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Ofgem's response to the Renewable Electricity Financial Incentive consultation

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Target audience: This document is addressed to DECC, but may be of interest to renewable and low carbon energy generators, environmental bodies and agencies, energy suppliers, energy market participants, consumer bodies, customers and other interested parties.

Overview:

Urgent action is needed to increase the deployment of renewable electricity generation to achieve the target of 30% share of total generation by 2020. Effective incentives, designed to deliver renewable electricity as efficiently as possible are important to achieving this goal in the interests of existing and future consumers.

We welcome Government proposals to introduce a **stabilisation mechanism for large scale renewable generation**. This is a step in the right direction to ensure stable and efficient support to renewables at a fair cost to existing and future consumers. However, as proposed, the introduction of this mechanism in addition to the RO, would further increase complexity for both generators and Ofgem E-Serve as its administrator. Given the challenging targets we would urge Government to use the window of opportunity between now and when a stabilisation mechanism is proposed to take effect in 2013, to fundamentally review the RO and alternatives to deliver a simpler and more efficient mechanism that can provide investor certainty, reduce complexity and encourage low carbon technologies. We stand ready to work with Government in this task.

Feed-in tariffs provide a vital, simpler form of support for smaller scale generation in communities, small commercial developments, businesses, and households. However, the Government's impact assessment shows that its preferred scenario will cost £3.4bn more to deliver the same level of renewable electricity than in an alternative scenario, as it includes high tariffs to encourage household investment at the lower end of the 0-5MW range set by Parliament. The prize for stimulating household engagement in tackling climate change is significant - households account for around 30% of UK emissions. However, programmes such as CERT, and in future smart metering and measures under the Heat and Energy Saving Strategy, potentially offer more effective ways to stimulate consumer engagement in reducing carbon emissions. We urge Government to revisit its proposed tariffs for microgeneration in this context.

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Context

Tackling climate change is a key challenge for all. The move to a virtually zero carbon electricity system will be essential if the UK is to achieve a 80% reduction in carbon emissions by 2050.

Renewable energy, in particular, will play a vital role. In recognition of its commitments under the EU Renewables Directive, the Government's UK Renewable Energy Strategy (RES) aims to increase renewable electricity generation as a share of total electricity generation from 5.5% in 2008 to over 30% by 2020. The Renewable Electricity Financial Incentive consultation proposes changes to large-scale renewable support, including the Renewable Obligation (RO) and the introduction of Feed-in Tariffs (FIT) for domestic and small scale renewable generation less than 5MW.

Ofgem has two separate roles that are relevant to responding to this consultation. Firstly, we are the regulator of the gas and electricity sectors, with a principal objective to protect the interests of existing and future consumers. We are also responsible for administration of the Renewable Obligation and will be the administrators of the new Feed-in tariff Scheme.

Associated Documents

- Ofgem's response to BERR consultation on the UK Renewable Energy Strategy
http://www.ofgem.gov.uk/SUSTAINABILITY/ENVIRONMENT/POLICY/Documents1/Renewable%20Energy%20Strategy%20response.pdf

- Ofgem's response to BERR consultation on reform of the Renewable Obligation
http://www.ofgem.gov.uk/SUSTAINABILITY/ENVIRONMENT/POLICY/Documents1/Ofgem%20response%20to%20Renewables%20Obligation%20consultation%5B1%5D.pdf

- Reform of the Renewables Obligation 2006: Ofgem's response
http://www.ofgem.gov.uk/Sustainability/Environment/Policy/Documents1/16669-ROrespJan.pdf

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Summary

Ofgem welcomes the Government's consultation on Renewable Electricity Financial Incentives. Given the scale of the challenge facing the UK in meeting its 2020 renewables target, urgent action is needed to ensure the right incentives are in place to help drive development and take-up of renewable technologies. The investment required is enormous and it is in the interests of existing and future consumers that the incentives deliver renewable energy and carbon reductions as efficiently as possible. Carbon dioxide saved under the RO in 2008/09 cost approximately £110 per tonne. Over the same period CO2 traded in the EU ETS cost between £20 and £9/tCO2 and energy efficiency programmes (such as CERT) delivered carbon savings while saving money for consumers.

Renewables Obligation

We are pleased Government is considering a revenue stabilisation mechanism to provide greater certainty to investors and at the same time protect consumers from paying unnecessarily high premiums for renewable generation. However, given the challenging renewables target and the acknowledged high costs of the RO, which has become increasingly complex over time, we urge Government to use the window of opportunity between now and when a stabilisation mechanism could be introduced in 2013 to undertake a more fundamental review. In the longer term a robust carbon market should provide carbon prices that investors can rely on, obviating the need for specific support for established renewables. A global deal in Copenhagen could help deliver this. These are important considerations for such a review.

Ofgem is doing further work on the policy responses required to deliver secure and sustainable energy supplies as part of its Project Discovery and aims to publish this work early next year. We are not alone in this and note that the Committee on Climate Change in its first progress report on the carbon budgets have also identified the need for a review of policy to achieve the decarbonisation of the power sector. We are ready to work with DECC on developing a simpler and more efficient mechanism that can provide investor certainty, reduce complexity and encourage low carbon technologies.

Extending the RO and increasing headroom would provide greater certainty for investors but at a cost to consumers. We are not persuaded that these are necessary steps at this stage and would encourage Government to hold off making further incremental changes pending a more fundamental review.

Feed-in Tariffs

We welcome and fully support the introduction of Feed-in tariffs as a simple, easy mechanism through which smaller generators can be rewarded for renewable generation. The experience in Germany demonstrates the success of guaranteed feed-in payments in encouraging the deployment of renewable generation.

However, given the motivation for feed-in tariffs, is to have a simpler set of arrangements for non- energy professionals we are concerned that the arrangements as proposed are unnecessarily complex. In total the proposal would set 22 generation tariffs, with six each for solar and wind depending on the scale of the

unit. In contrast, the German FIT scheme offers up to three tariffs per technology. Reducing the number of categories by grouping together different technologies depending on their state of development, for example, could simplify the arrangements and help promote more cost effective technologies.

More significantly DECC's impact assessment shows its preferred scenario will cost consumers £3.4bn more to deliver the same level of renewable electricity than a less costly alternative scenario. This is because it includes high tariff rates to encourage household investment at the lower end of the 0-5MW range set by Parliament.

We recognise that securing consumer engagement is a huge prize in tackling climate change - households account for around 30% of UK emissions. However, under the proposed FIT scheme consumers are paying a high price for securing such engagement which could otherwise be promoted through more cost effective ways. In our view there is potential to achieve greater consumer engagement, more cost effectively, through programmes such as CERT, CESP, and the future HESS, as well as smart metering. Both CERT and CESP already include incentives for installation of household scale microgen.

The consultation is also explicit that Government has not yet addressed the fuel poverty implications of this scheme – how to mitigate the impacts of the higher costs on those already struggling to pay their bills and to ensure that those in fuel poverty are able to benefit from the arrangements. These are important to address, both in the interests of ensuring the scheme is fair to consumers and mitigating more regressive effects.

Government's own consumer research ("The Big Energy Shift") makes clear that households are put off installing microgen by the initial capital costs (£5K - £15K) and are unlikely to respond purely on the basis of financial returns. As such the proposals risk over-rewarding those who may be prepared to pay for being "green" and who may be able to afford the upfront costs, while doing little to attract the overwhelming majority of the population.

Given these concerns we would urge Government to proceed more holistically. We recommend scaling back the technology specific tariffs at the household level, exploiting the synergies with other schemes such as CESP and CERT, addressing the other factors really needed to motivate consumer engagement and mitigating the distributional impacts.

For commercial and community scale projects investors will be focussed on economic returns and we encourage Government to ensure that, at the upper end of the 0-5MW scale, set by Parliament, the level of support is consistent with the RO.

If however, Government decides to proceed with its preferred scenario then it should look for opportunities to link FITs with programmes such as CESP that focus measures on fuel poor households where microgeneration could bring enduring benefits. We would also urge an early review of the scheme's progress, including the distributional impacts.

As administrator of the new scheme Ofgem E-Serve is committed to having the necessary arrangements in place to support the scheme from 1 April next year

provided that DECC confirms the policy design on the current timetable. Effective consumer protection will also be important to provide consumer confidence and ensure the experience is a positive one and we stand ready to work with DECC to help in this area.

1. Key issues in Ofgem's response

1.1 Ofgem welcomes the opportunity to respond to the Government's consultation on the Renewable Electricity Financial Incentive consultation (RFI). Ofgem supports the Gas and Electricity Markets Authority (the "Authority"), the regulator of the gas and electricity industries in Great Britain. In addition, the Authority (through Ofgem) carries out an administrative function for a number of energy-related Government environmental support schemes including the Renewable Obligation (RO).

Government's ambitions for renewable generation

1.2 Increasing the share of renewable energy will play a vital role in the UK's programme to tackle climate change. The Government's Renewable Energy Strategy (RES) aims to increase renewable electricity from 5.5% of total generation to 30% by 2020. This will be made up of 29% from large-scale renewables and 2% from small-scale generation.

1.3 The achievement of these targets will significantly alter the energy mix of the UK's electricity market. The benefits of this change will include lower electricity-related carbon emissions consistent with the EU ETS emissions cap, a lower reliance on and exposure to expensive imported fossil fuels and potentially a boost to UK's renewable-related industries. A higher penetration of renewable generation will have other implications as well. These include higher consumer energy bills, new challenges for the real-time management of security of supply, and a more visible presence of renewable generation in the built as well as the natural environment.

1.4 The deployment of renewable generation to meet the 2020 targets will represent a substantial step change from current levels. To achieve this step change the RES sets out the actions the Government will take to address some of the supply side barriers that have inhibited the rate of deployment to date arising from the planning system, long lead times that sometimes exist in obtaining network access and supply chain and skill constraints. The Government is also proposing changes in the Renewable Electricity Financial Incentive (RFI) consultation to bolster investor confidence in a supportive market framework including stable renewable electricity support incentives.

1.5 The two support schemes offering financial incentives for renewable generation will be the Renewable Obligation (RO) for large-scale projects and the Feed-in Tariff (FIT) scheme for installations less than 5MW. DECC estimates that total support provided to renewable generation in 2020 under the amended RO will cost consumers around £6bn p.a.[1] with a further £560mn p.a. for the FIT. This represents around a 15% increase on annual domestic and non-domestic electricity bills in 2009.

1.6 Ofgem's own work on Project Discovery published in October 2009 highlighted the likely significant increase in costs that consumers will face to deliver security of

[1] The estimated annual cost of the RO in 2020 is made up of the estimated £3.5bn cost of the existing regime and the incremental cost of the RO proposals in the RFI estimated to be £2.6bn.

supply together with the achievement of Government environmental targets – with investment of up to £200 billion required by 2020.[2]

1.7 These increases will have a significant impact on current and future consumers' bills and will be especially problematic for those consumers that are already struggling to pay higher energy bills. Therefore, it is all the more important to ensure that renewable financial incentives are effective, efficient, flexible in the face of changing circumstances, consistent with other policy interventions and robust to possible supply-side constraints – so that the renewables targets are met without unnecessary additional cost to consumers.

Our response

1.8 Our response to the RFI consultation seeks to contribute to the Government's proposals. We want to ensure that the financial incentives for the deployment of renewable generation are effective and efficient as this is consistent with current and future consumers' interests.

1.9 The response is divided into two sections:

- The rest of this section summarises Ofgem's key issues relating to proposals for large-scale and small-scale renewable generation covering both policy and administrative aspects.

- In section two we provide responses to the specific questions asked in the consultation.

Proposals for large-scale renewable electricity support

Revenue Stabilisation Mechanism

1.10 In the past, Ofgem has been critical of the RO because it has not proven to be robust to supply side barriers, or responsive to developments in wholesale market prices and the EU ETS. As a result the RO has proved, on its own merits and according to independent assessments by the NAO and the EU Commission, to be a very costly way of delivering carbon savings and promoting renewables. Ofgem has consistently argued that efficiency and flexibility should be a priority within the design of financial incentives for renewable generation. In the face of the challenging targets for renewable generation these principles are all the more important if Government's renewable support policy is to be fit for purpose and justifiable to existing and future consumers.

1.11 We welcome the fact that the Government has looked to build on its experience of the RO to consider significant proposals in the RFI consultation to address some of the key concerns that consumers have paid a higher than necessary premium for new renewables under the RO. In particular, the proposal for a stabilisation mechanism would provide a link between the revenue earned by renewable

[2] A copy of the document " Project Discovery – Energy Market Scenarios" can be found here: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Discovery_Scenarios_ConDoc_FINAL.pdf&refer=Markets/WhlMkts/Discovery

generation and the wholesale price. The mechanism could reduce the costs of renewables to the consumer in periods of high wholesale prices, whilst also providing greater certainty for renewable investors. Wholesale electricity prices can be expected to rise in future given an increasing reliance on more expensive imported fossil fuel supplies. A tighter carbon cap in the EU ETS is also feasible in the medium term as part of a move from the EU's 20% to 30% economy-wide greenhouse gas emissions reduction targets following a global deal in Copenhagen. This reinforces the need for such a mechanism to ensure consumers are not providing more support than necessary to renewable generators.

1.12 The wholesale revenue stabilisation mechanism proposal resembles the two-way 'Contracts for Difference' (CfD) concept which Ofgem put forward in the 2006 review of the RO but with a number of important differences:

- As proposed, the stabilisation mechanism would apply only to the wholesale market price and not the RO itself. The same concerns about consumers over-paying and investors lacking certainty apply to the renewables element. Our proposal would be for a revenue stabilisation mechanism that covered the whole price.

- The proposal is based around an administered price with the associated risk that, if this is set at the wrong level, either consumers will be over-paying or renewable generation will be under incentivised. Our original proposal envisaged the price being set through auctions.

- We have also previously highlighted the problems with the recycling of the buy-out fund in the RO which adds further to the rents received by renewable generators when there is a shortfall in ROC output. We have previously suggested that this could be used in other ways, for example, to support a renewable innovation fund or to help tackle fuel poverty.

1.13 While we welcome the Government's proposal as a step in the right direction, we are concerned that the introduction of the stabilisation mechanism alongside the RO would introduce further complexity to Government's renewable policy. With the successive changes that have taken place to the RO it is now extremely complex. Together, the stabilisation mechanism and the RO would for all intents and purposes transform the renewables support package into a very complicated feed-in tariff plus a premium from the RO.

1.14 Given the scale of the renewables challenges and the acknowledged high cost and increasing complexity of the RO there is a strong argument for the Government to take stock and re-consider the potential benefits of replacing the RO with a simple, more transparent scheme. Ofgem is doing further work as to whether any further policy responses are required to deliver secure and sustainable energy supplies as part of its Project Discovery. This is likely to be published in a paper early next year. We also note that the Committee on Climate Change, in its first progress report on the carbon budgets, identified the need for strengthening of policy to achieve the decarbonisation of the power sector and the need to review incentives to achieve this aim.

1.15 When considering future options it is worth revisiting the rationale for supporting renewable generation:

- If the aim is to support low carbon technologies then the policy design must be able to integrate higher carbon prices in the future and include a migration path for viable renewable technologies to become mainstream without the need for additional subsidy.

- If the aim is to promote fuel security the policy design must accommodate the scarcity signal provided by wholesale prices. Renewable technologies can be expected to transition to fully commercial operation as fossil fuel supplies tighten and become more expensive, reducing the need for specific support from consumers.

- If the aim is to support emerging technologies that are not yet commercial there is merit in providing time limited support based on explicit criteria such as the expected reductions in production costs and the likely potential contribution. This approach would provide support to emerging opportunities that have the potential to deliver low carbon energy cost effectively but also protect current and future consumers from open-ended commitments to technologies that lack evidence of significant prospects.

1.16 Ofgem understands the Government's concerns that replacing the RO outright with a different form of support could potentially trigger a hiatus in renewable generation investment. Nonetheless, we consider this uncertainty is unavoidable to some extent and could be minimised by taking decisions as soon as possible. Ofgem would be happy to work with DECC to further explore some of the policy and practical considerations associated with alternative models.

Extension of the RO

1.17 Extending the RO will add considerably to the costs to be borne by future consumers, therefore we agree with the proposal to introduce time limited support to help contain these costs. In addition, we would encourage Government to establish criteria for reducing or withdrawing financial incentives under the RO over time so that renewable electricity can transition to fully commercial operation. Over the extended lifetime of the RO we could expect to see reductions in technology costs and increases in wholesale market and carbon prices which should mean that longer term specific support for established renewables is not required. We would encourage Government to think now about how to manage this transition when looking at extending the RO well into the future.

Headroom

1.18 A collapse in ROC values through exceeding renewable generation targets has been one of the renewable sector's most consistent concerns, although not proven as yet given the actual level of new build. However, the risk in ROC price fluctuations is both an upside as well as a downside risk. Increasing the headroom from 8 to 10% will reduce the latter risk for renewable generators, that is the risk that the number of ROCs issued in a given year exceeds demand and triggers a ROC price crash. But this 'insurance' will increase the cost of renewable generation to consumers (by

approximately £300m to 2020) relative to what would have otherwise been the case if headroom remained at 8%.

1.19 In our view it is not proportionate for energy consumers to bear the higher costs of insuring generators against the downside risk of ROC price fluctuations absent any mechanism built in to contain the upside risk that incumbents receive higher rents at the expense of consumers, as they would if the actual supply of ROCs were more than 10% short of the predicted level. We are not persuaded that the current level of headroom is likely to cause difficulties and would expect there to be an optimism bias built into Government projections that will mitigate against a ROC crash at current levels of headroom. Certainly in recent years the external delays caused by planning and transmission access have led to a shortfall in renewable generation which has kept the price high. Rather than increase headroom at this stage we would encourage Government to press ahead quickly with a wider review building on its proposals for a stabilisation mechanism, which, if extended to cover the RO as well as the wholesale price, could address both the upside and downside risks involved.

Administrative Issues

1.20 The amendments proposed to the RO will have significant administrative and resource implications for Ofgem E-Serve. They will require substantial changes to the RO systems, to administration procedures, and to the guidance the administrator issues. Therefore as administrator, Ofgem E-Serve will need clarity and guidance from Government to be able to make the necessary changes in light of the short timescale envisaged by the Government for the proposed changes to come into effect (by 1 April 2010). We have written separately to DECC to emphasise the need for this information as soon as possible to complete the necessary planning and preparations.

1.21 Some aspects of the proposals, in particular in relation to overseas generation, raise complex administrative issues that are unlikely to be resolvable in time to allow them to be included at 1 April 2010.

Feed-in Tariff proposal for small-scale renewable generation

1.22 To achieve its target of 30% renewables by 2020, Government aims to stimulate small scale renewables with the aim that they should deliver 2% of total generation. It also wants the FIT scheme to achieve a level of public engagement that will engender better understanding, use and acceptance of renewables energy technologies and widespread behavioural change.

1.23 We welcome the fact that the Government have responded to calls from a number of sources, including Ofgem, for a simpler set of arrangements, in particular for smaller generators. However, we have a number of concerns about the scheme as proposed:

- with more than 22 tariffs on offer the proposed scheme is unnecessarily complex for consumers and as a result the scheme risks not achieving its primary goal of being more accessible to non-energy professionals. In

Germany the FIT schedule generally only offers two or three tariffs in each technology category for renewable generation less than 5MW;

- the costs of the scheme and in particular the large incremental cost of technology specific tariffs for household microgeneration to achieve a return on investment between 5 and 8%. This is disproportionately high compensation for the level of renewable electricity that will be generated. In our view this is a very expensive way of achieving consumer engagement and lacks proper consideration of the wider barriers and triggers for domestic take-up, identified in the DECC Big Energy Shift research, or the interactions with other schemes;

- allied to this, the lack of any thinking about the implications for those in fuel poverty or how to mitigate the impacts of what is otherwise likely to be a highly redistributive scheme benefitting primarily those who are better off.

1.24 Given these concerns, which we expand upon below, we would advocate that in addition to starting with a simpler set of tariffs, Government should scale back the tariff rates for household microgeneration, and undertake further work to identify the behavioural drivers for consumer engagement and household microgen take-up to exploit the synergies with other schemes and to mitigate the fuel poverty issues. We recognise that time is short if the 2020 targets are to be met but do not believe that this will cause a hiatus. A simplified scheme of FITs alongside a 'whole house' approach to reduce households' carbon footprint would not only be an improvement on ROCs but would provide integrated and accessible support to encourage efficient investment in household renewables.

1.25 Alternatively, if Government does want to provide a stronger impetus for household microgen take-up with higher tariffs then this should more explicitly be on a short term basis aimed at encouraging the exemplars, who are likely to be key to a wider take-up, and proving the technology. We would also encourage Government to look for opportunities to link FITs with supplier-led programmes such as CESP that focus measures on fuel poor households and where household microgeneration could bring enduring benefits. Further, there should then be a commitment from Government to an early review of progress, including distributional impacts of both the costs and the benefits.

Complexity of the proposed tariffs

1.26 In proposing the introduction of feed-in-tariffs Government acknowledges the importance of a scheme that is simple and accessible. However, the scheme as proposed is unnecessarily complex with 22 generation tariffs on offer across different technologies, which vary over time, as well as export tariffs. This complexity in what is a mandatory scheme risks undermining the rationale for a simple scheme and in particular:

- too much complexity will confuse the non-energy professionals who are the target for these tariffs with the risk they will not invest;

- greater complexity adds to the risk of supplier errors and the costs of administering the scheme;

- a complex scheme could also adversely impact on customer experience of the scheme and undermine credibility of the scheme;

- with such a complex schedule of administratively set tariffs there is a risk that the technologies that will dominate will be those where Government over-estimates the costs (and sets the tariff too high) rather than the technologies that are most efficient or have greatest consumer appeal.

1.27 We expand on these points below.

Complexity for consumers

1.28 The Government is promoting the FIT as a scheme for non-energy professionals, which includes individuals wanting to install generating technologies at home, communities, public sector organisations and small/medium sized enterprises. It hopes that the scheme will engage the public and encourage behavioural changes in energy use. We support this aspiration.

1.29 However the FIT scheme as proposed risks not achieving that objective and is unnecessarily complex for the majority of consumers. We are aware from our own work on the retail market that consumers can struggle to understand the range of existing tariffs and can make poor choices as a result. The same can be expected with the current structure of FITs which is a mandated scheme and therefore unlikely to be supported by the marketing and communications that in a competitive retail market help consumer engagement.

1.30 To address this we recommend reducing the number of tariffs per technology. A simple consumer friendly scheme should only offer a few tariff options. Schemes in Germany and Spain that provide FIT for the whole generation market, not just small scale generation, have just two or three options for tariffs in wind and solar <5MW. If the scheme is intended to be simple and easy for non-energy professionals a smaller range of tariffs is strongly to be preferred.

1.31 The German scheme is also a Feed-in tariff in the true sense of the term in that it provides a payment for generation 'fed onto' the network. Generators have an export meter whether they are domestic or large scale generators and receive 'one' payment for each unit of electricity generated. It is therefore easy for a non-energy professional to calculate their annual FIT income, whereas under the UK proposal the generator has a much more complex calculation to establish what their annual payments will be.

1.32 UK consumers already find their energy bills complex and confusing and the scheme proposed will add another layer of complexity to these bills.

Complexity for suppliers

1.33 The timescale for implementation of the scheme is tight (operational by 1 April 2010) and suppliers will struggle to have all the procedures in place in such a short time frame. Adequate and timely guidance from Government will be essential. A simpler scheme would be easier to implement and would also avoid costly set up and administration costs and reduce the risk of errors occurring for FIT consumers.

1.34 A simpler structure of tariffs would also be beneficial for suppliers. They will pay the generation and export tariff to consumers and as there are 22 generation tariffs - 7 of which have annual degression rates - the number of different rates being paid out by suppliers to small generators will grow dramatically over the next 10-20 years (to more than 200). The systems required to make and manage these payments will be more complex than if just a few rates were provided and presents a greater risk of errors in payments and susceptibility to gaming and fraud. Auditing and ensuring generators are receiving the correct rate will be more costly as a result of the complexity.

1.35 Such complexity is likely to increase the number of disputes over payments. While dispute resolution arrangements will need to be put in place in any event, a higher number of disputes risks adverse publicity undermining consumer confidence in the scheme.

Setting the right tariffs

1.36 The more complex the schedule of tariffs the more difficult the task for Government of ensuring that these tariffs are set at the right level. We have highlighted in the context of the RO the problem with administered tariffs that if the level is set too high consumers will pay more than they need and if too low then the desired investment will not take place. We recognise that with feed-in tariffs the level has to be set on an administered basis but caution the Government against making this task more challenging than it need be.

1.37 The current tariffs are set on the basis of trying to ensure that generators earn a certain rate of return on their investment. One disadvantage of this approach is that there is no incentive for generators to take-up what would be more cost effective solutions (or technologies with other appeals) and for these technologies to 'rise to the surface'. We understand that Government is keen to see the full range of technologies develop given the scale of the challenge ahead and accept that this is an important consideration. However what is likely to happen with the proposed complex set of tariffs given the inherent difficulties in projecting technology costs and efficiency is that the technologies that will win out will be those where Government has over-estimated the level of support required.

1.38 A simpler tariff structure would reduce this risk and the need for frequent reviews (as now with offshore wind). It remains open to Government to have a small number of tariffs which, as with the current RO, could allow higher incentives for less developed technologies to help drive a variety of solutions but without the risks associated with a highly complex schedule.

The lead scenario

1.39 The estimated net costs to consumers over 20 years of the Government's FIT proposals are £7.9bn for £780m carbon saved. The scheme will contribute additional renewable generation in 2020 of around 6TWh at a cost of £560mn (compared to business as usual) for which customers will pay a premium of around £93/MWh. The comparable costs of the RO are estimated to be £6bn for 117TWh of generation – a premium of around £52/MWh.

1.40 The FIT impact assessment accompanying the consultation compares the key outcomes of the Government's lead scenario for the FIT scheme with a number of alternative scenarios, one of which is highlighted below (see table 1).

Table 1

	Lead Scenario	**Non-Microgen Scenario**
Cumulative cost to consumers by 2030	£7.9bn	£4.5bn
Additional renewable electricity generation in 2020	6TWh	6TWh
Number of installations by 2020	870,000	8,600 (mainly between 2-5MW)
£/MWh in 2020	£93	£57
Cumulative CO2 savings to 2030	10m tonnes	9m tonnes

Source: DECC Impact Assessment

1.41 Although the alternative ("non-microgen") scenario would not achieve the same level of household and community engagement in microgeneration and small-scale renewables it would achieve the same additional renewable generation in 2020 (6TWh) at a much lower cost to consumers – a saving of £3.4bn over the 20 years. Government's stated reason for preferring the lead scenario, notwithstanding the higher cost, is the increased level of consumer engagement it offers.

1.42 We recognise that securing consumer engagement is a big prize in tackling climate change given that 30% of UK emissions come from the household sector. However, trying to achieve this through using FITs to increase household investment in expensive small scale technologies is a relatively costly way of delivering on that objective. There are a number of other programmes – including HESS, CERT, CESP, Warm Front work on building standards and smart meters – which can be expected to play important roles going forward in stimulating consumer engagement. While primarily focussed on energy efficiency – which is important given that (70%) of household emissions are from heat - these schemes also include incentives for household microgeneration and are likely to be a more cost effective way of meeting Government's goals. It is important that Government looks at the interplay of these schemes with FIT both in terms of securing consumer engagement and ensuring that the level of support provided through FITs is proportionate.

1.43 Improving the interplay between FITs and the various energy efficiency schemes will help domestic consumers make the right investment decisions about which technologies to install. In addition, combining a number of schemes such as installing a FIT generation unit alongside energy efficiency measures would have a

larger impact on consumers' energy bills, would contribute more to achieving the UK's low carbon objectives and would be consistent with the 'whole house' approach advocated in the HESS. The role of smart meters in contributing to the effectiveness of certain measures should also be considered.

1.44 In developing its thinking on the HESS, and based on the major research exercise carried out by DECC ('The Big Energy Shift'), the Government has recognised the full range of barriers and triggers associated with these technologies which are not simply financial ones. Achieving significant take-up of microgen in the household sector is not simply a case of providing generous subsidies. Under the current proposals Government risks over-rewarding those who are interested in green technology and who can more readily afford the capital costs, while attracting very little interest from the majority of households.

1.45 Although, the alternative scenario would not achieve the same level of household and community engagement, we believe that the large incremental cost to all consumers of the lead scenario proposal is disproportionate for what are less tangible benefits that could be delivered in a number of other ways. We would therefore urge Government to proceed initially on the basis of a simpler set of tariffs consistent with the alternative scenario ("non-microgen"). The Government should then take time to consider more carefully the mix of 'carrots and sticks' needed to encourage different groups of consumers to take-up microgeneration and the interplay with other Government programmes.

Implications for Fuel Poverty

1.46 In its consultation Government makes clear that the question of how to ensure that those in fuel poverty and on low incomes can benefit from FITs will not be addressed in the initial FIT structure from April 2010. It does however, acknowledge the need to look at the interaction with other existing and potential policy options for tacking fuel poverty.

1.47 We are concerned that while no provisions have been made for ensuring these customers can benefit from FITs they will nonetheless be bearing the costs from 1 April 2010 with the benefits going predominantly to those who can more readily afford the capital upfront costs.

1.48 The scheme is therefore likely to be highly regressive and raises issues of 'fairness' which has rightly been a concern for Government in other contexts. It is clearly vital that Government moves ahead quickly to look at the important questions of who pays and who benefits from the scheme, the interplay with other fuel poverty programmes and steps that can be taken to mitigate the impacts on those in fuel poverty.

1.49 We would also propose that, as an interim step, any levelisation should be based on the market share of suppliers in MWh (as is currently the case for the RO) rather than number of households (as for CERT) as this is a less regressive, although not perfect, approach.

1.50 In looking at the fuel poverty implications we would encourage the Government to consider ways to involve Local Authorities and other organisations in

helping those in social housing or on low incomes to access and benefit from FITs. The cost of installing a unit is prohibitively expensive (£5k-£15k) and with no access to finance these households will be unable to access the scheme. Yet the fuel poor and those on low incomes could benefit the most from the reduced energy bills that an FIT installation would bring. Unlike CERT and CESP there will not be a priority group quota for this scheme however, other measures could be put in place alongside FIT to ensure that there is a more equitable share of the scheme at domestic level.

Other Policy Issues

Containing the costs of the scheme going forwards

1.51 The costs of the scheme are high and Government needs to consider carefully how to ensure that these are contained going forwards. One way to protect consumers from excess costs is to periodically review the FIT scheme. We encourage the Government to provide more detail on its review policy and how the success of the scheme will be measured for example, on the basis of the percentage increase in kwh of renewables, number of installations or technology cost reductions. It is also important that the likely increases in wholesale and carbon prices are considered as the scheme is developed. Higher prices, including a robust carbon price, would create more favourable conditions for renewable energy and should ultimately lead to less support being required for small scale renewables.

Consumer protection

1.52 Effective consumer protection needs to be in place to help build consumer confidence and ensure that the customer experience is a positive one. However it is equally important that any such arrangements are not overly bureaucratic.

1.53 It will be important to ensure that a dispute resolution procedure is in place prior to the scheme beginning on 1 April 2010. Generators will need transparency on how such disputes will be dealt with and what the escalation procedure will be should the supplier be unable to satisfactorily resolve the issue. The existing Energy Supply Ombudsman provides a potential model.

Impact on competition

1.54 It will be important to ensure that there is no impact on FIT consumers wishing to switch supplier – in particular suppliers' provision of the FIT to customers should not interfere with their ability or incentives to switch supplier.

1.55 There also needs to be consideration of cash flow in scheme design. The time lag between suppliers making payments and recovering these payments through levelisation needs to be as short as possible to reduce any negative impact this might have on suppliers' cash flow – especially those at the smaller end of the market.

1.56 The Government also needs to consider the impact that fixing the export price has on suppliers. If the Government sets a minimum export price this is likely to override the existing export market for small scale generation which will in the longer

term need to be reinvented by suppliers when subsidies and intervention are reduced/removed.

Metering

1.57 While we recognise that ultimately separate generation and export meters will be needed we would encourage a pragmatic approach to be adopted ahead of smart metering rollout.

Administrative issues

1.58 Ofgem will be administering the FIT scheme and although Ofgem E-Serve are liaising directly with DECC on the scheme design and are fully involved in its development there are a number of key points that we wish to raise at this stage.

1.59 As administrator of the new scheme Ofgem e-Serve is committed to having the necessary arrangements in place to support the scheme from 1 April next year. However, given the tight timescales and the scale of the work and resources involved it is essential that DECC confirms the policy design and agrees the recovery of costs for set–up and operation by 13 November. The implications of DECC delaying these decisions may result in Ofgem e-Serve being unable to deliver by 1 April.

1.60 Robust scheme design will enable Ofgem E-Serve to adequately secure compliance, and to minimise the potential for fraud and gaming. Clearly this will be balanced with objectives of simplicity and accessibility, consistent with Ofgem's better regulation principles.

1.61 A robust change process is important as based on our RO experience it is highly likely that the Government will be changing the details of the scheme on a regular basis, at least annually. Additionally, we foresee the need to be able to introduce changes quickly particularly in the earlier years of the scheme's life when new procedures are first being put into practice. It is therefore important that effective, flexible and responsive change processes are established through the legal instruments.

1.62 If significant sums are to be redistributed through the levelisation process then arrangements need to be made to deal with cases where a supplier defaults or pays late to ensure that Ofgem does not have to bear the costs of any shortfall.

Conclusion

1.63 We do not underestimate the scale of the challenge that the Government faces to get renewables installed at the rate required to meet its targets. There is now a focus and impetus behind meeting this challenge and Ofgem is committed to playing its part in administering the schemes and in helping Government refine its thinking to ensure that consumers' aspirations and interests are fully taken on board.

2. Response to consultation questions

2.1 In this section we respond to the questions raised by DECC within the RFI strategy consultation. We have responded to those questions that we consider relevant to our remit as well as in relation to our role as administrator of various Government environmental programmes. Where we have not incorporated a response to a question, it can be assumed that either we do not consider that the area falls within our remit or that we have no relevant information to provide.

Q1: Do you agree that at this point, no extension beyond 2037 is required?

2.2 We agree with the Government's assessment that extending the ROO to 2037, currently due to lapse in 2026-27, will provide longer term certainty to investors that financial support (in the RO) will be in place to allow them to build new projects up to 2020. Given external constraints such as grid access and planning many projects now under consideration will have lead times that will require payback from operations in the second half of the decade after next.

2.3 However, extending the RO will add considerable costs to consumers, in particular future consumers, therefore we agree with the proposal to introduce a time limited support to keep the cost down. It would also be desirable to further contain excess support paid to renewable producers by consumers. Over the lifetime of the RO we can expect to see reductions in technology costs and increases in wholesale market prices, including carbon prices. One approach we would recommend to Government is establishing criteria to reduce or withdraw financial incentives over time under the RO for particular sources of eligible renewable electricity so that they can transition to fully commercial operations. Ultimately we would expect Government to be looking to a robust carbon price to provide signals for investment. It is important that in extending the RO Government is looking at how long-term renewables could become mainstream without a need for long-term ongoing additional subsidy – and thinking about that migration path in its design of the scheme.

Q2: Do you agree that the criterion for treating projects under either the old 2027 end or the new 2037 end should be accreditation before or after 26 June 2008? If not, what should the criterion be and why?

2.4 In determining the cut off date we expect Government would take into consideration of transparency, fairness, implications for the costs on consumers and the administrative practicalities. The Government clearly indicated its preference for the effective cut off date in the 2008 RES consultation to potential renewable investors.

2.5 It is unlikely that the June 2008 cut off date will have made any particular investment project worse off than it would have otherwise been. In fact it is likely that a number of projects accredited since June 2008 will benefit under the new regime as they will receive an additional support than they would have otherwise expected when they made the decision to invest. This represents a windfall to renewable generators accredited for some time after June 2008. The corollary of this

is that consumers will pay more than they otherwise would have had to for those projects that were going to proceed under the old regime. It would be administratively complex to ascertain on a case by case basis the timing of the investment decision and whether this was based on an expectation that the project was economically viable under the old RO regime.

2.6 Nonetheless we think it would be preferable to change the cut off date to July 2009 (the date of the final RES) in order to reduce some of the unnecessary cost to consumers. Given the lead time between investment decisions and accreditation we doubt this would jeopardise the future returns of projects accredited under the RO between June 2008 and July 2009 relative to expectations at the time the investment decision was made.

Q3. Do you agree that additional capacity or plant that is refurbished or replaced should be entitled to the full 20 years of support, regardless of when the original capacity started to receive support?

2.7 In respect of additional capacity the key date for the commencement of the 20 years should be when the additional capacity was commissioned. This is in line with the provisions made in the RO 2009 for the banding and grandfathering of additional capacity.

2.8 In the case of a station refurbishing plant Ofgem would need to collect extra information from generators to ensure that replacement capacity receives ROC benefits for the correct amount of time, if this is the conclusion reached through this consultation. It may require careful drafting within the revised RO in order to limit gaming by generators with multiple sites who might otherwise be able to rotate assets in order to claim ROCs for a longer period than is desired by the Government.

2.9 It would reduce complexity and the cost to consumers if the station as originally accredited was limited to 20yrs, but this may be at the expense of maximising renewable output.

Q4. Do you agree with the proposal to increase headroom to 10% by 2014?

2.10 At this stage we are not persuaded of the need for an increase in headroom and would instead encourage an early review of how best to deal with both upside and downside risks as proposed with the revenue stabilisation mechanism.

2.11 If new renewable deployment is predominantly wind it could become more difficult to accurately predict renewable generation's share of total annual generation. Variability in actual ROC output relative to predicted ROC output could increase the risk of fluctuations in future ROC prices. However, the risk in ROC price fluctuations could be both to the upside as well as the downside. Increasing the headroom from 8 to 10% will reduce the latter risk for renewable generators, that is the number of ROCs issued in a given year exceed demand and trigger a ROC price crash. But this 'insurance' will increase the cost of renewable generation to consumers (by approximately £300m to 2020.) relative to what would have otherwise been the case if headroom remained at 8%.

2.12 As currently proposed there is no mechanism in the new regime to limit the upside risk of ROC price fluctuations and consumers paying more than they need to for renewables. It is not appropriate that energy consumers should bear the higher costs of insuring that generators do not face the downside risk of ROC price fluctuations if there is no mechanism built in to contain the upside risk that incumbents receive higher rents at the expense of consumers if the actual supply of ROCs is more than 10% short of the predicted level. This would only continue the problems we have seen in the existing regime with fixed annual targets.

2.13 Indeed, in the announced Obligation level for 2010/2011, the Secretary of State has determined the number of ROCs to be supplied using the Headroom as this calculation produced an estimate of ROC output that was larger than the fixed annual targets for that year. We think this calculation suffers from optimism bias about the likely level of ROC output, and as a result poses significant upside risks to ROC price in the 2010/11 obligation period especially when more than a third of the fixed target was unmet in 2008/09. This large shortfall inflates the recycled element of the ROC price and allows incumbents to earn high rents at the expense of consumers. Efforts should be put in to developing robust forecasts of ROC output to accurately set the obligation level in order to improve the cost effectiveness of the RO subsidy mechanism.

2.14 Rather than increase headroom we would advocate proceeding now with a broader review of the RO, looking at revenue stabilisation mechanisms and other options.

Q5. Do you agree that the proposed series of 0.5% annual increase in headroom over the time period set out is the best approach to implementing any increase?

See response at Q4.

Q6. Do you agree a wholesale price stabilisation mechanism would bring benefits to renewable generators by providing a predictable and adequate level of compensation?

2.15 Yes (but see below)- the mechanism could improve the effectiveness of renewable support as it would reduce the potential revenue risk for investors if wholesale prices fall. Stable wholesale electricity prices are likely to give some comfort to developers and financiers and be positive for investor confidence in proceeding with future renewable projects.

2.16 However, there are other mechanisms that could further increase predictability for generators and we would urge Government in looking at this to consider these more radical options as well. (See Q13)

Q7. Do you believe that these benefits can be realised in practice? In particular, during periods of high fossil fuel prices, would suppliers pass the benefits onto consumers?

2.17 The potential of the mechanism to deliver better value for money for consumers will depend on a number of factors. One of these is the number of projects covered by the stabilisation mechanism. The mechanism would deliver less efficiency if it were optional and not all new renewable projects were covered. Therefore we would suggest that to deliver benefits for consumers the stabilisation mechanism should be compulsory for new renewable projects if it comes into effect.

2.18 Given the competitive nature of the retail electricity market, suppliers need to ensure their retail offerings are attractive compared to those of their competitors to avoid losing market share and profit. On this basis we would expect cost savings to be passed on to customers.

Q8. Do you agree that revenue stabilisation mechanism could help us meet our target by encouraging more deployment?

2.19 Yes - as noted in answer to Q6 reducing the fluctuations in generator revenue should help to increase investor confidence and promote new investment. Improving the appeal of investing in renewables could be particularly important as it will, as a sector, face major competition for investment from other parts of the UK energy sector.

Q9. What would be the best choice of wholesale power price index to adopt for use with any stabilisation mechanism and why?

2.20 There are two important drivers in determining the index, firstly it should reflect the actual price received for electricity prices across whatever period is chosen and secondly it should be set in such a way to minimise attempts to manipulate the price. In terms of the question of which products and time periods to use for determining the index, there is a wide range of options one could adopt. For example, if calculating the index over a year, then outturn prices could be used for instance, half-hourly prices observed on the APX. However, this is unlikely to be an accurate estimate as not all volume will be sold within day.

2.21 It is therefore more appropriate to use forward prices in deriving the index - this could be done by examining the forward prices for a range of contracts such as month-ahead, quarter-ahead etc. These would need to be weighted to obtain an index. One way to do this would be to come up with a view of how renewable generators hedge their output, i.e. how far forward they sell their output and what volume do they sell and adopt a similar strategy. It will be important that a published methodology for deriving the wholesale price index is available.

2.22 We would be happy to work with DECC to explore these options further.

Q10. What impact do you think a stabilisation mechanism would have upon the operation of the wholesale electricity market?

2.23 The impact on the market would depend on the exact design of the proposal. As currently proposed the mechanism would effectively provide the generator with a financial swap which would hedge against wholesale market movements. It is not a physical contract and therefore it is compatible with the competitive wholesale

market. The mechanism could however reduce the motivation to sign long term power purchase agreements and lead to lower levels of forward trading. But in turn this might increase spot liquidity since renewable generators would be more likely to have an open physical position. The impact on liquidity is unlikely to be significant, at least initially, given it would probably apply only to new renewable projects but this might become more material as the share of renewable generation in the energy mix increases.

Q11. Do you envisage any other implementation challenges which might result from the introduction of a stabilisation mechanism? If so, how do you propose we deal with them?

2.24 There is a potential issue of the level of liquidity in the electricity market in terms of setting the price index. Under BETTA generators and suppliers may enter into contracts with each other which bypass the wholesale market. For these contracts the price and volume information may not be visible to the market. This may mean that the wholesale price index is set on the basis of a few unrepresentative trades and may either under or overestimate the actual value of the electricity.

2.25 The consultation does not provide any information on how the reference price, the guaranteed level of support, would be set. In Ofgem's original proposals for a Contract for Difference (CfD) it was envisaged that this price could be discovered through renewable producers' bids in open auctions. The risk of an administered price is that it would require judgements by the administrator about likely project costs, cost structures and changes to these costs. If the price is set too high consumers will pay more than they need and if too low then the investment will not be forthcoming. Developers will have much better information about the factors which determine the price. There are therefore strong arguments for avoiding an approach where the reference price is administratively determined. The reference price will be very important to the effectiveness (and efficiency) of the mechanism and it is likely to be very difficult for an administrator to get the level 'right' given the factors that need to be taken into account. While the same issues arise in relation to feed-in-tariffs there is more scope with the smaller number of large generators to conduct auctions and we would encourage Government to consider this option.

2.26 In terms of the administrative role for implementing the mechanism, further work is required to identify the magnitude of the administrative costs, given the likely increase in the number of generators who pay or are paid by the administrator. There would need to be adequate provision made for the recovery of costs incurred in administering the mechanism. In addition to this, there are also administrative questions regarding arrangements when generators enter administration or do not make payments on time. Although it is not clear from the proposals who the administrator of the stabilisation mechanism would be Ofgem E-Serve is able to share its experience in administering the RO to help Government further consider these issues if it is decided to pursue the option of CfDs.

Q12. Do you agree that this approach will minimise undesirable effects on market confidence whilst we consider the introduction of revenue stabilisation?

2.27 The incremental changes to Government renewable energy policy creates ongoing transitional issues that can only have a negative impact on investor confidence. Significant changes, such as the introduction of a stabilisation mechanism could create additional uncertainty for investors considering new developments. However, we consider this uncertainty is unavoidable to some extent to address major issues if Government's renewable support policy is to be fit for purpose and justifiable as an appropriate use of electricity consumers' money. We agree with the transitional arrangements as proposed and think they provide sufficient transparency for investors about the timetable for further policy development and implementation should the Government decide to proceed with the stabilisation mechanism. Any impact on future investment decisions could be minimised by taking decisions as soon as possible.

Q13. Do you agree that a Contract for Difference option would be the best choice of wholesale price stabilisation mechanism? If not, what would you recommend as a best option and why?

2.28 We are pleased that Government is now looking at a stabilisation mechanism based on a CfD as a good way to provide investor certainty and improve the value for money of large scale renewable support. We recognise this proposal represents a step in the right direction to address our concerns that consumers have paid a higher than necessary premium for renewables under the RO. However, the proposal to introduce a stabilisation mechanism in addition to the RO would introduce further complexity to renewable electricity support policy and fails to address the risk (for consumers and investors) in the level of the RO itself. Our original proposal for a CfD also envisaged using auctions to set the reference price to avoid the risk of an administered price being set either too high or too low. Given the objectives the Government is seeking to achieve, and the very challenging target it has set for renewables, we advocate a more fundamental rethink from first principles to develop a more efficient, transparent and simple support scheme that is viable for the long-term decarbonisation of electricity.

Q14. Do you have any initial views on whether a stabilisation mechanism should remove wholesale price risk from generators altogether or leave them with some degree of risk, via a cap and collar mechanism?

2.29 Ofgem is of the opinion that generators should be subject to some level of risk such that they are encouraged to act competitively and thus deliver the best value for consumers. Also, since a cap-and-collar scheme is less likely to result in cash transfers between generator and administrator, administration costs will be lower. For these reasons, we would prefer a cap and collar mechanism. In implementing a cap and collar scheme, we recognise it will also be important to ensure the right balance is found between minimising administrative burden and minimising generator exposure to risk.

2.30 There are also other risk sharing models where, for example, the generator receives a percentage of the difference between the index and the reference price (either with or without a cap and collar). This would be more complex to administer but could allow a measure of risk sharing.

Q15. Do you have initial views on whether a stabilisation mechanism after 1 April 2013 should be optional or mandatory for generators under the RO?

2.31 We would prefer a mandatory mechanism as it is likely to be an important factor in delivering the potential efficiency benefits for consumers (see answer to q6).

Q16. Do you agree that biomass and generation involving co-firing should be excluded from any new stabilisation mechanism? If not, why?

2.32 It would be premature to take this decision ahead of more information about the correlation between prices for biomass fuels and fossil fuels. There is a good case for making the mechanism mandatory for renewable generation technologies where the fuel is 'free'.

Q17. Considering the balance between the benefits and the implementation challenges do you think that we should introduce wholesale price revenue stabilisation mechanism?

2.33 With the prospect of upward pressure on energy bills and the step change in the target level of renewable energy, delivering better value for money for customers whilst delivering the challenging renewable targets is an imperative. We therefore strongly encourage Government to further consider the options for introducing a form of revenue stabilisation. As set out above we believe that improvements can be made to the proposed mechanism and would encourage Government to undertake a more fundamental review looking at the total revenue of renewable electricity projects, from first principles. We think that such an approach would result in a more efficient, transparent, simple and viable support scheme for the long-term decarbonisation of electricity.

Q18: If you believe that a price stabilisation mechanism should be introduced for wholesale power price, do you think that it should be applied to the ROC price as well?

2.34 Yes - this was what was originally envisaged when Ofgem suggested a CfD mechanism to support large scale renewable electricity. It is stability in total revenues that matter to investors and the total cost that is of concern to consumers. Introducing stabilisation on the RO price would also remove the need for Headroom.

Q19: Do you agree with the proposed conditions? Are there any more conditions we should consider?

2.35 To the extent that the most efficient means of meeting the renewables target is through development in other Member States or third countries, we would support this, provided the projects are genuine and verifiable, and that their inclusion towards the target does not reduce environmental benefits overall. Allowing stations outside the UK to claim ROCs could also improve the robustness of the support scheme to deliver on targets despite possible supply side barriers to new projects in the UK.

Q20: Do you think we should set support levels for stations located outside the UK in line with those for UK based generation?

2.36 No - the support levels for UK stations have been set based on the technology costs developers face in bringing forward projects in the UK. The RO also has other objectives in terms of supporting industrial development in the UK. The level of support allowed for stations located outside of the UK should focus on delivery of the renewable energy targets at least cost**.**

Q21: Do you agree with our proposal to limit the eligibility for stations located outside the UK to those with a direct interconnection to the UK? If not, why not?

2.37 In order to successfully implement the scheme Ofgem E-serve the administrator would need to ensure that as part of the proposed case by case assessment of potential projects they are satisfied that they will be able to carry out their full range of duties. This is especially important in the areas of audit and fraud prevention. We believe that this may require a change in primary legislation to provide the Authority with powers that extend outside of the UK. For this reason we would suggest that DECC should work closely with Ofgem lawyers in order to ensure that we are able to administer any such extension to the RO. We believe that this might mean that introducing such measures would not be possible by April 2010.

2.38 In terms of generation sited outside of UK territorial waters, outside of the RO, there may be legislative complications with regards to treating such assets as transmission or exempt. Changes in primary legislation may be required to make this proposal possible and Government will need to investigate this in conjunction with any changes made to the RO.

Q22: Are there any specific issues we should consider when implementing international trading in renewable electricity through the RO?

2.39 Please see our response at Q21. We would also want to ensure that provisions were made to ensure that electricity that ROCs were claimed on was not able to claim similar benefits from the country they are based in.

Q24: Do you agree with our proposed level of support for offshore wind, including our proposal to step down support from 2 ROCs/MWh to 1.75 over 2 years?

2.40 The analysis of the E&Y report and the evidence of the change in capital costs support a temporary uplift support for offshore wind projects. However, the announcement of this proposed change so soon after implementation of the previous review has risks for investor confidence in policy stability. This highlights the tensions that can arise when faced with changing circumstances. Therefore, we would like Government to develop its banding review policy to set out clearly how it plans to manage reviews of the RO, particularly early reviews, including advanced announcements ahead of firm proposals.

Q25: Do you agree the proposed eligibility criteria and cut off date for offshore wind are appropriate?

2.41 The use of 'firm contracts' is an eligibility criteria that we currently do not consider within our administration of the RO. The proposals outlined in the consultation suggest that operators will submit these contracts to Ofgem. If Ofgem are called on to review these contracts to ensure that they are 'firm' and meet the requirements of the banding criteria this may require us to use extra legal resources. Therefore, this extra requirement may increase the cost of administering the RO.

2.42 It would seem preferable to tie the temporary bands to accreditation and commissioning, much like the existing provisions for grandfathering. This would also reduce the requirement for amendments to Ofgem's systems and reduce the potential increase in administration costs.

Q28: Do you consider the cap be retained at 12.5 % going forward?

2.43 No we don't agree with the proposal to retain the cap on co-firing. We would like to see the cap removed going forward. The cap potentially disadvantages independent co-firing generators if vertically integrated suppliers self-supply a considerable proportion of their demand for co-firing ROCs. This would mean that the market for independent generators may be smaller than that implied by the cap. We also are concerned that the cap constrains the contribution to our renewable energy targets from a relatively low-cost renewable technology. This might be the case if independent generators constrain output below the level at which they perceive there is a risk that a supplier with demand for ROCs could negotiate ROC price discounts. We also think the concerns about the potential volatility of co-firing volumes could have on ROC prices are overstated. This is because of the reduction in the number of ROC given to co-firing (down to 0.5 ROC/MWh) and the headroom will effectively set the size of the obligation from 2010/11.

Q29: If you think the cap should be changed, when should this happen and at what level should the cap be set? Please provide evidence supporting your answer.

No comment.

Q30: Do you have a view on how we should predict expected electricity use in a subsequent obligation period? What are the advantages/disadvantages of any suggested methods of predicting expected electricity use?

2.44 We expect DECC have sufficient capability within its energy statistics and modelling teams to undertake electricity demand forecasts. As part of this process DECC could undertake a peer review within government, industry and research organisations to ensure robust assumptions, methodology, inputs and judgement. We would be happy to work with DECC on this.

Q31: Do you have any view on how we should predict the expected level of ROCs generated from existing generating stations in a subsequent

obligation period? What are the advantages/disadvantages of any suggested method?

2.45 As noted in our answer to Q4, accurate predictions of ROC output will contribute to stable ROC prices under headroom and also ensure value for money for consumers. We appreciate that this is not a trivial task. We don't have a particular preference for the approach used in predicting the level of ROC output in future obligation periods but we do recommend trialling a number of approaches. It would also be important to conduct some forecast error analysis to identify whether some sources of information used in the estimation have a bias (this could be upward or downward).

Q32: Do you agree with our proposal for accounting for banked ROCs?

2.46 Yes.

Q33: Do you agree with our proposal for predicting new generation capacity for subsequent obligation period? What are the advantages/disadvantages of this method of predicting this new capacity?

Please refer to Q31 response.

Q34: Do you agree that the proposal to offset redeemed ROCs against a generator future output presents a proportionate approach?

2.47 We agree that the Government's proposal to offset future ROCs to a generator presents a proportional approach. This will add clarity for the ROC market and will move much of the risk of revocation from the supplier to the generator, which we believe is appropriate. However, in the situation where the station ceases to produce renewable electricity such it would not be possible for us to withhold the issue of these ROCs and we may still be required to revoke the original ROCs. We would like to highlight that again places a risk on the supplier.

Q35: Do you agree that FITs should be structured in order to recognise all generation, rather than just exports?

2.48 Ofgem agrees that recognising all generation is a sensible approach. This is especially so at domestic level where households will use a proportion of their generation on site (reducing their energy supply bills) but still receive the same level of support for their generation. It also provides a fixed level of support for domestic generators as the export payment is likely to be variable between seasons e.g. more energy consumed in the winter months than in a summer months therefore less exported at times of higher demand.

2.49 However, having three different elements of reward under the FIT, a generation payment, an export payment and on-site use is a complex scheme design. In particular:

- too much complexity will confuse the non-energy professionals who are the target for these tariffs with the risk they will not invest;
- greater complexity adds to the risk of supplier errors and the costs of administering the scheme;
- with such a complex schedule of administratively set tariffs there is a risk that the technologies that will dominate will be those where Government over estimates the costs (and sets the tariff too high) rather than the technologies that are most efficient or have greatest consumer appeal.

2.50 Please see the key issues section for more detail how this complexity risks undermining the whole rationale for a FIT scheme for small scale generators

Q36: Do you agree that the best way of delivering security for the investor is to set a long term guaranteed price for exports?

2.51 We do not agree that setting a minimum export price is the best way of delivering security for the investor.

2.52 Investors will have a fixed generation payment for 20 years which should provide adequate security. Household generators are more likely to consider their investment based on this payment as their on- site use and therefore their level of export (and subsequent payment) will be seasonally variable and more difficult to calculate. We recognise that the intention is to assist generators, particularly domestic generators to secure finance for their installations. However, there is no guarantee that this stream of income will be included in finance calculations for the provision of loans, particularly as the level of export for domestic generators will be variable depending on the circumstances of the household.

2.53 In addition, intervention will override the existing export market for small scale renewables. If a market did not exist then setting a minimum price could be seen as a positive way of trying to establish one. However, a market does exist and suppliers currently purchase the export directly from small scale generators. If an administered price were introduced it is not clear how market based tariffs could then be reintroduced

2.54 There are also complexities looking ahead to a time when time of use tariffs could be introduced with smart metering which would not sit well alongside a fixed export tariff.

2.55 In addition, requiring suppliers to pay a minimum price leads to complications about whether this payment should be included in any levelisation process and whether the value to the supplier of the generation purchased will ever reach consumers.

2.56 Given all these factors our preference is for the administered FIT to cover generation only with export prices set by the market – or at least for there to be an assessment of the impact of the introduction of the FIT scheme on export prices after a period of 12 months with any decision for intervention on export delayed until that date.

Q37: Do you agree that FITs generators should also benefit from on-site use of generation?

2.57 We agree that generators should benefit from on-site use and there are a number of positive outcomes of allowing this. Primarily, households and small businesses will see an immediate impact on their energy bills and secondly it also provides an element of protection against exposure to higher energy prices which is attractive to consumers. Both of these benefits would also greatly assist the fuel poor and those in social housing if the scheme could be developed to benefit these groups.

2.58 However, as indicated in the key issues section those vulnerable customers who would benefit the most from reduced energy bills have little chance of accessing the scheme as they will not have access to the up front finance needed for installation and are less likely to own their home.

Q38: Do you have any other views on the basic structure of the FITs?

2.59 We have concerns about the complex design of the proposed scheme - please see the key issues section for more detailed discussion.

2.60 A consumer friendly scheme should only offer a few tariff options. Therefore, we recommend reducing the number of generation tariffs per technology.

2.61 To secure the level of consumer engagement Government is aiming for it needs to integrate FITs for small-scale renewables with other consumer facing programmes to ensure households receive integrated 'whole house' solutions and advice. For example, CERT, CESP and Warm Front already offer some incentives for microgeneration, provide funding (rather than financing) for low income households, as well as addressing some of the non-financial barriers to the uptake of low carbon behaviours through the way they are marketed.

2.62 The 20 year timeframe for payments under a FIT is unlikely to be very effective in terms of driving consumer engagement, particularly at the household and community level. Consumers have a relatively high discount rate and as a result expected future benefits from a FIT 10 years into the future will have little bearing in their investment decisions. We would encourage Government to look again at the option of providing capital support which could be more attractive to domestic generators concerned about up front costs and that may face difficulty accessing finance.

2.63 We also think the proposal to include a mandatory metered export tariff may also be counterproductive in encouraging investment in small scale renewables by households, at least until a time when smart meters have been rolled. Please see our answer to Q49.

Q39: Do you agree with the proposed limits of 5MW for renewable technologies and 50kW for gas fired CHP for FIT installations?

2.64 Towards the larger end of the scale e.g. 5MW the proposed FIT provides a similar level of incentive as that expected under the RO. This should avoid gaming or

distorting investment decisions about projects that are at the margin. Investment decisions should be driven by the risk appetite of particular developers and the expected transaction costs of accessing the FIT support scheme.

Q41: Do you agree that generators off the electricity grid should be eligible for FITs? If so, what safeguards should be in place for those generators to ensure the electricity is being used?

2.65 Allowing off grid generation brings with it the possibility of increased fraud or gaming, so that if allowed there may need to be additional checks in place to ensure that the generation is being generated and used. The likely remoteness of the generator may mean that physical meter readings may not be easy to obtain and this could result in higher costs to the scheme. However, we do recognise benefits for remote locations and islands with limited or no grid access, therefore it may be beneficial to establish criteria or regions were we would consider it be suitable.

Q42: Do you agree with the selection of technologies for which we will be providing tariffs from April 2010?

2.66 Yes.

Q43: Should technologies for which we do not propose to offer a specific tariff from April 2010 be handled by:

- **providing a single tariff from April 2010 for all remaining technologies; OR**
- **considering as a new tariff band as part of regular FIT reviews?**

2.67 If Government continues with the proposed tariffs which are structured to reflect the costs of installation of specific technologies then it would seem consistent to continue to match tariffs to technologies based on the investment required and expected output etc which would necessitate the creation of new tariff bands as required. However, it is important that new technologies can benefit from FITs as quickly as possible. Having a single tariff for all remaining technologies would enable this and avoid adding further complexity to the scheme.

Q44: Do you agree that FITs should not require on-site generators to comply with any energy efficiency standards as a condition of eligibility?

2.68 We agree that it should not be a necessary requirement for eligibility but we see benefits in trying to incentivise energy efficiency through the FIT scheme.

2.69 Requiring FIT generators with on-site use to comply with energy efficiency standards would likely increase the costs of installation and would result in fewer households engaging with FIT. In addition, the administration to verifying energy efficiency measures would significantly increase the administration costs of the FIT.

2.70 As noted in our key issues section and answers above increasing the interplay between FITs and the various energy efficiency programmes will ensure that

domestic customers with onsite use make the right decisions about which technologies to install. This could be prompted through information, guidance and options provided at the point of installation to encourage on site use generators to become energy efficient. For example, a home report for household generators could be required so that at least the customer could receive advice about how to be more energy efficient, other measures which would assist this and also how these would work together with FIT to reduce their bills and increase their FIT support. Combining a number of measures such as installing a FIT generation unit alongside energy efficiency measures would have larger impact on consumers' energy bills, would contribute more to achieving the UK's low carbon objectives and would be consistent with the 'whole house' approach advocated in the HESS. The roll out of smart meters should also increase awareness of opportunities to improve end use energy efficiency.

Q45: Are there any issues regarding eligibility that we have not foreseen here? If so, how should we address them?

2.71 We are currently designing the processes to administer the FITs and are liaising with DECC to inform this design work. We will raise any issues regarding eligibility with DECC as they arise through this design process.

2.72 We agree with DECC's proposal to align definitions and standards used for the FITs with those used for the RO, particularly considering the short time available to develop the scheme. It is important to take this approach to ensure the schemes are consistent, to minimise gaming opportunities, and also to help maximise the efficiency of the accreditation processes.

2.73 It will be important to decide on the approach required to determine the renewable portion of biomass-based electricity generation, i.e. the portion of output to pay the tariff on. We would suggest that the same approach used under the RO is used for the FITs, as this will again ensure consistency, minimise gaming and maximise the efficiency of processes.

2.74 Eligibility for non-renewable CHP will also need to be considered. Under the Climate Change Levy, non-renewable CHP units only receive levy exemptions for the good quality portion of their output. This provides an incentive to maximise the thermal efficiency of the unit and thereby reduce the fossil fuel used to generate that energy. We would suggest that DECC consider what requirements will be in place for the use of heat from non-renewable CHP units, and whether the tariff level for these units will be linked to the use of heat.

Q46: Do you agree with our approach not to offer up-front capitalisation to schemes as part of the FITs? If not, what alternative approach do you propose and why?

2.75 The costs to consumers of the FIT are high and we would not wish to increase this by including another element of support. However, as indicated earlier we are greatly concerned that the large majority of householders would not be able to obtain the finance to install an FIT. The Government's own market research (The Big Energy Shift) shows that it is the upfront costs that are seen as one of the major barriers to take-up. Therefore access to low cost loans or support from other

schemes such as CERT and CESP to help with the finance would make the scheme more accessible to a much wider group of consumers. The interplay between FITs and these other schemes urgently needs to be considered.

2.76 Those who can afford to install small generation in their home or on a larger scale will receive very positive returns (around 8%). However, only a limited number of consumers will have access to the capital to cover the upfront costs of equipment and installation. Instead they will need to raise finance from lenders. The Government is hoping banks will respond by offering financial packages for FIT Consumers but in today's tight credit climate this may not happen. We would recommend that to encourage lending, the Government may need to promote the FIT to financial institutions to encourage the commercial availability of loans or start up of Green Funds to ensure a wider group of consumers can access the scheme. The Pay as you Save schemes currently being piloted will provide some useful learning.

2.77 The Scottish Government announced on 6 October a pilot scheme to provide interest free loans to households wishing to install small scale renewables, improve insulation or replace inefficient boilers. We welcome this initiative and would like to see other such schemes being offered across the UK to help those who cannot afford the upfront costs access the FIT scheme.

Q47: Do you agree with our approach that a generator may assign the rights to their FIT payments to a third party? If not what alternative approach do you propose and why?

2.78 This option could allow access to FIT by those who do not have the finance for the capital to cover the up-front costs of installing a small scale generator. Local Authorities or other organisations, could install small scale generators in fuel poor households and social housing and receive the generator payment from the Supplier to recover the costs of their investment. The household would benefit from reduced energy bills as a result of the onsite generation and also receive a payment for any energy exported further reducing their bills. Although we would prefer fuel poor households to receive the full financial benefit of the FIT, such an arrangement as proposed above would provide an incentive for LAs to set up such a scheme[3], and provide fuel poor and low income households with access to FIT which otherwise they may not have.

2.79 However in cases where microgen would be installed anyway either to meet tougher building standards (zero carbon houses) or as part of CESP or other programmes then there are much stronger arguments that the householder should see the benefit of the FIT. Again this highlights the urgent need for further thought to be given to the interplay with other schemes and the impacts on fuel poverty before a long term commitment is made to the scheme design.

2.80 There would need to be adequate provisions in place to ensure that consumers were fully aware of the implications of assigning their rights and there was no scope for abuse.

[3] They would receive returns for their investment and if the LA was MCS certified this sort of scheme could also provide jobs.

2.81 Allowing for payments directly to third parties is likely to represent a significant fraud risk under the FIT scheme. We are carefully considering the circumstances under which arrangements for third party involvement can be robustly assigned and will be happy to discuss these with DECC.

Q48: Do you agree with the proposed model for registration and accreditation of plant claiming FITs discussed in the Accreditation, Registration and Connection section?

2.82 We broadly agree with the proposed model for registration and accreditation. We are currently designing the processes required for us to administer the FITs and are liaising with DECC to inform this design work. We will raise any issues regarding accreditation and registration with DECC as they arise through this design process.

2.83 We believe that it is important to minimise the potential for fraud in the scheme, and a central registry will help to achieve this.

2.84 We agree that the RO accreditation process should apply to installations in the 50kW to 5MW capacity range to ensure the schemes are consistent, to minimise gaming opportunities, and also to help maximise the efficiency of the accreditation processes.

2.85 Should the MCS not be modified in time to accredit certain types of small generators we would be happy to continue to use the RO accreditation process to accredit generators in the interim until the MCS is ready. However, we would need to be notified of this by the 13 November in order to be able to implement this by 1 April 2010. We would also note that we do not currently have systems in place to accredit non-renewable CHP generation and as such we are not currently in a position to provide this service should the MCS not be ready to accredit this type of generation by 1 April 2010.

2.86 We note that the proposal as described will result in small generators receiving accreditation from the MCS and registering for FITs with a supplier, but having to approach Ofgem separately if they wish to apply for LEC or REGO accreditation. This will introduce an additional administrative burden compared to the current arrangements whereby they can apply for the RO, LEC and REGO schemes in one application with Ofgem. We recognise however that many small generators will not be interested in LEC accreditation as electricity used domestically does not benefit from LECs.

2.87 The Microgeneration Certification Scheme (MCS) will ensure consumers can be sure that the installers and equipment at the microgeneration scale meet certain standards which will be essential for building consumer confidence in this area. However the MCS might also act as a bottleneck for new suppliers and cheaper equipment if the accreditation process is seen as a costly barrier to entry to supply to the UK market, particularly if the UK represents a small market. This would not be in the interests of the consumer or the development of the market. Therefore we recommend the Government include, as part of a future review of the scheme, the requirement for MCS for all installations less than 50kW and whether this is restricting access to cheaper equipment.

Q49: Do you agree with the principle that all generation should be metered to qualify for FITs? Do you foresee any issues with that approach?

2.88 At present microgenerators under the RO do not require an export meter – only a generation meter. The FIT proposal would require each household to have three meters, introducing additional costs which together with the additional complexity may outweigh the benefits or receiving the export tariff. We would prefer a more flexible approach in order to simplify the scheme and potentially reduce costs to household scale generators. Given the plan to roll out smart meters over the next 10 years it might be more also be more pragmatic to delay requiring an export meter until then and allowing small generators the option to have an export tariff paid either on a metered basis or on a deemed amount of export. This would avoid small generators incurring the costs of an export meter if they do not think the value of the expected export energy warrants doing so.

Q50: What are your views on regulating which suppliers should be required to offer FITs, and in what circumstances?

2.89 We consider the provision of an FIT service to be proportionate for those suppliers with more than 50,000 customers. This will ensure that there is widespread availability of FITs for consumers and that the large majority will be able to access it through their existing supplier.

2.90 Smaller suppliers may also chose to provide FITs and as many smaller suppliers provide green and innovative services it is likely that will already have in place mechanisms to support FIT. In addition, new entrants are likely to find it easier to put this in place alongside the development of their supply service. Therefore, we support the 50,000 threshold and we expect that more suppliers will opt to provide an FIT service.

Q51: Do you agree with the tariff levels, lifetimes and degression rates we have set out for the chosen technologies? If not, what evidence do you have for choosing alternatives?

2.91 We have argued above for reduced complexity and would like to see a much reduced list of tariffs, with the aim of reducing costs making the scheme more accessible and reducing the risk of gaming and fraud. We quoted the examples of Germany and Spain where the number of tariffs provided for <5MW in wind and solar is just two or three each. If the Government wants to increase deployment of small scale renewables having fewer tariffs would reduce the complexity for non-energy professionals and possibly result in higher numbers engaging with the scheme.

2.92 Inevitably this would mean a lower tariff for microgen than envisaged in the Government's lead scenario. However, as demonstrated under the alternative (non microgen) scenario in the IA this could be expected to lead to a very similar level of renewable energy being generated and comparable carbon savings – but at around half the cost to consumers. On this basis we would favour a tariff structure more like that under the alternative scenario.

2.93 We note that the proposed lifetimes of the tariffs are consistent with the RO which has benefits. However tariffs with shorter lifetimes may be more beneficial for

domestic generators who are unlikely to obtain finance for periods longer than 7 years and given that longer term benefits would be heavily discounted in a self-financing model. However we would be concerned if this lead to a higher initial cost of the scheme to be borne by consumers.

2.94 We also welcome in principle the proposal of degression rates for wind and solar tariffs as this will keep pressure on the market to innovate, improving the cost efficiency of the scheme and providing greater value for money.

2.95 However, there is a concern again that this adds to an already complex schedule of tariffs with the risk that if degression rates are set too low or too high particular technologies will benefit (or lose out) regardless of whether they are actually cost effective and appealing to consumers. With a simpler initial structure of tariffs the use of degression factors would be a valuable driver for improved efficiency.

Q52: Do you agree with our proposed guaranteed minimum price for the exported electricity? If not, what price would you propose and what is your proposal based on?

2.96 As outlined in our key issues section and at Q36 we would prefer that the Government did not intervene by setting a minimum export price but allowed the market to continue to determine the export price. The benefit of this is that the export price would represent the value of energy to the supplier and not be included in the socialised costs and therefore would reduce the costs to consumers of the FIT scheme. This would also incorporate future movements in wholesale prices and carbon prices.

Q53: Does the proposed review structure provide the right balance between providing certainty and adapting FITs to the changing circumstances in which it operates?

2.97 As highlighted in our key issues section we want to ensure that the criteria for reviewing the FIT scheme are appropriate and that consideration is given to the containment of the costs of the scheme to consumers. Looking ahead it is likely that wholesale prices and carbon prices will increase and such movements should be taken into consideration in planning future reviews. This is important as higher prices would reduce the level of support required and provide the opportunity to make the FIT more cost efficient for consumers.

2.98 In addition, we would like to ensure that an efficient change process is established so that administrative practices can be streamlined quickly when the scheme commences operation.

Q54: Do you have any initial views on the relationship between FITs and those in fuel poverty or on low incomes?

2.99 We are concerned about the lack of consideration of the implications for fuel poor and low income households in the development of the FIT scheme both in terms of cost impact and their ability to access the scheme.

2.100 The high net cost of the proposed scheme will impact greatly on the fuel poor especially when added together with the costs of RO, CESP, CERT and the future costs of RHI. We ask the Government to look more closely at this and to further consider the issue of 'who pays' as quickly as possible. Ideally such schemes should be funded through taxation but we recognise that in the current economic climate this is not realistic. However it is essential that Government looks hard at how to avoid burdening those on lower incomes or in fuel poverty with the costs of this scheme.

2.101 In the interim pending the full review which the consultation alludes to, we would advocate calculating suppliers' market share for levelisation on the basis of MWh rather than customer numbers as, this is slightly less regressive. An Ofgem discussion paper looks at the distributional impact the structure of supplier obligations can have on consumers' bills assuming that suppliers pass these costs on to consumers in the same way.[4]

2.102 In addition, we are greatly concerned that the households that would benefit most from reduced energy bills (which would come from an FIT installation) will not be able to access the scheme. At present the scheme will only be accessible to those with access to funds or loans of £5-15K for purchase and installation. In the present climate this number is likely to be small and will be predominantly those who are better off. The proposal will therefore have very worrying distributional impacts. We would like to see the Government work with Local Authorities (LA) and other organisations to ensure that the fuel poor and those in social housing are able to access FIT. This could be done in a number of ways with assistance from other organisations such as the EST. Unlike CERT and CESP there will not be a priority group quota for this scheme however, other measures could be put in place alongside FIT to ensure that there is a more equitable share of the scheme at domestic level. Such measures could also assist the Government in achieving its fuel poor targets.

2.103 We would urge Government to ensure it has worked through the implications for those in fuel poverty or on low incomes before committing to a long term FIT arrangement for microgen.

Q55: Do you agree that the levelisation process described above provides the best system for redistributing costs amongst suppliers? If not, what other ways can we levelise costs across suppliers?

2.104 As noted above we prefer the per MWh mechanism of establishing levels of contribution from suppliers (as currently applies for the RO) as we believe that this method rather than a per household method provides some protection for the fuel poor and low income households, who typically – although not always – have lower levels of usage.

[4] A copy of the discussion paper "Can energy charges encourage energy efficiency?" can be found here:
http://www.ofgem.gov.uk/Sustainability/Documents1/Final%20discussion%20paper%2022%20July.pdf

2.105 We are happy to carry out the levelisation process as one of our functions as scheme administrator. We are confident that we will be able to deliver a process which will be able to facilitate timely levelisation payments on either a monthly or quarterly basis. We are currently working on designing the processes required for us to administer the FITs and are liaising with DECC to inform this design work. We will raise any issues regarding levelisation with DECC as they arise through this design process.

- We would however note we have already identified some issues which will need to be considered in the detailed design of the levelisation process. These include: Dealing with shortfalls, e.g. from suppliers going into administration.

- Cashflow issues for the administrator, i.e. the administrator will not be able to pay money out to suppliers if it has not received money in.

- Fraud prevention and compliance – sufficient checks and balances need to be in place to ensure suppliers are complying with their obligations, and to minimise the risk of fraud. These will include validation of costs.

- Securing compliance with levy payments – there are risks and inefficiencies which would arise if the levy collection and enforcement functions were to be carried out by two different parties. Other issues such as legal vires, legal liability and indemnity would also need to be considered.

2.106 In addition, it is important that our costs as scheme administrator are recoverable. We believe that it is most appropriate to recover these from suppliers, whether as part of the levelisation process or in parallel with it, as they are the obligated party under the FITs.

Q56: How can the levelisation process facilitate participation in FITs for small suppliers?

2.107 See response at Q55. We are of the view that regular levelisation will assist smaller suppliers participating in FIT. Otherwise, cash flow may mean that it is too prohibitive for smaller supply businesses.

Q57: Should suppliers be able to include an administration cost in the levelisation process? If so, what should the level of that allowance be and how should it be determined?

2.108 The costs incurred by suppliers in establishing the FIT scheme and providing it to their supply customers will depend to some extent on the exact role and responsibilities they have. Although some of the costs of providing FITs would be marginal to the cost of services suppliers already provide to import customers there could be additional costs if suppliers take on a more hands on role in the registration and accreditation of FIT units. With the potential for a range of fixed and variable costs in providing FITs it is also important that these do not create barriers to entry for small suppliers and deter new entrants from providing FITs. This would suggest that administration costs included in the levelisation process could be a combination of a fixed cost and a very small cost recoverable per FIT customer to reduce the risk

that the cost recovery process gives undue advantage to particular suppliers over others.

2.109 It is important that consumers are not exposed to inflated administrative costs on top of the already high scheme cost. Therefore, the method for determining the level of allowance will need to be transparent and easily measurable or verifiable to prevent the possibility of suppliers over claiming on their costs. It should also encourage suppliers to be as efficient as possible with their administration costs.

Q58: Should the levelisation process include consideration of large and unforeseen price differences between prices paid to generators and the market value?

2.110 At present we see no need to include an element to cover suppliers for unforeseen price differences. It is expected that the wholesale price will increase and therefore the value of the FIT export will increase and we would expect suppliers to reflect that in their export price bearing in mind that the Government only intend to set a minimum export price. If the wholesale price were to drop it would have to be a dramatic fall before it would fall below the value that suppliers could derive from the FIT export which will be free from transmission and distribution charges. If an issue occurs at a later stage it can be taken up as part of the review process.

Q59: Do you agree with the proposed approach to auditing, assurance and enforcement? If not, what alternative approach do you propose and why?

2.111 We agree with the principles of auditing, assurance and enforcement proposed by DECC. It will be important for us as scheme administrator to establish an effective balance between simplicity and ease of access to the scheme while minimising the potential for fraud, gaming and non-compliance and ensuring that appropriate remedies are available should these occur. As with other schemes, we will be taking a proportionate and risk based approach to the design of our processes and to the processes we would expect to see suppliers put in place to deal with these issues.

2.112 We are currently working on designing the processes required for us to administer the FITs and are liaising with DECC to inform this design work. We will raise any issues regarding auditing, assurance and enforcement as they arise through this design process.

Q60: Are there any issues regarding the role of suppliers that we have not forseen here? If so, how should we address them?

2.113 It will be important to establish a dispute resolution procedure that is common across all Suppliers and that allows the small scale generator to take the dispute to a higher level. As indicated earlier, the less complex the scheme is the easier it is for non-energy professionals to understand and this therefore should reduce disputes. In addition, the less complex the scheme is for suppliers the less chance of errors occurring. However, a unified process will be required and guidance given to generators of escalation procedures should they not be satisfied with the supplier’s decision.

Q61: What do you think is the best way of defining installations for the purposes of FITs?

2.114 We would suggest that for generation between 50kW and 5MW the definition of installations is aligned as closely as possible to "generating stations" under the RO, in order to ensure the schemes are consistent, to minimise gaming opportunities, and also to help maximise the efficiency of the accreditation processes. We agree that the potential for creating perverse incentives such as those described in 3.133 need to be addressed, and agree that the suggestion in 3.135 may address this in many cases for sub-50kW generation (though perhaps not for all cases). However, we would suggest that the accrediting body have some discretion on the evaluation of what constitutes an installation, as we do with the RO, in order to allow for the specifics of individual cases.

2.115 We would also want to ensure that the possibility for gaming is reduced by ensuring that any RO accredited station at a site is taken into account before determining what constitutes an installation.

Q62: Once an installation is defined, do you think further checks are required to verify this? If so, what would these checks be?

2.116 We expect to continue to need to sample audit generating stations accredited by us after stations are accredited, as we currently do under the RO. This is needed to verify that the information originally provided by generators is correct. It is also to check that there are no changes to the generating station that have not been reported to us. We regularly find discrepancies between the information provided to us and the actual configuration of generating stations, though these are usually minor. Our RO Annual Report lists the issues that we find each year in our audits.

2.117 We would also expect that suppliers would put appropriate processes in place to check the validity of the information provided to them as part of the registration process. We would suggest that further checks would be required periodically after registration to ensure that installations have not materially changed.

Q63: How could we deal with installations at a single site installed in different years?

2.118 Any measure to deal with the issue of installations made over a number of years will add additional, unwelcome complexity to the Feed in Tariff. We recognise that there may be a need to introduce a measure in order to avoid the potential for gaming or for introducing perverse incentives against maximising the generation potential of a site, but would suggest that the complexity of any solution is carefully considered. We are happy to work with DECC to ensure that any measures taken are as efficient as possible.

Q64: Do you agree with the proposed approach for the treatment of existing generating stations?

2.119 In general we agree with the proposed approach for the treatment of existing generating stations. However, use of the publication date of the RES on 15 July 2009

provides a cliff edge for those generators who were close to completing their application for ROCs or who are not sufficiently engaged in the electricity industry to have been aware of this cut off date. We would therefore propose that a date was chosen earlier than this date (e.g. 1 April 2009) to ensure that the impact of this cliff edge is reduced. Whilst this may provide support for some installations that are currently operating without support, we believe that this will be a small number.

Q65: Do you agree with the proposed approach for the treatment of generating stations that completed installations during the interim period?

2.120 We believe that the proposed approach is appropriate. However, for those stations that are accredited under the RO in the interim period but who transfer to the Feed in Tariff it doesn't seem appropriate that the cost of accreditation under the RO should be recouped from the RO Buy-out fund. Ofgem would suggest that these costs should be reclaimed as part of the FIT cost recovery.

Q66. Do you agree that, for non-household installations built during the interim period, we should make access to FITs conditional upon repayment of any central Government grant received for such installations?

No comment

Q67: Do you agree with the proposed approach for the treatment of new generating stations once the FITs scheme becomes operational?

2.121 We believe that the proposed approach is appropriate. However we would ask DECC to ensure that mechanisms are put in place to ensure that there is not a disincentive for stations to increase their capacity to beyond the maximum level of FITs. Current proposals could mean that these stations would not be able to benefit from either the RO of the FIT.

68: Do you agree with the decoupling of support for heat and electricity for new renewable CHP plants? What are the technical issues that need to be considered in implementing transitional arrangements towards the introduction of FITs and RHI for CHP installations?

2.122 As we detailed in our response to the governments consultation on the RO 2009 we agree that the decoupling of support for heat and electricity may provide greater policy clarity for renewable CHP. We also believe that this is more appropriate as it ensures that electricity customers are not subsidising heat that may have displaced gas or other fossil fuels.

Q69: Do you agree that FITs should not restrict access for those projects covered by other schemes?

Yes – a combination of measures should be allowed. This is especially important in fuel poor households and social housing and also in the Government's proposed whole house approach for communities. As indicated earlier the Government will be able to reach its renewable and carbon savings targets quicker if energy efficiency measures are used in conjunction with FITs.

Appendices

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Appendix 1 – The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.[3]

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly[4].

1.4. The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them[5];
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.[6]

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed[7] under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;

[5] under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.
[6] The Authority may have regard to other descriptions of consumers.
[7] or persons authorised by exemptions to carry on any activity.

- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation[8] and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

Appendix 2 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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