Ireland authority administers the RO in Northern Ireland. The practical effect of this provision is that it allows the obligation in Great Britain to work alongside the obligation in Northern Ireland thereby providing a single market for ROCs across Great Britain and Northern Ireland.

New section 32G

137. New section 32G provides for the order to make provision for electricity suppliers to discharge their obligation by paying a 'buyout' price to the Authority. *Subsection (1) (b)* provides for late payments made by electricity suppliers to the Authority to be used towards discharging the obligation too. *Subsection (2)* provides for the buyout price to be determined through the order and *subsection (3)* allows the buyout price to be linked to, for example, the Retail Price Index.

138. *Subsections (5)* to *(8)* provide that an order can make arrangements to require electricity suppliers to make additional payments where there is a shortfall in the amount due into the buyout fund for a particular obligation period. These additional payments are referred to in the current renewables obligation order as mutualisation payments. They arise in circumstances where an electricity supplier cannot fulfil its obligation and is unable to make a buyout payment; for example, if a supplier goes into administration. Additional sums are then required from the remaining electricity suppliers to cover the amounts that would have been paid by the insolvent supplier. *Subsections (9)* and *(10)* define shortfall for these purposes.

New section 32H

139. *Subsection (1)* requires that payments made to the Authority in respect of the buyout fund and late payment fund be paid to electricity suppliers using an allocation system specified in the order. *Subsection (2)* allows for these payments to not be made where the money in the fund is instead used for the purposes set out in Section 32I (which relates to the recovery of the Authority's costs in administering the RO). *Subsection (3)* allows for these payments to be made to specified categories of electricity supplier only.

140. *Subsection (4)* allows an order to specify that if certain circumstances are met, monies in the late payment fund will be held over till a later period. This is intended to provide for situations where, typically, sums in the late payment fund are so small that the bank charges incurred by the electricity suppliers of receiving this money would be larger than the amounts received. In this situation the payments could be postponed, for instance, until the following year and paid out with the money for that year. The order may specify the amounts which may trigger such a carry over.

New section 32I

141. New section 32I is a new power which enables the order to specify that a proportion of the money received into the buyout fund and late payment fund from electricity suppliers can be used by the Authority to cover some or all of its costs of administering the RO in England, Wales and Scotland. Money from the buyout fund could also be used by the Authority to make payments to the Northern Ireland authority to cover some or all of the costs incurred by that authority of administering the RO in Northern Ireland.

New section 32J

142. New section 32J enables the order to provide for the Authority to require electricity suppliers and others (who may include electricity generators and agents acting on behalf of generators) to provide certain information in relation to their participation in the RO.

143. *Subsection (3)* introduces a new power which allows the order to require operators of stations generating electricity wholly or partly from biomass to provide information relating to the biomass. This information could, for example, relate to the source of the biomass and the circumstances under which it is grown. The purpose of this provision is to enable the Authority to gather and make public information on sustainability. If generators fail to provide the information in the time and form specified, the Authority may be empowered to postpone the issue of ROCs until such time as the information has been provided, or not to issue ROCs at all.

New sections 32K and 32L

144. New section 32K enables the order to make general provisions about a number of matters, including transitional provisions. New section 32L concerns the procedure for making an order and requires the Secretary of State and the Scottish Ministers to consult the Authority, the National Consumers Council, electricity suppliers subject to the RO, appropriate electricity generators and such other persons as the Secretary of State considers appropriate before making an order. As at present, both the order for England and Wales and the order for Scotland will be subject to affirmative resolution procedure. In addition, there is a statutory requirement to consult before the power is exercised.

New Section 32M

145. New Section 32M provides definitions for various terms within the preceding sections, including a definition of what constitutes a renewable energy source. That definition, in *subsection (1)*, includes 'waste of which not more than a specified proportion is fossil fuel' as a renewable source for these purposes.

146. *Subsection (2)* enables the order to define 'waste' and say how the fossil fuel element of waste is to be determined. The provision is designed to enable energy from waste generators to benefit from the renewables obligation by making it easier for them to claim ROCs in respect of the non fossil fuel element contained in waste.

Section 38: Section 37: supplemental provision

147. *Subsection (1)* of section 38 enables the requirement to consult under section 32L of the Electricity Act 1989 (as inserted by section 37) to be satisfied by consultation which takes place before commencement of section 37 or the passing of the Act.

148. *Subsections (2) and (3)* of section 38 enable the making of consequential amendments to certain references to Northern Ireland legislation contained in sections 32 to 32M. The Government anticipates that these references will need to be updated if the Northern Ireland legislation is amended to take account of changes made by this Act.

Section 39: Existing savings relating to section 32 of the Electricity Act 1989

149. Section 39 amends section 67(1)(c) of the Utilities Act 2000. This provision confers on the Secretary of State a power to modify, preserve, replace or otherwise deal with arrangements made pursuant to non fossil fuel obligation (NFFO) orders under section 32 of the Electricity Act 1989 in its original form. The amendment clarifies that the Secretary of State's powers under this provision extends to any arrangements which have replaced the original arrangements.

Section 40: The Northern Ireland renewables obligation

150. *Subsection (1)* of section 40 amends section 121 of the Energy Act 2004. Section 121 permits the Authority to carry out, on behalf of the Northern Ireland Authority, functions conferred on the Northern Ireland authority under or for the purposes of Articles 52 to 55 of the Energy (Northern Ireland) Order 2003. These functions relate to the administration of the RO in Northern Ireland. The amendments made by this section ensure that the Authority can continue to act on behalf of the Northern Ireland authority even if Articles 52 to 55 are amended by an order under Article 56. Article 56 confers power to amend Articles 52 to 55 to reflect any changes made to the corresponding legislation for Great Britain.

151. *Subsection (2)* ensures that the power in Article 56 of the Energy (Northern Ireland) Order 2003 to amend articles 52 to 55 of that Order, extends to making provision corresponding to the amendments made by section 37 (i.e. the new sections 32 to 32M of the Electricity Act 1989).

152. *Subsection (3)* applies where an order is made under Article 56 amending articles 52 to 55 of the Energy (Northern Ireland) Order 2003, and, by virtue of changes made by that order, a Northern Ireland Renewables Obligation Order is made under Article 52 of the Energy (Northern Ireland) Order 2003 ("the NI RO order"). It provides that the consultation requirements which have to be satisfied before the NI RO order is made may be satisfied by consultation carried out before the Article 56 order came into force or this Act was passed.

Feed-in Tariffs for Small-Scale Generation of Electricity

Summary and Background

153. 'Small-scale low-carbon electricity' generation is the generation of electricity from renewable or low carbon sources such as wind turbines, solar photovoltaic panels and micro combined heat and power (micro CHP). The benefits of encouraging small scale electricity generation include:

- Reduced transmission and distribution losses because the electricity is generated close to where it is used;
- businesses, communities and households can move from being passive users of electricity to active users who are more aware of energy generation and usage. This can promote behaviour changes such as increased energy efficiency and reduced energy demand; and
- the potential of the built environment can be harnessed for the deployment of renewables, such as rooftops and brown field sites.

154. Although renewable small scale electricity generators are eligible to claim Renewable Obligation Certificates (ROCs) under the Renewables Obligation (RO), key stakeholders have advised that many of these smaller generators, such as households and community players (for whom electricity generation is not their primary purpose), can be deterred by the administrative burdens of claiming and selling ROCs. To encourage these smaller generators up to a maximum capacity cap of 5MW, this element of the Act would enable a system of feed-in tariffs to be introduced. Such a system

would work in tandem with the RO which is bringing forward larger scale renewable electricity.

155. The purpose of a feed-in tariff system would be to incentivise households, businesses, and community groups to generate low-carbon electricity. This can be achieved by making a fixed payment for each kilowatt hour of electricity generated from an eligible small-scale low-carbon source, to be passed onto such a generator or in some cases, potentially offering a payment up-front for the electricity 'deemed' to have been generated. We would expect this to encourage potential generators to make the necessary upfront capital investment in generating equipment, because they would have increased certainty of the payback from their investment.

Commentary on Sections

Section 41: Power to amend licence conditions etc: feed-in tariffs

156. *Subsection (1)* gives the Secretary of State the power to modify electricity supply and distribution licences (as well as standard conditions incorporated in licences, documents maintained in accordance with the conditions of licences or agreements that give effect to those documents) to introduce a scheme (that will be known as "feed-in tariffs") to encourage small-scale low-carbon generation of electricity. S*ubsection (2)* sets out the purposes for which modifications are to be made under the power.

157. *Subsection (2)(a)* states that the modifications in *subsection (1)* may be made for establishing feed-in tariffs for small scale low-carbon electricity generation, or for making arrangements for the administration of such a scheme. *Subsection (2)(b)* states that these modifications may also be made to require that electricity generated by small scale generators is able to enter the distribution network. *Subsection (2)(c)* also allows the Secretary of State to modify the documents referred to in subsection (1) to require the holder of a licence to make arrangements relating to matters referred to in subsection (2)(a) and (b). This is to facilitate the establishment and operation of the feed in tariff scheme.

158. *Subsection (3)* sets out some of the kinds of modifications which could be made under this section to the documents described in *subsection (1)*.

159. Under *subsection (3)(a)*, modifications may require holders of electricity supply licences to make a payment to small-scale low-carbon generators or a payment to the Authority to be passed onto such generators. *Subsection (3)(b)* states that the modifications can provides for how a payment under *subsection (3)(a)* is to be calculated.

160. *Subsection (3)(c)* allows for degression rates, where the tariffs to be paid to new installations would decrease over time. These degression rates could be set in anticipation of technology improvement or cost reductions, and may therefore differ for different technologies and at different sizes of installation.

161. *Subsection (3)(d)* allows the modifications to provide for circumstances where feed-in tariff payments will not be made or where reduced payments will be made. For instance, it is intended that generators will not be entitled to claim "double incentives", such as both feed-in tariffs and ROCs for the same electricity generation.

162. There may be situations where, subsequent to making a payment under subsection *(3)(a)*, an error is discovered, such as a payment being made in error or a generator being overpaid as a result of error in administration or in cases of miscalculation. In such circumstance, *subsection (3)(e)* allows for payments to be recovered from generators.

163. *Subsection (3)(f)* allows the modifications to require the holder of a supply licence or distribution licence to pay a levy to the Authority at specified times. *Subsection (3)(g)* allows provision to be made as to how this levy may be calculated. *Subsection (3)(h)* allows the holder of an electricity supply or distribution licence to receive a payment from the Authority. These subsections allow modifications to ensure that costs of tariffs

paid out are redistributed fairly across all suppliers. The calculation in *subsection (3)(g)* could include, for example, consideration of the number of small-scale low-carbon generators a supplier services or the amount of electricity generated by small-scale low-carbon generators as a proportion of the total amount of electricity supplied to all customers. Funding for any such redistribution would come from the levy specified at *subsection (3)(f)*.

164. *Subsection (4)* provides definitions of the main terms used in the section. In particular, "the Authority" is defined as the Gas and Electricity Markets Authority and "small-scale low-carbon generator" is defined as the owner of plant used or intended to be used for small-scale low carbon generation. In turn, "small-scale low-carbon generation" is defined as the use, for the generation of electricity, of any plant which relies on the energy sources and technologies listed at *subsection (5)* and which does not exceed the maximum capacity (to be specified by order).

165. *Subsection (4)* puts an upper capacity cap of 5 megawatts on the level which can be specified as the maximum capacity for small-scale low-carbon generation plant under the Order. Beneath this maximum capacity cap the Secretary of State has the power to set a "specified maximum capacity" for small scale low carbon feed-in tariffs by order.

166. *Subsection (5)* sets out the sources of energy and technologies that are eligible for feed-in tariff payments for the generation of small-scale low-carbon electricity. These are biomass, biofuels, fuel cells, photovoltaics, water (including waves and tides), wind, solar power, geothermal sources and non-renewable micro combined heat and power systems with an electrical capacity of up to 50 kilowatts.

167. *Subsection (6)* provides that the list of sources of energy and technologies provided by *subsection (5)* can be modified by order which will be subject to the affirmative resolution procedure (see section 105), thereby enabling the Secretary of State to modify the list in the future. This gives the Secretary of State the flexibility to modify *subsection (5)*, for example if technological developments bring forward new low carbon technologies that the Secretary of State wished to receive feed-in tariffs. In this Act, by virtue of section 106, the power to modify includes the concepts of amending, adding to, revoking or repealing.

168. *Subsection (7)* provides that the power in *subsection (1)* may be exercised generally, only in relation to specified cases or subject to exceptions and also allows for the powers to be exercised differently. *Subsection 7(c)* gives the Secretary of State a power to make any incidental, supplemental, consequential or transitional modifications that may be required. This mirrors the general provision relating to subordinate legislation made under powers in this Act and thus applies similar concepts to the licence modification power to enable the feed-in tariff scheme. *Subsection (8)* further clarifies the scope of the licence modification power.

Section 42: Power to amend licence conditions etc: procedure

169. This section sets out the procedure that the Secretary of State must comply with in order to exercise the modification powers conferred by section 41.

170. *Subsection (1)* obliges the Secretary of State, before making modifications, to consult the holders of licences being modified, the Gas and Electricity Markets Authority and others as he considers appropriate. *Subsection (2)* specifies that this consultation requirement may be satisfied by consultation either before or after the passing of the Act.

171. *Subsections (3)* and (*4)* provide that before making modifications to any of the documents in *section 41(1)*, the Secretary of State must lay the draft modifications before Parliament and allow a period of 40 days for either House of Parliament to reject the draft. *Subsection (5)* states that if Parliament does not reject the draft modifications then the Secretary of State may proceed to make those proposed modifications,

and under *subsection (7)* he must publish details of any modifications as soon as reasonably practicable. S*ubsection (6)* makes it clear that if Parliament rejects the draft modifications the Secretary of State may, if he wishes, lay a revised draft in front of Parliament. *Subsections (8) and (9)* outline how the 40 day period is to be calculated. This process mirrors the negative resolution procedure.

Section 43 Feed-in tariffs: supplemental

172. Section 43 makes three supplemental provisions in relation to the modification power conferred by section 41. *Subsection (1)* ensures that any modifications made to a standard licence condition under the new power do not prevent any other part of the condition from being a standard condition.

173. *Subsection (2)* ensures that where licence modifications are made to standard licence conditions, the Gas and Electricity Markets Authority must make the same modifications for the purpose of future licences, and also must publish those modifications.

174. *Subsection (3)(a)* is an order making power for the Secretary of State to make provisions conferring functions either on the Authority or the Secretary of State, or both, in connection with the administration of any scheme established through section

175. *Subsection (3)(b)* allows the Secretary of State to make consequential amendments to provisions made by or under an Act (including Acts of the Scottish Parliament) as he considers appropriate in consequence of any provision made under *subsection (3)(a)* or under the section 41 power more generally. Orders made under section 43(3)(a) are subject to the negative resolution procedure (see section 105), whereas orders made under section 43(3)(b) are subject to the affirmative resolution procedure if they contain provision to modify an Act or an Act of the Scottish Parliament, and negative resolution procedure in other cases (see section 105).

Offshore Electricity Transmission

Summary and Background

176. The Government is putting in place a framework intended to encourage the development of generation of electricity from offshore renewable energy sources, for example offshore generating stations driven by wind. Offshore generating stations tend to consist of a device (for example, wind turbines placed on towers driven into the seabed) which powers a generator to convert the (wind) energy into electricity. These offshore generating stations will need to connect to the main onshore electricity network (transmission and distribution) in order for the electricity generated to be supplied to end-users, including domestic consumers.

177. Electricity transmission generally constitutes the movement of electricity around a national grid system using high voltage networks, whilst electricity distribution generally constitutes the delivery of electricity on local low voltage networks to end users.

178. The Energy Act 2004 provides powers for the Secretary of State to make changes to the codes, agreements and licences – which regulate onshore electricity transmission and distribution – for the purposes of regulating offshore electricity transmission and distribution.

- Since the Energy Act 2004 was passed, the Government has been working with the Gas and Electricity Markets Authority ("the Authority") to establish an offshore transmission licensing regime to regulate:

- the conveyance of electricity along high voltage lines offshore (defined in the 2004 Act as those with a nominal voltage of 132kV or more), and

- associated plant and equipment which connect offshore generating stations to the onshore electricity network.
- the high voltage lines and associated plant and equipment together make up the "transmission assets".

179. The overall objective of the regulatory regime for these transmission assets is to enable large amounts of electricity from renewable sources generated offshore to connect to the onshore electricity network in a safe, economic and efficient manner, whilst maintaining the integrity of the electricity system as a whole.

180. To date, the transmission assets for offshore generating stations have been built and operated by generator-developers.

181. The new offshore transmission regime will:

- require the transmission assets to be owned and operated by a separate licensed entity (not the generator).
- extend National Grid's role as the onshore transmission system operator offshore.
- introduce a competitive tender process for determining to whom the Authority will grant a transmission licence to build, maintain and finance the transmission assets for a project. The Authority will make regulations under section 6C of the Electricity Act 1989 to enable it to run competitive tender processes and determine the successful bidders. The regulations will need to be approved by the Secretary of State. The Government anticipates that the Authority will consult on the way in which these provisions will be implemented, before the regulations under section 6C are made.

182. The new offshore transmission regime will come into force on commencement of section 89 (which makes changes to the Electricity Act 1989 so that certain activities offshore require a licence) and section 180 (which adds a new definition of "high voltage line" in the Electricity Act 1989) of the Energy Act 2004. From that date, those participating in offshore transmission will require a licence.

183. In addition to the powers contained in the Energy Act 2004 for offshore transmission, two further areas have been identified where powers are necessary to ensure the effective operation of the new licensing regime.

184. The Authority's new function of carrying out tender exercises will cause it to incur additional costs beyond those incurred in exercising its existing functions. The Act contains new provisions relating to cost recovery. These will ensure that the Authority is able to use alternative mechanisms to cover its costs in running the tender process. These will include mechanisms to ensure commitment to the tender process from different parties.

185. The combination of the offshore generating station and the transmission assets are described in these explanatory notes as the "offshore project". Some of the earliest projects for which a tender exercise for an offshore transmission licence will be required are offshore projects where the generator-developer will either:

- have funded and already built the transmission assets; or
- have funded and be part way through building the transmission assets; or
- be ready to construct the assets (in that it has all necessary funding in place to do so),

at the time the offshore transmission regime comes into force.

186. These offshore projects will require the transfer of property, rights and liabilities (which might include the transmission assets) from the existing owner (e.g. the generator-developer) to the successful bidder (as a result of the tender exercise for an offshore

transmission licence) in order for that successful bidder to be able to perform its licence and statutory functions. For offshore projects where the transmission assets will have already been built when the new regime comes into force, and where a transfer to the successful bidder has not taken place by that time, a generator-developer will be "stranded" since it will not be authorised to convey its electricity lawfully to the onshore network. Although in the majority of cases it is anticipated that the transfer will be agreed via commercial negotiations between the parties, the Government considers that a mechanism is needed to cover the possibility of such negotiations failing. This will enable the Government to ensure that property is transferred in a fair, timely and effective way, and avoid generator-developers being "stranded". The Act enables the Authority to make a property scheme in those cases.

187. There is an amendment to the definition of "relevant offshore line", which is set out in section 180(2) of the Energy Act 2004 (which has not yet been commenced), and will be inserted into section 64 of the Electricity Act 1989. The amendment to this definition through the Act clarifies that any line built for the purpose of transmitting electricity from an offshore generating station and which is wholly or partly in internal waters, the territorial sea or an area designated under section 1(7) of the Continental Shelf Act 1964 (which currently includes the Renewable Energy Zone) is a "relevant offshore line", even if only a small proportion of the line is situated offshore. The definition in section 180(2) of the Energy Act 2004 is being repealed.

Commentary on Sections

Section 44 and Schedule 2: Offshore electricity transmission and property schemes

188. This section and Schedule amend Part 1 of the Electricity Act 1989 so as to confer on the Authority:

- power to recover costs related to competitive tenders for determining to whom offshore electricity transmission licences will be granted, and
- power to make property schemes to transfer property, rights and liabilities from the existing owner to the successful bidder for an offshore transmission licence.

189. *Subsection (2)* inserts a new section 6D into the Electricity Act 1989. It supplements section 6C which (as mentioned in the summary and background above) gives the Authority the power to make regulations to enable it to run competitive tender processes and determine the successful bidders. These regulations can include provisions about the process the Authority will follow in making such determinations.

190. New section 6D of the Electricity Act 1989 gives the Authority the ability, in making regulations under section 6C, to create new mechanisms to recover its costs in carrying out and administering tender exercises, including the ability to:

- seek payments from the participants in a tender exercise to cover its tender costs for a particular tender exercise (this is set out in section 6D(1)(a)). The participants are identified in sections 6D(2) to (4), being:
  - a person who made a connection request to a transmission system or, if a project connects to shore at 132kV, a distribution system; this may include the generator-developer; and
  - applicants for the offshore transmission licence.
- require the person who made a connection request to pay a deposit of an amount set by the Authority or require that person to provide other such security in respect of the Authority's tender costs (such as a letter of credit or bond) as the Authority agrees (set out in section 6D(1)(b)). The Authority will also accept payment of the deposit or other such security by an approved party, for example a parent company. This power could be used to obtain a financial commitment from a generator-developer to the tender process. For example, the Authority could use this power

on the basis that such security would only be realised if the generator-developer withdrew from the tender exercise before the process was complete.

- require costs incurred by the Authority, in assessing the expenditure which has been incurred – or which in the Authority's view ought to have been incurred if done in an economic and efficient manner – on certain assets, to be met by the owner of the assets – see section 6D(1)(c). The Authority will need to undertake such assessments in cases where transmission assets need to be transferred to the offshore transmission licence holder from, for example, the generator-developer. The assessment will enable the Authority to determine the appropriate transfer value of assets for the purpose of arrangements between the parties for the transfer itself, and also for the purpose of calculating the offshore transmission licence holder's regulated revenue stream. This power applies to projects which are eligible for a property transfer scheme under the new Schedule 2A for the Electricity Act 1989. More details on how this property transfer scheme will operate and the specific circumstances in which interested parties can apply are given below;

- set out the timing of payments under these provisions;

- provide mechanisms for refunding payments to, or withholding payments (or deposits or other security) from, the persons providing the payments; and

- specify the consequences for the tender exercise or any participant in it should that participant fail to make a specified payment, or provide deposits or security, as required in new *subsection (1) (a*) or *(b).*

191. The Authority's tender costs will include the costs which are incurred in relation to a specific tender exercise and an appropriate proportion of costs incurred in relation to tender exercises generally (and which are not specific to that tender exercise). The detail of how amounts will be determined will be set out in the regulations but they would reflect the direct and indirect costs of running tender exercises.

192. New section 6D(5) prevents the Authority from recovering costs that are greater than those that it has incurred in carrying out each specific tendering exercise (with the proviso that it can also still recover in each case an appropriate proportion of costs incurred in relation to tender exercises generally). At any particular time during a tender exercise the Authority may hold amounts which exceed the amount of its tender costs. However, at the end of the exercise, it must ensure (for example, by making refunds) that it retains no more than its tender costs. In other words, the Authority's powers to recover costs are cost-reflective.

193. New section 6D(6) and (7) would enable the Authority to charge for an assessment of whether someone wishing to participate in a tender exercise would be able to meet specified requirements (which might include, for example, general technical competence to undertake the activity of offshore transmission) before a tender exercise takes place.

194. New section 6D(9) provides for all payments received by the Authority in respect of the tender exercises to be paid into the Consolidated Fund

195. *Subsection (3)* clarifies the scope of the regulatory regime for offshore transmission as set out in the Electricity Act 1989. It aims to make clear that the regime encompasses all offshore lines of 132 kilovolts or more which are:

- built wholly or mainly for the purpose of conveying electricity generated by an offshore generating station, and

- wholly or partly in an area of GB internal waters, an area of the territorial sea adjacent to the United Kingdom or an area designated under section 1(7) of the Continental Shelf Act 1964.

196. The definition of "relevant offshore line" is set out in section 180(2) of the Energy Act 2004 (which has not yet been commenced). Once commenced, the definition will be inserted into section 64 of the Electricity Act 1989. Section 64 of the Electricity Act contains the definition of "high voltage line" which is used to determine which electricity lines are considered, and regulated, as transmission lines.

197. *Subsection (3)* amends the definition of "relevant offshore line" so that any line built for the purpose of transmitting electricity from an offshore generating station is a "relevant offshore line", even if only a small proportion of the line is situated offshore. The definition in section 180(2) of the Energy Act 2004 is being repealed.

198. Without such an amendment through the Act, the definition of "high voltage line" in section 64 of the Electricity Act 1989 (once amended by the Energy Act 2004) would not cover a line of 132 kilovolts connecting an offshore generating station to the onshore grid in England and Wales, if the majority of the electric line was onshore. This is because such lines would not fall within the definition of "relevant offshore line" as set out in the Energy Act 2004. Such a line would therefore not be regulated as transmission.

199. *Subsection (3)* also extends the definition of "relevant offshore line" so as to include electric lines which are located within GB internal waters (in addition to lines located in the territorial sea adjacent to the United Kingdom and an area designated under section 1(7) of the Continental Shelf Act 1964 (which currently covers the Renewable Energy Zone)). As a result of this amendment, electric lines which are located in internal waters and which convey electricity from an offshore generating station will be categorised as "high voltage lines", i.e. transmission, if they *are* 132 kilovolts or more. Without this amendment, any such lines located in England and Wales would only be "high voltage lines" if they had a nominal voltage of *more than* 132 kilovolts. This amendment will not affect the treatment of lines in internal waters which do not convey electricity from an offshore generating station, for example a line which forms part of an onshore system and which crosses internal waters to connect one side of a river estuary to another.

Property Schemes

200. S*ubsection (4)* introduces Schedule 2, which gives effect to a new Schedule (Schedule 2A) to the Electricity Act 1989, (see also the new section 6E to that Act inserted at the end of *subsection (2)*). The new Schedule enables the Authority, in certain circumstances, to make a scheme transferring property, rights and liabilities from the existing owner to the successful bidder for an offshore transmission licence. The Authority can only make provision in such a scheme where it is necessary or expedient for the purposes of the successful bidder performing its licence and statutory functions as an offshore transmission licence holder. The property scheme could, for example, include the transfer of electrical plant equipment together with rights and liabilities which are necessary for operation of the transmission system.

Scheme making power

201. *Paragraphs 1(1)* and *(3)* of Schedule 2A sets out a limit on the situations in which the power for the Authority to make a property scheme under this Schedule is available. The Schedule applies in cases where there is a tender exercise to select an offshore transmission licence holder, and the transmission system (or part of it) is transferred, or needs to transfer, to the successful bidder. The new Schedule does not apply where the successful bidder or its affiliate constructs or installs the relevant transmission assets (or where it procures the construction or installation of transmission assets by another party, e.g. a sub-contractor).

202. *Paragraph 1(2)* enables the Authority, upon application, to make a property scheme which transfers property, rights and liabilities to the successful bidder.

203. *Paragraph 2* sets out other provisions which may be included in a scheme, for example, provisions creating joint interests or rights in property between the asset owner and the successful bidder. A scheme may also provide for compensation to be paid to the parties and to third parties who are affected by the scheme (that is, a person whose consent would be required to the making of the provision if there was no scheme – see *paragraph 38(2)*).

Applications for schemes

204. *Paragraphs 3* to *10* set out rules governing applications for a property scheme including: the timing of applications; the giving of notice of an application to relevant persons; and the making of representations on an application to the Authority.

205. *Paragraph 3* states the parties who may apply for a scheme, namely the preferred bidder, the successful bidder or an asset owner. The definitions of preferred bidder and successful bidder are set out in *paragraphs 35* and *36*. In essence, a preferred bidder is a particular person to whom the Authority has announced it will grant the offshore transmission licence if certain matters are resolved to the Authority's satisfaction.

Timing of applications

206. Section 92 of the Energy Act 2004 gives the Authority the power to run competitive tender processes for the purpose of identifying to whom to award an offshore transmission licence. Under *paragraph 5* of this new Schedule, applications for a property scheme must be made within 4 years of section 92 of the Energy Act 2004 coming into force. However, the Secretary of State may by order extend the period for applications by a maximum of a further 3 years in respect of specific projects or groups of projects.

Notifying the non-applicant party

207. Notice of an application must be given to the non-applicant party (i.e. whichever of the asset owner and preferred or successful bidder has not made the application for a scheme) (*paragraph 6*) and also to any third parties who may be affected by the scheme (*paragraph 7*). There is also a requirement for the Authority to publish notice of the application (*paragraph 8*).

208. The non-applicant party may modify the application by adding further property, rights or liabilities to be considered by the Authority for inclusion in the scheme (*paragraph 9*). If the application is modified, there are further requirements for notice to be given to the other party and affected third parties. There are also publication requirements in relation to a modification notice (*paragraph 10*).

209. The parties and third parties are given the opportunity to make representations to the Authority on an application and any modifications to it.

Restricting or withdrawing the application

210. Under *paragraph 11*, the applicant and the non-applicant party may jointly withdraw an application in whole or in part. This situation may typically arise if the parties have successfully negotiated the transfer of property, rights and liabilities before a property scheme has been made. If this is done, the Authority may require the applicant or the non-applicant party to pay costs incurred by either the Authority or any third party in connection with the application.

The Authority's functions in relation to applications

211. *Paragraph 12* contains provisions governing the Authority's consideration of an application. The Authority must consider the application on the basis of whether a property scheme is necessary or expedient for the performance of the successful

bidder's functions as offshore transmission licence holder. The paragraph also sets out a procedure for the Authority to propose alternative arrangements in cases where it decides that the proposed treatment of particular property, rights or liabilities is not necessary or expedient, but that some other kind of provision should be made. For example, the Authority might decide that transfer of ownership of a particular piece of equipment was not justified, as the granting of access rights would be sufficient. Before making alternative arrangements, the Authority must inform the parties and affected third parties, who have the opportunity to make representations to the Authority on the proposal.

212. In order to ensure that property is not transferred prematurely, *paragraph 13* provides that the Authority may not make a scheme until:

- the offshore transmission licence has been awarded to the successful bidder; and
- the System Operator (described as the co-ordination licence holder in the Schedule) issues a notice of completion to the Authority in respect of the relevant transmission system. (Some large projects are being built in phases, with a working transmission system being in place as each phase of the generating station is completed, so that electricity can be transmitted to shore as and when each phased part of the project is ready. For such projects, it is envisaged that separate completion notices might be issued in respect of the transmission systems in place for each phase (and ultimately form part of a larger transmission system for the entire project once all phases had been completed).

Terms of a property scheme

213. *Paragraphs 14* and *15* set out rules governing the terms of a property scheme. In particular, the Authority may not set terms which adversely affect a third party (that is, a party whose consent would normally be required to the proposed provision if made other than by a property scheme but who has not consented to it) unless it concludes that it is necessary or expedient for the performance of the successful bidder's functions. In such a case, it must also consider including provision for compensation to be paid to the adversely affected third party. In addition, a scheme can include a requirement for the successful bidder and/or asset owner to pay costs incurred in connection with the scheme by each other, the Authority and affected third parties.

214. Any decisions by the Authority on terms which relate to financial matters (for example, compensation to be paid) must be on the basis of what is fair. Decisions on other matters must be on the basis of what the Authority considers is appropriate in all the circumstances of the case.

Additional powers of the Authority

215. Under *paragraph 16(1)*, the Authority may require certain persons to provide it with information and assistance in connection with the Authority's functions in relation to the property scheme power. *Sub-paragraph (2)* allows the Authority to seek information in respect of any provision of a property scheme (or proposed scheme) from any other person, as may be necessary. For instance, if information or assistance provided by a person under *sub-paragraph (1)* alerts the Authority to relevant information held by someone else (e.g. a parent company), the Authority would be able to approach that person for a copy of that document. The Authority is also able to engage consultants to advise it for the purposes of making a property scheme under this Schedule (*paragraph 17*).

Notification of property scheme

216. *Paragraph 18* sets out the provisions for notification and publication of a scheme once made, including notification of affected third parties.

Refusal of application or part of an application

217. *Paragraph 19* sets out a requirement for the Authority to notify the parties and affected third parties of any decision to refuse an application for a scheme in whole or in part. If it refuses an application (in whole or in part), the Authority may direct the parties to pay costs incurred in connection with the application by each other, the Authority or affected third parties.

Effect of property scheme

218. *Paragraphs 20* and*21* provide for the transfers and other matters provided for in a scheme to take place by operation of law, according to the terms specified by the Authority, subject to any statutory requirements for registration of a particular transaction. *Paragraph 22* provides that where compensation is payable to a person, it may be recovered by that person if unpaid.

Review of determinations

219. *Paragraphs 23* to *27* provide for appeals against the Authority's determinations in relation to an application. Affected parties can appeal to the Competition Appeal Tribunal within 21 days of the scheme being made and coming into force or, if the scheme has not yet been made, the determination being made (*paragraph 23*). The Competition Appeal Tribunal has discretion to allow an appeal which is lodged after the 21 day period has expired.

220. *Paragraphs 24* to *27* set out the types of order the Competition Appeal Tribunal may make having considered an appeal. The Tribunal has, among other things, the power to overturn or amend the Authority's determination of any property scheme, or require the Authority to reconsider any financial matter.

Interim arrangements pending review of determination

221. *Paragraphs 28* to *32* provide for the Tribunal to have the power to make interim arrangements (such as the suspension of a scheme, or the granting of interim access to property included in a scheme) pending the outcome of an appeal. For example, if a successful bidder is appealing the Authority's decision not to transfer a particular asset, it could apply to the Tribunal for emergency interim access to that asset.

Appeal on a point of law

222. *Paragraph 33* provides a further appeal to the Court of Appeal or Court of Session on a point of law.

Change of asset owner

223. If transmission assets are transferred to a new asset owner after an application is made, paragraph 34 ensures that any reference in the Schedule to the asset owner applies to the new asset owner.