

# Annex C – Renewables Obligation transition

## INTRODUCTION

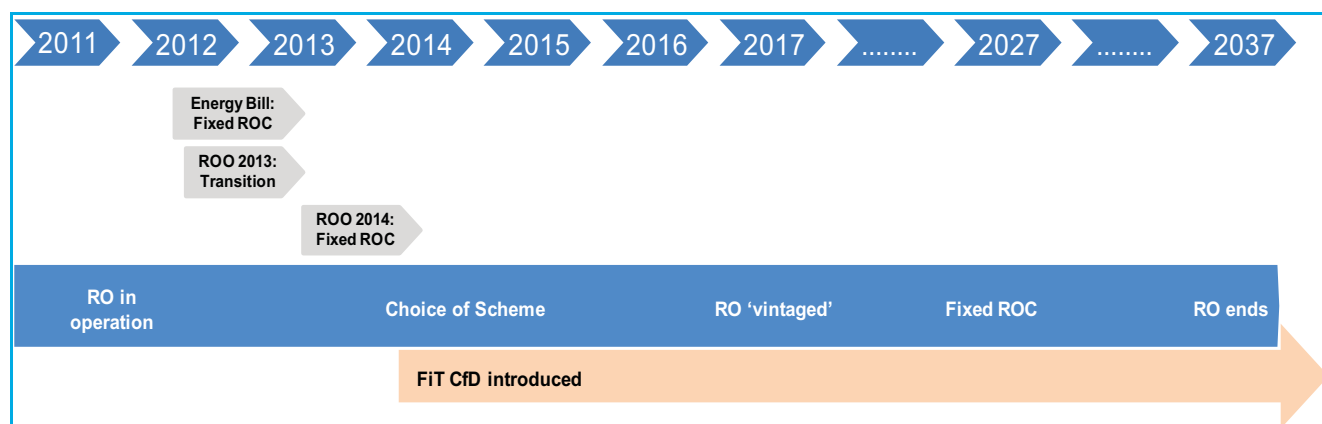
188. The Government recognises that significant investments have been made under the current Renewables Obligation (RO), with around 9 GW of installed capacity to date, and 10 GW in the pipeline expected to be deployed before 2017. Throughout the Electricity Market Reform process, we have set out clear and transparent transition arrangements from the RO to the new support mechanism, with the aim of preventing a hiatus in renewables investment while the new arrangements are being put in place
189. The Electricity Market Reform White Paper– **Planning our electric future: a White Paper for secure, affordable and low-carbon electricity**<sup>34</sup> – set out in detail our proposals for the Renewables Obligation (RO) transition. These include:
- RO support to 2017:
    - a choice of scheme for new renewable generation projects;
    - some limited grace periods; and
    - provisions for offshore wind phasing.
  - RO support from 2017:
    - RO is closed to new generation;
    - RO calculated by headroom until 2027, then we fix the price of a Renewables Obligation Certificate – ‘Fixed ROC’ to 2037;
    - all technologies benefiting from grandfathering on 31 March 2017 will be grandfathered in the vintaged RO in 2017;
    - provisions will be made for additional capacity; and
    - Non-Fossil Fuel Obligation (NFFO) generation will be treated consistently with other RO generation.
190. The majority of these changes will be implemented through amendments to the RO legislation itself, via a future Renewables Obligation Order (ROO). However, the Fixed Renewables Obligation Certificate (ROC) proposals cannot be implemented using existing powers. Therefore we intend to seek powers in primary legislation, alongside the other Electricity Market Reform measures, to enable us to implement the Fixed ROC proposals.
191. A timeline for the RO transition implementation is shown in Figure 12. The timeline, as well as the enactment of the primary legislation, is subject to Parliamentary time being available and the will of Parliament.

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<sup>34</sup> <http://www.decc.gov.uk/assets/decc/11/policy-legislation/emr/2210-emr-white-paper-full-version.pdf>

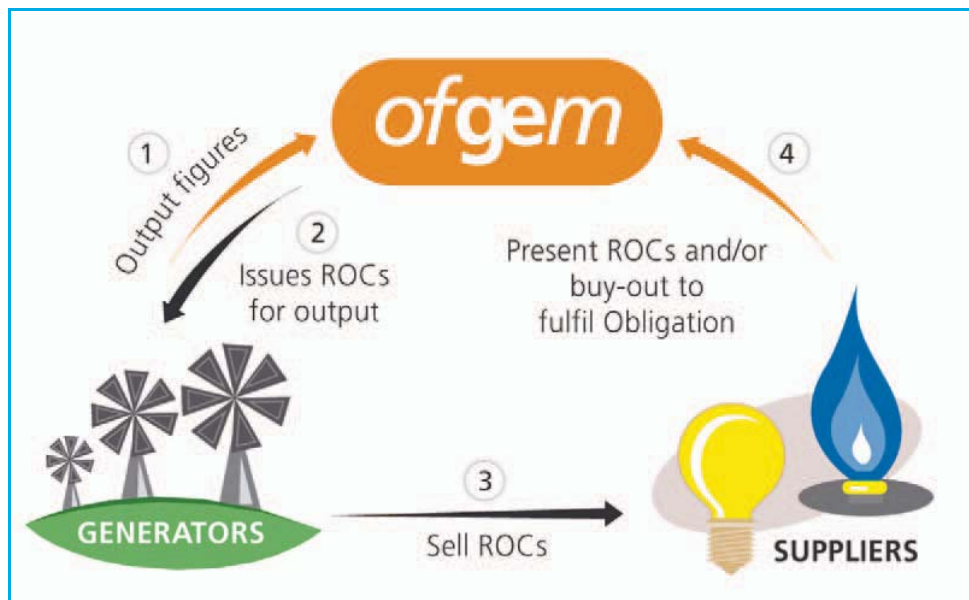
192. The Fixed ROC powers we propose to take in the primary legislation will not provide full details of the Fixed ROC scheme. We are aware that investors and developers taking long-term investment decisions would like more detail on how the Fixed ROC scheme will operate from 2027-37. Therefore, the aim of this update is to provide further detail of our proposals.
193. The RO currently operates as three separate mechanisms working together – the England and Wales RO, the Scottish RO, and the Northern Ireland RO (NIRO). All of the jurisdictions are committed to support for renewables.
194. The proposals for RO transition have been discussed by a Steering Group comprising policy advisors and technology experts from the UK Government and the Devolved Administrations. We will continue to work closely with the Devolved Administrations to ensure that the transition arrangements are simple and transparent across all three RO schemes. Our overall goal remains to introduce any changes on a consistent and common basis.

Figure 12: Renewables Obligation transition timeline



195. Under the present RO system, Ofgem issues ROCs to generators for the eligible electricity that they generate. Generators can sell these ROCs to suppliers.
196. In order to comply with their obligation suppliers either present the ROCs they have bought to Ofgem or pay into the buyout fund, or a combination of the two.
197. After deducting its administration costs, Ofgem recycle the buyout fund back to the suppliers who presented ROCs on a pro-rata basis.
198. The obligation on suppliers is set annually by DECC, as the higher of either a fixed target (Calculation A), or the amount of expected generation, plus 10 per cent 'headroom' (Calculation B).
199. As set out in the Electricity Market Reform White Paper, from the point where the RO is closed to new generation (31 March 2017), we propose to set the obligation on the basis of expected generation plus 10 per cent 'headroom' (Calculation B), until the Fixed ROC scheme is introduced (2027-28).
200. The current RO system is set out in Figure 13.

Figure13: Current Renewables Obligation system



## THE RENEWABLES OBLIGATION 2027-2037: FIXED RENEWABLES OBLIGATION CERTIFICATE SYSTEM

### In Principle

201. In the Electricity Market Reform White Paper, we set out our intention to calculate the RO on a headroom basis until 31 March 2027, when we would move to a Fixed ROC system. The reasons for this are as follows:

- gives certainty over ROC income, and enables generators to access the full value of the ROC;
- enables generators to access ROC income on a more regular basis than the current lag of up to 18 months; and
- provides confidence in the final years of ROC income from 2027-37, removing the perception that a shrinking obligation could be volatile in quantity and hence vulnerable to price volatility.

202. The Fixed ROC system would come into force in 2027. This date was chosen to avoid impacting existing Power Purchase Agreements (PPAs), the majority of which expire before 2027.

### Fixed Renewables Obligation Certificate Price

203. Our intention is for the price of the Fixed ROC to be set at the long term value of the ROC. In 2027, this will be the 2027 buyout price, plus 10 per cent. The Fixed ROC price would remain inflation-linked from 2027, in the same way that the buyout price is currently inflation linked.

### *Fixed Renewables Obligation Certificate Institution*

204. The RO is currently administered by Ofgem. We intend the role of purchasing ROCs under the Fixed ROC scheme to be carried out either by Ofgem, or by another institution appointed by the Secretary of State.

### *Payment Model: Options and assessment criteria*

205. We looked at three different model options for raising the money to pay for the purchase of ROCs, which fitted within the Fixed ROC principles outlined above. These were:

- **Model A, Supplier Levy:** Fixed ROC Institution buys ROCs at a fixed price, and levies suppliers in line with their share of the market for electricity supplied to consumers, to recoup the cost of the ROCs
- **Model B, General Taxation Model:** Fixed ROC Institution buys ROCs at a fixed price, and the cost is recouped from Government, funded by general taxation.
- **Model C, Replicate small-scale FiT:** a pool of 'RO Suppliers' (those above a certain threshold) are obliged to purchase ROCs at a fixed price. The Fixed ROC Institution would carry out a levelisation exercise across all licensed suppliers, spreading costs according to their share of the market for electricity supplied to consumers. 'RO suppliers' would recoup the cost (above their own share) from the institution.

206. We assessed the above models according to the following criteria:

- **stability:** does the model provide a stable ROC value for generators?
- **administrative burden:** will the model increase or decrease the administrative burden on generators, suppliers or government?
- **transition:** will it be simple to move from the current RO system to the new model?
- **investment impact:** will investors and developers have confidence in the model?

### *Chosen Payment Model: Supplier Levy*

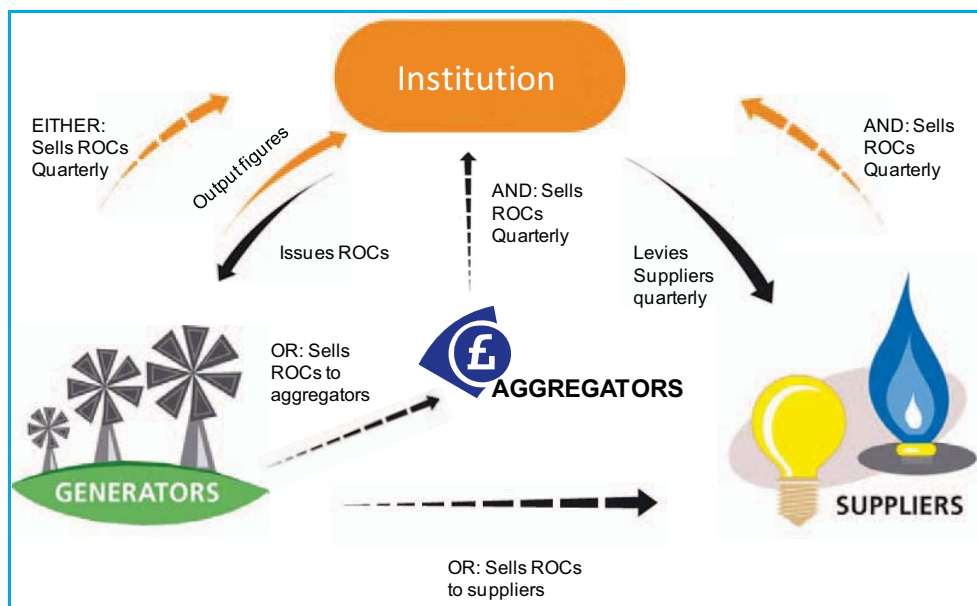
207. We have chosen to introduce Model A, the Supplier Levy. This decision was based on our assessment against the criteria, as follows:

- **stability:** this model removes the risk of a ROC price crash, and it is possible for generators to realise the full value of the ROC;
- **transition:** this model provides a simple transition for generators. There would be transition implications for suppliers and Government;
- **administrative burden:** there will be administration burdens for generators, suppliers, and Government. Generators will have the option of dealing with a single ROC purchaser. There may be some increased burden for smaller suppliers who are used to 'buying out' once a year, and may now be levied more frequently; and
- **investment impact:** preserving the ROC market makes it more likely that PPA and finance structures can continue to be used.

### Proposed Fixed Renewables Obligation Certificate System: Supplier Levy

- 208. Ofgem will issue ROCs to generators in the same way as at present. The Fixed ROC Institution will then purchase ROCs at the fixed price.
- 209. Once a ROC has been issued, we intend to set an expiry date, by which time the ROC should have been submitted to the Fixed ROC institution for purchase. We also intend to set time limits on the Fixed ROC institution, for the maximum time it should take to carry out the purchase of a ROC once a request for purchase has been validly made.
- 210. Government will set the level of the levy on suppliers annually. The levy will be based on the expected costs of purchasing ROCs over the year ahead, adjusted for any shortfall or surplus expected to accumulate over the current year. The levy would then be payable to the Fixed ROC Institution on a quarterly basis. The costs will be spread across suppliers in line with their market share.
- 211. Generators can choose whether to hold their ROCs and sell to the Fixed ROC Institution, or whether to sell their ROCs to a third party, which could be either a supplier or an aggregator, who would then sell the ROCs to the Fixed ROC Institution.
- 212. The proposed Fixed ROC system is set out in Figure 14.

Figure 14: Proposed Fixed Renewables Obligation Certificate system



## PROVIDING INVESTOR CERTAINTY

### Maintaining the Renewables Obligation Certificate market

- 213. We intend to impose a legal obligation on the Fixed ROC Institution to purchase ROCs at a fixed price. This means that generators will be able to know the value of a ROC in advance. There are likely to be conditions that need to be satisfied before the Fixed ROC institution is obliged to purchase the ROC. For example, the Fixed ROC Institution will need to be satisfied that the ROC is valid.

214. However, by preserving the Certificate system, we have ensured that there is a market for ROCs, and that generators are able to sell their ROCs to a third party if they choose. This maintains the current 'portability' of the ROC, and allows generators to maintain a monthly income from selling ROCs either to a supplier or to a third party aggregator.
215. As with the current mutualisation arrangements, we intend to make provision for situations where there is a shortfall in the levy due to a supplier becoming insolvent.

## **STATE AID**

216. All changes to the RO are subject to State Aid approval, which will be sought for the Fixed ROC scheme before it is brought into force. The proposals for the Fixed ROC scheme are also subject to Parliamentary approval.

## **NEXT STEPS**

217. This document is intended to update stakeholders on our intentions with regard to the Fixed ROC scheme. The detailed regulations for the Fixed ROC scheme will be subject to a statutory consultation before they are made.