

EXPLANATORY MEMORANDUM TO
THE RENEWABLES OBLIGATION (AMENDMENT) ORDER 2018

2018 No. [XXXX]

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument makes provision for controlling the costs of supporting under the Renewables Obligation scheme (“RO”) two forms of renewable energy generation in former fossil fuel generating stations using as fuel biomass or a mixture of biomass and fossil fuel, respectively called ‘biomass conversion’ and ‘co-firing’. It also requires a declaration to be provided by certain stations when claiming support for combined heat and power (“CHP”) generation, and clarifies the greenhouse gas emission trajectories with which certain CHP stations must comply.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 The Department considers that the exception in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015 applies to this instrument. This is because article 7 of the Renewables Obligation Order 2015 (“the 2015 Order”) imposes a requirement on electricity suppliers in England and Wales to fund the costs of supporting renewable electricity generated under the RO. The cost this imposes on suppliers is passed on to domestic and business electricity users through their electricity bills. Bill payers do not have a choice as to whether they make this payment. On this basis, the RO has been classified as a notional or imputed tax by the Office for National Statistics and as a result it is subject to the Control for Low Carbon Levies.¹
- 3.2 This instrument is intended to come into force on the day after the day on which it is made. This is to ensure that it comes into force as soon as possible in the interests of controlling the costs biomass electricity generation imposes on consumers.
- 3.3 However, the caps on the amount of support generators may receive come into effect only from the second month after the month in which this instrument comes into force. This means that operators will have a chance to adapt their systems including, if

¹ In 2011 Government introduced the Levy Control Framework (LCF) to govern the budget for low carbon electricity schemes, including the Renewables Obligation, which are paid for through consumer bills. The Autumn Budget 2017 announced the Control for Low Carbon Levies, which sets out that the Government will not introduce new low carbon electricity levies until the burden of such costs is falling. The Government will continue to monitor spend against the original LCF budget until 2020/21

necessary, making arrangements for the electrical output of their combustion units to be metered separately in order to continue to receive support.

Other matters of interest to the House of Commons

- 3.4 This entire instrument applies only to England and Wales.
- 3.5 In the view of the Department, for the purposes of House of Commons Standing Order 83P, the subject-matter of this entire instrument would be within the devolved legislative competence of the Northern Ireland Assembly if equivalent provision in relation to Northern Ireland were included in an Act of the Northern Ireland Assembly as a transferred matter.

4. Legislative Context

- 4.1 This instrument amends the 2015 Order which is the present legal basis for the RO.
- 4.2 The RO was introduced in 2002 and is designed to encourage investment in large-scale renewable electricity generation to contribute to meeting low carbon goals.
- 4.3 Government is committed to keeping energy bills as low as possible for consumers, in conjunction with cutting greenhouse gas emissions and supporting economic growth. This instrument seeks to strengthen cost control measures for biomass conversion and co-firing stations by implementing annual caps on the support that these generators can receive.
- 4.4 The RO also supports generation from CHP stations. Support for renewable heat generation is available under the Renewable Heat Incentive Scheme (“RHI”). This instrument ensures that the 2015 Order interacts properly with regulation 69 of the Renewable Heat Incentive Scheme Regulations 2018 (2018 No. 611) to prevent support for CHP generation being claimed under both schemes.
- 4.5 Furthermore, this instrument clarifies Schedule 2 of the 2015 Order, making it clear that post-2013 dedicated biomass stations and post-2013 dedicated biomass with CHP stations must comply with the same greenhouse gas emission thresholds.
- 4.6 The instrument also corrects typographical errors in article 28 of the 2015 Order.
- 4.7 State aid approval for the RO was given in 2009 (case N414/2008) and most recently in 2013 (case SA.35565 (2013/N)). This instrument does not make any changes that affect the state aid approval.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is England and Wales.
- 5.2 The territorial application of this instrument is set out in Section 3 under “Other matters of interest to the House of Commons”.
- 5.3 The RO is provided for in relation to England and Wales by the 2015 Order and in relation to Scotland by the Renewables Obligation (Scotland) Order 2009. There is also an RO in Northern Ireland which is provided for by the Renewables Obligation Order (Northern Ireland) 2009. These complementary Renewables Obligation Orders together in effect create a UK-wide RO. Responsibility for policy as it relates to the operation of the RO in Scotland and Northern Ireland is devolved to the Scottish Government and Northern Ireland Assembly respectively.

- 5.4 Decisions regarding the subject matter of this instrument are for the Scottish Government and Department for the Economy in Northern Ireland respectively. However, both have confirmed that they do not intend to make changes to their respective RO legislation to introduce caps as they do not have any biomass co-firing and conversion projects operating under the RO in their countries.
- 5.5 The Scottish Government is considering the need to make changes to their RO legislation regarding the requirement for a declaration for pre-2013 CHP capacity and the clarification of the definition of “post-2013 dedicated biomass station”. The Department for the Economy do not intend to make legislative changes to require the declaration as the Non-Domestic Northern Ireland RHI Scheme was closed to new applications from 29 February 2016.

6. European Convention on Human Rights

- 6.1 Claire Perry, Minister of State for Energy and Clean Growth, has made the following statement regarding Human Rights:

“In my view the provisions of the Renewables Obligation (Amendment) Order 2018 are compatible with the Convention rights”.

7. Policy background

What is being done and why

How the RO works

- 7.1 The RO places an obligation on licensed electricity suppliers to produce a certain number of Renewables Obligation Certificates (“ROCs”) to the Gas and Electricity Markets Authority (Ofgem, “the Authority”) in respect of each megawatt hour of electricity supplied during an obligation year. The obligation year runs from 1 April to 31 March. This number – ‘the obligation level’ – is set six months ahead of the start of each obligation period.
- 7.2 The RO is administered by the Authority, which issues ROCs to generators accredited under the scheme in relation to the renewable electricity they generate and the technology type they use. Generators can sell ROCs to suppliers or traders, with or without the electricity generated, as tradable commodities. Suppliers present ROCs to the Authority to demonstrate their compliance with the obligation. Suppliers failing, or choosing not, to present enough ROCs to meet their obligation make a payment per ROC into a buyout fund. After the Authority’s administration costs have been deducted, the money collected in the buy-out fund is recycled on a pro-rata basis to suppliers who presented ROCs. This encourages suppliers to choose ROCs over payments to the buy-out fund.

Support for biomass co-firing and conversion projects.

- 7.3 Biomass conversions are former coal generating stations that have converted to run wholly on biomass, including wood pellets, straw, energy crops etc. Biomass co-firing plants use a mixture of biomass and coal. Generating stations with more than one combustion unit may fully or partially convert the station on a unit by unit basis. Stations or units receive different rates of support (i.e. ROCs) for their renewable output based on the proportion of biomass used. All support for biomass co-firing and conversions will end in 2027.

- 7.4 The RO is now closed to new projects (subject to certain grace periods) and the number of RO accredited stations that could claim biomass conversion or co-firing ROCs is relatively small. However, these stations tend to be large and increases in the levels of biomass they use can be made relatively quickly.
- 7.5 In 2014, Government recognised that deployment of additional biomass conversion and co-firing units under the RO was likely. In order to control costs under the LCF and protect consumer bills, the Government stated in July 2015,² following consultation, that the support rates under the RO for new biomass conversion and co-firing stations and combustion units coming forward on or after 12 December 2014, should no longer be covered by Government's 'grandfathering' policy.³
- 7.6 Despite these changes to grandfathering policy, in early 2017 evidence suggested further deployment of biomass conversion and co-firing under the RO, resulting in likely additional costs for consumers.

Implementation of caps to strengthen cost control for biomass co-firing and conversion projects

- 7.7 To minimise this additional spend, this instrument implements annual caps on the number of ROCs that certain 'non-grandfathered' biomass co-firing and conversion units can receive. Two types of generating station are described by the cap mechanism: 'capped generating stations' which are comprised of only non-grandfathered ("capped") units, and 'mixed generating stations' which are comprised of both capped units and grandfathered ("exempt") units.
- 7.8 At capped generating stations this instrument applies a station-level cap on the number of ROCs the station can be issued in each obligation year. This cap is equal to 125,000 ROCs for each unit of which the station is comprised.
- 7.9 For mixed generating stations, the Secretary of State will estimate the number of ROCs likely to be issued in respect of generation at their exempt units in the coming obligation period (the "exempt combustion unit estimate"). To this estimate will be added the sum of 125,000 ROCs for each of the station's capped units (the "capped combustion unit allowance"). The resulting figure (the "mixed generating station estimate") is a cap on the number of ROCs which the station can receive where generation by the station's capped units exceeds the capped combustion unit allowance. As a result of this arrangement, this instrument allows generators operating mixed generating stations the flexibility to optimise generation between their units, whilst still controlling the costs to consumers.

Measures to require a declaration from pre-2013 combined heat & power capacity

- 7.10 Although the RO is focused on support for electricity generation, CHP stations may, in certain circumstances, claim additional support under the RO via separate CHP support bands. These bands are provided in acknowledgement of the additional capital costs of CHP stations and the additional energy and greenhouse gas emission savings

² See ' The Government Response to the consultation on changes to grandfathering policy: future biomass co-firing and conversion projects under the RO' (July 2015) at : <https://www.gov.uk/government/consultations/changes-to-grandfathering-policy-with-respect-to-future-biomass-co-firing-and-conversion-projects-in-the-renewables-obligation>

³ Grandfathering is a commitment that projects will receive no less support under the RO than they have received historically.

that they deliver. But it rewards only the electrical output of the generator, rather than the heat generated.

- 7.11 The introduction of the RHI in 2011 presented an opportunity to differentiate support for electricity and heat. A public consultation in 2011 sought views on the interaction between the RO and RHI. The Government response in 2012⁴ made it clear that generating capacity receiving ROCs at the RO's CHP band will be ineligible for the RHI. The changes arising from the Government response were implemented from 1 April 2013 by the Renewables Obligation (Amendment) Order 2013, and carried forward in the consolidated 2015 Order.
- 7.12 This instrument brings the declaration requirements for generating stations accredited on or before 31 March 2013 that become CHP stations on or after the day on which this instrument comes into force in line with the requirements for generating capacity accredited or added on or after 1 April 2013.

Clarification of the definition of “post-2013 dedicated biomass station”

- 7.13 Following a public consultation in 2012 on proposals to enhance the sustainability criteria for biomass under the RO, the Government response in 2013⁵ set out the greenhouse gas (GHG) emission trajectories that stations must comply with. It also made it clear that the same GHG trajectories applied to generation from pre-2013 capacity for both dedicated biomass stations and dedicated biomass with CHP stations. The trajectories are set out in Schedule 2 to the 2015 Order.
- 7.14 The existing definition of “post-2013 dedicated biomass station” in paragraph 1 of Schedule 2 relies on the definition of “dedicated biomass” in Schedule 5. ‘Dedicated biomass with CHP’, as defined in Schedule 5, is a subset of ‘dedicated biomass’, so the GHG trajectories apply equally to stations that have generated electricity in the way described as ‘dedicated biomass’ and ‘dedicated biomass with CHP’. However, to make it clear that this is the case, this instrument adds a clarification to the definition of ‘post-2013 dedicated biomass station’.

Correction of typographical errors in article 28

- 7.15 This instrument also corrects typographical errors in article 28(1) and (3) of the 2015 Order.

Consolidation

- 7.16 This is the sixth amendment to the 2015 Order. No consolidation of the Order is proposed at this time.

8. Consultation outcome

- 8.1 A consultation – proposing either a ‘banding review’ to reduce the rate at which biomass and co-firing stations receive ROCs, or a cap (of 105,000 ROCs) on the

⁴ The Government response to the consultation on proposals for the levels of banded support under the Renewables Obligation for the period 2013-17 and the Renewables Obligation Order 2012 is available at: <https://www.gov.uk/government/consultations/renewables-obligation-banding-review>

⁵ The consultation and Government response to the consultation on proposals to enhance the sustainability criteria for the use of biomass feedstocks under the Renewables Obligation are available at: <https://www.gov.uk/government/consultations/ensuring-biomass-affordability-and-value-for-money-under-the-renewables-obligation>

issuance of ROCs to non-grandfathered individual units – was published on 15 September 2017 and closed on 26 October 2017.⁶

- 8.2 In total, 22 responses were received from stakeholders, including affected generators, energy companies, non-governmental organisations (NGOs), companies in the biomass supply and distribution chain and one individual. The majority of respondents (apart from those representing two affected generators and five supply chain companies) considered that some form of cost control was necessary to protect consumers. Those generators to be materially affected by the proposals were concerned that either option would make it uneconomic to burn biomass and would result in them burning coal for as long as it was economically viable to do so ahead of the planned phasing out of unabated coal by 2025⁷. They suggested a variant on the cap proposal which they considered would enable affected units to run on biomass rather than unabated coal, while still keeping costs low for consumers.
- 8.3 Following analysis of the responses, Government decided to control RO costs by introducing a more flexible cap mechanism which continues to control costs to consumers whilst addressing some of the concerns of generators. Moreover, it provides wider benefits to the electricity system by allowing units to operate when electricity demand is highest and possibly bringing forward the end of some unabated coal generation before 2025.
- 8.4 Responses to the consultation were also received from NGOs about the sustainability of biomass, with some considering that the proposals were not sufficiently stringent and all subsidies for biomass or biomass conversions should be phased out.
- 8.5 The UK has amongst the most stringent biomass sustainability provisions in Europe. Government has introduced mandatory sustainability criteria for biomass used for electricity (and heat) to ensure biomass reduces carbon emissions and is sourced sustainably. Generators only receive support under the RO for the electricity output which complies with the sustainability criteria. Government documents, including the recent Clean Growth Strategy, have been clear that sustainable biomass conversions play an important transitional role in decarbonising the grid and helping to meet carbon targets. Ending all subsidies for existing biomass projects would be disproportionate to the policy objective of limiting additional RO spend and could result in some units returning to coal.

9. Guidance

- 9.1 The Authority, as administrator of the RO, intend to publish draft guidance on the generator cap mechanisms for informal consultation. A final version of the guidance will then be made available once this instrument comes into force.

⁶The consultation and Government Response to the consultation on controlling the costs of biomass conversion and co-firing under the Renewables Obligation are available at:

<https://www.gov.uk/government/consultations/controlling-the-costs-of-biomass-conversion-and-co-firing-under-the-renewables-obligation>

⁷ Government has committed to phasing out unabated coal by 2025. See : "Implementing the end of unabated coal by 2025- Government Response to unabated coal closure consultation at :

<https://www.gov.uk/government/consultations/coal-generation-in-great-britain-the-pathway-to-a-low-carbon-future>

10. Impact

- 10.1 The changes made by this instrument to control the costs of biomass co-firing and conversion projects under the RO will impact business, charities or voluntary bodies where they generate electricity from these projects in one of the specified ways. In these circumstances, generators may receive less income from ROCs than they might have if we did not implement a cap. We have, however, built flexibility into the cap mechanisms to allow units to operate more when most required by the electricity system, i.e. at times of high system demand and low intermittent renewable output. This should also allow operators more commercial flexibility to provide competitive capacity in other areas such as the balancing mechanism and the ancillary services market.
- 10.2 These measures are estimated to prevent around an additional annual £135m to £240m spend, which would equate to an increase to average household bills of £1 to £2 per annum from 2019/20 (figures based on 2011/12 prices, central estimate).
- 10.3 The requirement for the simple declaration for pre-2013 CHP capacity will have negligible impact as a maximum of 15 generators may potentially be affected if they choose to convert to CHP.
- 10.4 The clarification of the definition of 'post-2013 dedicated biomass station' will have no impact as there is no change to the existing requirements.
- 10.5 The impact on the public sector relates to the costs of administering the changes made by this instrument. We estimate that the Authority will incur minimal additional costs to prepare guidance and to administer the cap mechanism. There is existing provision to allow these costs to be met from monies paid by electricity suppliers who do not meet their annual obligation, as explained in paragraph 7.2 above.
- 10.6 An Impact Assessment is submitted with this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), we have excluded 'microgenerators' (defined as those operating projects at or below 50 kW capacity) from the scope of the cost control measures. We have also excluded generating stations that previously operated as dedicated biomass projects and tend to be operated by smaller companies. Those projects captured by this legislation are mainly large-scale coal plants that use/are planning to use biomass and are owned by companies employing more than 50 people.
- 11.3 In line with the current requirements in the 2015 Order for other capacities, the requirement for the simple declaration for pre-2013 CHP capacity does not apply to microgenerators. The clarification of the definition of 'post-2013 dedicated biomass station' will have no impact on small businesses as there is no change to the existing requirements.

12. Monitoring & review

- 12.1 The Authority carries out monitoring to ensure compliance by electricity generators and suppliers with their obligations under the RO. The Authority publishes an annual

report into the operation of the RO in the preceding obligation year (as required by article 86(1)(f) of the 2015 Order).

13. Contact

- 13.1 Julie Whiting at the Department for Business, Energy and Industrial Strategy (Tel: 0300 068 6194 or email: julie.whiting@beis.gov.uk) can answer any queries regarding the instrument.