

# **THE RENEWABLES OBLIGATION REVIEW PRELIMINARY CONSULTATION DOCUMENT**

## **INITIAL REGULATORY IMPACT ASSESSMENT**

### **TITLE OF PROPOSAL**

1. Initial Regulatory Impact Assessment for the Preliminary Consultation on areas for consideration under the Renewables Obligation (RO or “Obligation”) Review 2005/6.

### **PURPOSE AND INTENDED EFFECT OF MEASURE**

#### **The Objective**

2. The objective of the Review is to ensure that the RO continues to work as effectively as possible in stimulating the generation of renewable electricity and thereby contributes to reducing the UK’s carbon dioxide emissions up to 2010 and beyond. This fulfils a Government commitment to review the RO in 2005/6 as part of the Energy White Paper.
3. The specific objective of the Preliminary Consultation ([www.dti.gov.uk/renewables](http://www.dti.gov.uk/renewables)) is to continue the process of stakeholder engagement that we started when we invited views on the draft Terms of Reference (TOR) for the Review in August 2004 (see [www.dti.gov.uk/energy/renewables/policy/terms\\_of\\_reference.shtml](http://www.dti.gov.uk/energy/renewables/policy/terms_of_reference.shtml) for final terms of reference published in November 2004).
4. This Preliminary Consultation is to elicit feedback on:
  - the detailed economic analyses/qualitative studies (also posted on [www.dti.gov.uk/renewables](http://www.dti.gov.uk/renewables)) which support the consultation; and,
  - the options for change discussed in the document.
5. The responses to the consultation will inform our considerations of the Review, base don which we will propose a Government position using the criteria below for assessment of any proposed change to the RO:
  - the impact on investor confidence;
  - the impact on the Obligation’s effectiveness in meeting our renewables objectives;
  - the impact on the cost to consumers; and,

- the potential cumulative impact on any changes on confidence in the stability and consistency of the framework.
6. Later in the year, we expect to hold a Statutory Consultation on our proposals, with any subsequent changes to the Order coming into force by 1 April 2006 at the earliest. The Statutory Consultation will include a full RIA.

## **The Background**

7. The Renewables Obligation is the Government's main policy measure to encourage the development of electricity generation capacity using renewable energy sources in the UK. It is underpinned by a substantial package of financial and non-financial supporting mechanisms and active assistance to the industry to develop its competitive potential. The Obligation has already provided and will continue to provide, an impetus for the new renewable generating capacity that will be needed to meet the UK's current 10% 2010 target for electricity produced from renewable energy sources and as a basis for further reductions in carbon dioxide emissions.
8. The details of the Obligation are contained in the Renewables Obligation Order 2005 in England and Wales, the Renewables Obligation (Scotland) Order 2005 in Scotland and the Northern Ireland Renewables Obligation Order 2005. RIAs were produced for the implementation of the Obligation in England & Wales and Scotland in 2002, for the amendment to the Obligation in 2004 and for the new powers set out in the Energy Act 2004 and for the Consolidated Order 2005 (see [www.dti.gov.uk/access/ria/index.htm#energy](http://www.dti.gov.uk/access/ria/index.htm#energy) ).
9. The Obligation requires licensed electricity suppliers to ensure that specified and increasing amounts of the electricity they supply are renewable, rising to 15% in 2015. Eligible generators of electricity using renewable energy sources receive one Renewables Obligation Certificate (ROC) for each MWh of electricity generated from renewable sources ("renewables electricity"). These certificates can then be sold to suppliers. In order to fulfill their obligation, suppliers can either present enough certificates to cover the required percentage of their output, or they can pay a 'buy-out' price (£30 per MWh in 2002/03 adjusted by RPI annually) corresponding to the required percentage (or that part of it for which they have not presented certificates). All proceeds from buy-out payments are recycled to suppliers in proportion to the number of ROCs they present.

## **RISK ASSESSMENT**

10. The Renewables Obligation is a key part of the Government's policies to reduce CO2 emissions and tackle climate change. By not considering the

necessity for amendments to the RO based on the areas set out in this preliminary consultation, it is likely that the market for renewable electricity in the United Kingdom will not operate as efficiently as it otherwise could do. This tends to limit the probability that the Government will meet its renewable energy targets.

## **AREAS CONSIDERED IN PRELIMINARY CONSULTATION**

### **Area (a)**

#### **Effectiveness of the Obligation and achievement of the 10% target**

11. This section is a general overview of the effectiveness of the Obligation so far. It invites views on: the impact of the Obligation on the development of additional renewables capacity; the effectiveness of the ROC market and the relationship between Obligation levels and the Government's target for the percentage of renewable electricity that is consumed; and, on the impact of the Obligation on the price of electricity for consumers.

### **Area (b)**

#### **Energy from mixed wastes**

12. Amended rules in this area may help the Government meet its renewable energy and waste management objectives more effectively. This section invites views on whether changes should be made to eligibility rules for ROCs in respect of electricity generated using mixed wastes and considers relevant issues associated with possible changes. Analysis by ILEX Energy Consultants is being published to inform the consultation on this issue. Views are invited on ILEX's analysis. Sections 3.15 to 3.25 of the consultation document set out the key arguments for and against changes, including assessments of costs, benefits and other regulatory impacts.

### **Area (c)**

#### **Lower cost technologies**

13. This section invites views on the economics of certain lower cost forms of renewable technologies including how these may be affected by the European Union Emissions Trading Scheme (EU ETS), technology costs and other factors. We also seek views on how, as technologies become more commercially viable, the Obligation could be modified in this area. Analysis by Oxera and Enviro is being published to inform the consultation on this issue. Views are invited on the analysis.

## **Area (d)**

### **Obligation levels post 2015/16**

14. This section invites views on whether it is necessary or desirable at this stage to make any further changes to the profile of the Obligation beyond 2015/16. The document invites views on these and suggestions for alternative options for ensuring investor confidence for projects with long-lead times. Sections 5.1 to 5.10 of the consultation document set out the key costs (including costs to consumers) and benefits of options in this area as we understand them.

## **Area (e)**

### **Combined heat and power**

15. amended rules in this area may help bring forward additional capacity of generation from CHP, which is a very energy efficient form of generation. This section invites views on how CHP is handled in the context of the Obligation, in particular whether the supply of electricity generated using CHP should be exempt from the Obligation base. A short qualitative study by Impax Capital supports discussion in this area. A study by Cambridge Econometrics will quantify cost and benefits of CHP exemption.

## **Area (f)**

### **Working arrangements**

16. Three years into the Renewables Obligation represents a good time to assess the detailed operation of the Obligation. This section invites views on a number of detailed issues relating to the operation of the ROC market and possible amendments to the Obligation. It also invites views on a number of detailed changes to the administration of the Obligation.

17. A number of other detailed technical or definitional issues are also discussed.

## **BUSINESS SECTORS AFFECTED**

18. Electricity suppliers and generators in the UK and, by implication, all UK consumers of electricity.

## **ISSUES OF EQUITY AND FAIRNESS**

19. The Government believes that all sectors must play their part in contributing to improving energy efficiency and reducing emissions of

greenhouse gases to contribute to meeting our Climate Change targets. The Renewables Obligation is one of the main components of the UK Climate Change Programme specifically designed to assist the power sector in continuing to achieve greenhouse gas reductions. The RO is a market-based mechanism whose rules apply in a non-discriminatory way to all participants in the electricity sector. This will remain the case with any possible changes considered in this document.

## **CONSULTATION WITH SMALL BUSINESS: THE SMALL FIRMS' IMPACT TEST**

20. Some small businesses could be affected by changes that could follow from the Preliminary Consultation, but not to a disproportionate extent. In addition, the Consultation raises no new issues of specific concern to small firms. However, the Preliminary Consultation will be used to test the above. In one area of the Review (Section 819 – 8.24) we bring forward some proposals to simplify administration for smaller generators.

## **COMPETITION ASSESSMENT**

21. We do not anticipate that there will be any significant impact on competition in any of the affected markets (beyond any that may have already resulted from introduction of a renewables obligation in the UK).

## **ENFORCEMENT AND SANCTIONS**

22. The Renewables Obligation Orders are administered and enforced by Ofgem. Non-compliance with the Obligation is considered as a breach of a 'relevant requirement' of a supplier's licence and Ofgem may impose appropriate sanctions. Ofgem reports on the progress of the Obligation.

## **CONSULTATION**

### **Within Government**

23. DTI officials have worked closely with colleagues in HMT, Defra, DETI (Northern Ireland), the Scottish Executive and Ofgem. Colleagues in those Departments and Ofgem have agreed the contents of the consultation document.

### **Public Consultation**

24. Views of the full range of stakeholders on the draft Terms of Reference for the Review were incorporated in final Terms of Reference, published in November 2004 (see [www.dti.gov.uk/renewables](http://www.dti.gov.uk/renewables)). Views on the contents of this Preliminary Consultation will be considered when we agree the

Government position to be published as a Statutory Consultation later in the year (this will include a full RIA). This is in addition to on-going liaison with industry and stakeholders about the assessment of these areas.