

IPA BRIEFING PAPER
ISSUE 8 November 2005



Recent developments in the Renewables Obligation

AN UPDATE FROM IPA ENERGY CONSULTING



Clarifying the amendments from 2004 and detailing the recent changes

There have been two updates and amendments to the Renewables Obligation (RO) since the original 2002 Renewables Obligation Orders in England & Wales and in Scotland. The original Orders were first amended by the Renewables Obligation (Amendment) Order 2004, and have been updated further by the Renewables Obligation Order 2005, which came into force in April this year¹.

This briefing note provides an update on the current situation, clarifying the amendments from 2004 and detailing the more recent changes. The key new developments are:

- Expansion of the stepped Obligation profile to 2015;
- Creation of a Northern Ireland Obligation;
- Creation of a UK-wide buyout fund recycling mechanism;
- Introduction of safeguards against financial default by electricity suppliers (mutualisation); and
- Making it easier for small generators to benefit from the obligation.

A Review is also underway for the Renewables Obligation in England & Wales and in Scotland.

Extension of the Obligation

The 2002 Renewables Obligation Order imposed a commitment level on suppliers that started at 3% for the year to 31st March 2003 and rose to 10.4% for 2010/2011, remaining at that level through to 2026/2027. The April 2005 revision expands the Obligation by 1% each year for the five years from April 2011, to reach 15.4% for March 2016 and beyond. The Northern Ireland (NI) Obligation has been set at a lower level, ostensibly to minimise the price impact on electricity consumers in NI.

¹The relevant Orders are: for England & Wales SI No 926 The Renewables Obligation Order 2005; for Scotland SSI 2005 No 185 The Renewables Obligation (Scotland) Order; and for Northern Ireland SR No 38 The Renewables Obligation Order (Northern Ireland) 2005.

Obligation Period (financial year)	percentage of total supplies	
	GB Obligation	NI Obligation
2005/6	5.5	2.5
2006/7	6.7	2.6
2007/8	7.9	2.8
2008/9	9.1	3
2009/10	9.7	3.5
2010/11	10.4	4
2011/2012	11.4	5
2012/2013	12.4	6.3
2013/2014	13.4	6.3
2014/2015	14.4	6.3
2015/2016	15.4	6.3
2016/17 - 2026/27	15.4	6.3

Figure 1: Obligation level (percentage of total supplies)

Level of the obligation (percent of electricity supplied)

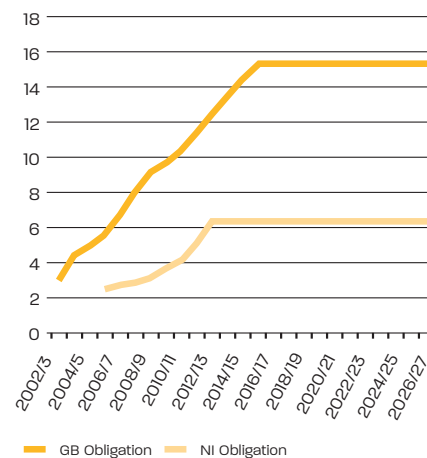


Figure 2: Obligation profiles

The extension of ramped increases to the Obligation beyond 2010 means that the UK renewables industry has a guaranteed period of growth for ten years to come.

Further extension of the Obligation profile beyond 15.4% was considered during the preliminary consultation on the Review of the Renewables Obligation, but the Government position is that no extension is required at present.

Northern Ireland ROCs

The RO scheme has now been expanded to include NI, meaning that there is now an obligation on all suppliers of electricity in the UK. The 2005 Order ensures that all ROCs are fully fungible, meaning that ROCs generated in NI (NIROCs) can be presented in Great Britain and vice versa, and that there will be just one ROC price.

Level of the NI Obligation

The level of the obligation in NI is lower than the obligation level in the UK. The level of 2.5% rising to 6.3% (as shown in figure 1, left) equates to 207 Gigawatt hours rising to 590 Gigawatt hours in 2012/2013 at current electricity supply estimates. There has been no commitment as yet to extending the ramped increase beyond 2013.

Surplus Renewable Energy in NI?

IPA forecasts suggest that existing and planned renewable generation in NI will meet the current obligation and that there will be an oversupply of NIROCs throughout the 2005 to 2012 period. Given the small size of the NI electricity supply compared to GB supply, however, the oversupply in NI is not expected to have a significant impact on ROC prices.

Status of the Northern Ireland NFFO

The NIRO replaces the Northern Ireland Non Fossil-Fuel Obligation (NI-NFFO) as the primary renewable energy support mechanism in NI. There were two NFFO rounds in NI, in 1994 and 1996, with a total of 30 contracts (around 32MW capacity) awarded.



The ROCs relating to generation under NFFO contracts will be auctioned by the Northern Ireland Electricity Power Procurement Business, with the proceeds going in part or in whole towards reducing the price impact of the NIRO on consumers. As in GB, when these contracts come to an end the generator will be able to benefit from the sale of the ROCs (see final page).

A UK-wide buy-out fund recycling mechanism

As well as introducing mutual recognition in the three Renewables Obligations, the 2005 Order also introduced a single Recycling Mechanism for the UK buy-out funds. This means that suppliers who have fulfilled their obligations using ROCs, SROCs or NIROCs receive a share of what is effectively a single buy-out fund. Under the new legislation there are still three buy-out pots, but the recycling payments are made to all suppliers who fulfilled their obligations (or part of their obligation), regardless of which kind of ROC they used. This legislation means that regulatory arbitrage between the different obligations is no longer possible.

Buy-out mutualisation and late payments fund

The new Orders introduce mutualisation to mitigate the impact of any future shortfalls on the market for certificates, such as the £23 million buy-out fund shortfall produced by TXU's failure in 2003. In future if a shortfall occurs, all suppliers will be required to contribute sums, according to their share of the supply market, to make up the shortfall. Another 'loophole' that has been closed relates to late payments: the 2004 amendments introduced the concept of a late payments fund, which would be shared out in the same way, and the 2005 Order introduced a surcharge to discourage late payments.

Mutualisation, combined with the late payments fund, ensures that there are mechanisms in place to ensure a fair sharing in any risk of non-payment, which should help to increase investor confidence in the renewables sector.

There is not at present any provision for mutualisation in the Renewables Obligation Order (Northern Ireland). However, the small size of the NI system means that a default in the territory will not have a large effect on the value of recycling payments.

Co-Firing rules

The 2004 amendment changed various details of the original Order, notably to extend the period of ROC support for co-firing of fossil fuels and biomass:

- The time period for co-firing ROC eligibility was extended from 2011 to 2016;
- Limits on the use of biomass waste (as opposed to dedicated energy crops) for co-firing will now come into force in 2009 and be ramped up until 2016 (see figure 3 below); and

- The limit for the amount of Obligation a supplier could satisfy using ROCs was reduced for future Obligation periods from the current 25%, to 10% for 2006-2011 and 5% from 2011 to 2016 (see figure 3 below).

Small Generators

The 2004 Amendment Order allowed for generating stations up to 50kW capacity ('sub 50kW stations') to calculate their output for the purposes of issuing ROCs on a yearly, rather than monthly, basis. This provision allows small generators to earn ROCs where their cumulative output during a year is more than 0.5MWh but their output per month may be below the 0.5MWh cut-off.

To increase flexibility for smaller generators the 2005 Orders allow sub 50kW stations to choose at the beginning of each Obligation period (starting in 2006) whether to calculate emissions by year or by month.

	% Energy Crop of biomass component		% Co-firing cap
	2002 Order	2004 Amendment	
2002/3	0	0	no cap
2003/4	0	0	no cap
2004/5	0	0	no cap
2005/6	0	0	25
2006/7	75	0	10
2007/8	75	0	10
2008/9	75	0	10
2009/10	75	25	10
2010/11	75	50	10
2011/2012	75	50	5
2012/2013	No co-firing	75	5
2013/2014		75	5
2014/2015		75	5
2015/2016		75	5
2016/17-2026/27		No co-firing	No co-firing

Figure 3: Co-firing limits



Review of the RO

A review of the Renewables Obligation England & Wales is currently being undertaken. The statutory consultation document was released in September and is available for download, along with supporting documents, from www.dti.gov.uk/renewables/renew_2.2.5b.htm. The consultation period runs until 9 December 2005.

The review considers, and invites, views on:

- The effectiveness of the Obligation;
- The operation of the ROC market; and
- Modifying the rules for low cost technologies, combined heat and power, and energy from mixed wastes.

The consultation exercise is supported by separate consultants' reports on several of the issues covered, including:

- Eligibility of Energy from Waste;
- Costs of supplying renewable energy;
- Potential for commercially viable renewable generation technologies; and
- Changes to the treatment of CHP under the RO.

The DTI envisage that any secondary legislative changes resulting from the review would take effect from April 2006; changes to primary legislation would take longer and would need a suitable gap in the legislative timetable.

A parallel review is underway in Scotland, led by the Scottish Executive (www.scotland.gov.uk/Publications/2005/09/13105127/51293). Unlike in previous years, the two consultations differ in some important aspects, which could signal an end to ROC conformity in the UK.

The different consultations suggest that the Executive is at least considering introducing changes to the Renewables Obligation Scotland without equivalent changes to the England & Wales and NI Obligations.

The main difference regards the issue of differential ROC support for emerging technologies; this follows a report by the Scottish Parliament's Renewables Inquiry that was critical of the dominance of large onshore wind in Scotland and recommended using the Renewables Obligation to support other technologies (wave and tidal in particular).

Another important difference concerns a Scottish Executive proposal to amend the definition of energy crops to include managed woodland products. IPA has produced a key report on this issue, which is available for download at: <http://www.scotland.gov.uk/Topics/Business-Industry/infrastructure/19185/IPAenergyCropsStudy>

However, the Executive's current position is that neither of these changes will be introduced during the current Review.

Decision on NFFO contracts and ROC eligibility

Energy Minister Malcolm Wicks announced at the RPA's annual conference on 23 June 2005 that a decision has been made by the DTI that NFFO 3, 4 and 5 contracted generation will remain eligible for ROCs beyond the expiry of the current NFFO contracts. The March 2005 consultation had suggested that since these projects would already have benefited from up to 15 years of Government support through their NFFO contracts, it was not clear that further support would be required.

The announcement confirms that in future, when a NFFO contract expires, the value of ROCs from electricity generated will go to the generator (as with all other ROC-eligible generation). During the period of the NFFO contract the ROCs go to the Non-Fossil Purchasing Agency, which releases them in periodic auctions.

There has not yet been a decision on the ultimate destination of the NFFO ROC auction funds.

IPA Energy Consulting - The Company

IPA is an independent company that has worked at the forefront of electricity and gas market development for 15 years.

The Company has global experience in creating, implementing and strengthening energy markets, both electricity and gas, in order to increase competition, raise economic efficiency, attract private sector capital, foster renewables and promote emissions reduction.

Founded in 1989, IPA's headquarters are in Edinburgh.

IPA has recently undertaken studies on:

- Marine energy;
- Energy from waste;
- Energy crops and managed woodland products;
- Community benefits from renewables;
- Community-ownership of wind turbines; and
- Dedicated biomass generation sets at fossil fuel stations.

For more information, contact IPA's Renewable Energy team:

Francisco Ascui – Associate Director
Gareth Swales – Senior Consultant



41 Manor Place, Edinburgh EH3 7EB, Scotland.
T: +44 (0) 131 240 0840 F: +44 (0) 131 220 6440
E: contact@ipaenergy.co.uk