POLICY NOTE

THE RENEWABLES OBLIGATION (SCOTLAND) AMENDMENT ORDER 2017

SSI 2017/432

The Renewables Obligation (Scotland) Amendment Order 2017 ("the amending Order") was made in exercise of the powers conferred by sections 32, 32A, 32J and 32K of the Electricity Act 1989. The instrument is subject to affirmative procedure.

Introduction

1. The Renewables Obligation ("RO") scheme is a policy designed to encourage investment in large scale renewable electricity generation to contribute to meeting the Scottish Government's target to generate the equivalent of 100 per cent of Scotland's gross annual electricity consumption from renewable sources by 2020 and the UK's EU target to produce 15% of our energy from renewable sources by 2020.

2. However, the costs of funding this policy expose Energy Intensive Industries ("EIIs") to high electricity bills. As EIIs operate in international markets these costs place them at a competitive disadvantage and increase the risk of investment leakage through businesses choosing instead to make investments in countries with less ambitious climate policies.

3. The amending Order makes adjustments to the supplier obligation mechanism under the RO, which will have the practical effect of exempting eligible EIIs from a proportion of the indirect policy costs of the RO scheme.

The Renewables Obligation (Scotland) Amendment Order 2017

Purpose

4. The amending Order makes a number of amendments to the Renewables Obligation (Scotland) Order 2009 to provide the basis for exempting eligible EIIs from a proportion of the indirect costs of the RO scheme (RO exemption). In particular, the Order:

- makes changes to the methodology for calculating the obligation level, to take account of the amount of electricity likely to be supplied to eligible EIIs during an obligation period; and
- imposes additional obligations on electricity suppliers to provide information about the supply of electricity to eligible EIIs to the Gas and Electricity Markets Authority (Ofgem).

5. The practical effect of adjustments to the methodology will be that the supplier obligation will not apply to up to 85% of electricity supplied to eligible EIIs. Eligible EIIs will benefit from the exemption through suppliers passing on their reduced RO payments via the setting of lower electricity prices. There will be a proportionately higher obligation level for non-EII excluded electricity to offset the exemption.

6. Eligibility for the RO exemption is intended to reflect eligibility for a related exemption introduced by the UK Government in respect of Contracts for Difference (CfD) scheme[1].

7. The RO exemption is intended to be implemented across Great Britain. An Order making equivalent provision in relation to the RO in England and Wales is expected to be laid before the UK Parliament at the same time as this amending Order.

8. Following scrutiny of the Renewables Obligation (Scotland) Amendment Order 2015, the Scottish Government gave an undertaking to the Subordinate Legislation Committee to correct a defect in article 16 by removing the words "Subject to paragraph (2)", and in paragraph 6(2)(b) of schedule A2 (land criteria) by inserting the words "the principles". These changes are also included in the amending Order.

Policy background

How the RO works

9. The Renewables Obligation (Scotland) Order 2009 ("ROS") places an obligation on licensed electricity suppliers to submit the relevant number of renewable obligation certificates (SROCs) to Ofgem in respect of each megawatt hour (MWh) of electricity supplied during an obligation period. This number – called the 'obligation level' - is set six months ahead of the start of each obligation period - which runs from 1 April to 31 March.

10. The RO is administered by Ofgem, who issue SROCs to generators accredited under the scheme in relation to the renewable electricity they generate and the technology type. Generators can sell SROCs to suppliers or traders as tradable commodities.

11. Suppliers present SROCs to Ofgem to demonstrate their compliance with the obligation. Suppliers failing, or choosing not, to present enough SROCs to meet their obligation make a payment into a buy-out fund. The money collected by Ofgem in the buy-out fund is recycled on a pro-rata basis to suppliers who presented SROCs, after Ofgem's administration costs have been deducted.

12. Suppliers assess the overall costs of the RO scheme and pass on the costs of meeting the obligation to domestic and business electricity users through their bills.

Impact of the RO on EIIs

13. EIIs are those businesses in sectors where electricity costs are a high proportion of their Gross Value Added (which is a measure of the value of the goods and services they produce). The costs of the RO are passed through in bills to EIIs from energy suppliers and, as they operate in global markets where commodity prices are set internationally, they are often unable to pass these costs through to the end customer. Therefore EIIs that face higher electricity costs are placed at a competitive disadvantage. Typical EIIs in the UK include chemicals, steel, cement, aluminium, glass, paper, plastics and ceramics.

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1 https://www.gov.uk/government/consultations/energy-intensive-industries-exemption-from-indirect-costs-of-the-contracts-for-difference-scheme

Objectives of the EII RO exemption

14. A compensation scheme for eligible EIIs for the policy costs arising from the RO (and Feed-in Tariff scheme), funded by the then Department for Business, Innovation and Skills, opened in January 2016. In line with UK Government's proposals, we are transitioning from a compensation scheme to exempting eligible EIIs from up to 85% of the policy costs of the RO, in order to improve long term investment certainty for EIIs (as the exemption will provide real-time support and will not be contingent on UK Government departmental budgets, which can fluctuate). This increased certainty can lower production costs and thereby help maintain competitiveness of EIIs, which could reduce the risks of investment leakage and may, in turn, have beneficial impacts on output and employment.

Implementation of the EII RO exemption

15. To implement the RO exemption, changes are required to (i) the methodology for calculating the obligation level and (ii) the scope of the obligation to take into account the volume of electricity supplied to eligible EIIs ("EII excluded electricity").

16. The methodology for setting the obligation level in respect of electricity supplied in Scotland is set out in Part 2 (articles 5 to 12) of the ROS. This requires the Scottish Ministers to carry out two specified calculations (referred to as Calculation A and Calculation B) to determine the total obligation and then carry out a further calculation to determine the obligation level that applies to electricity supplied in Scotland (in terms of SROCs per MWh supplied). The RO in England and Wales contains identical provisions for the calculation of the obligation in respect of electricity supplied in England and Wales, which when combined with the provisions in the ROS, enable the setting of a single obligation level for Great Britain.

17. To implement the exemption we do not intend to change the methodology for calculating the total obligation, but this instrument provides for adjustments to be made to the way that we calculate the obligation level to reflect the fact that it will be applied to a narrower consumption base (i.e. it will not apply to up to 85% of electricity supplied to eligible EIIs). As these proposals are being implemented as part of a GB-wide scheme, and the changes are equivalent to those being made by the UK Government in respect of the RO in England and Wales, the obligation level will continue to be set on a Great Britain basis after the exemption is introduced.

18. These changes to the calculation of the obligation level will result in a proportionately higher obligation for non-EII excluded electricity to offset the exemption. It will ensure that the availability of ROCs continues to match demand, and therefore will not affect the value of the ROC nor the operation of the ROC market.

19. The second stage of implementation of the RO exemption involves changing the scope of the obligation to exclude EII excluded electricity. This means the obligation level (ROCs/MWh rate) for electricity supplied in Scotland will be applied to:

- 100% of electricity supplied by licensed electricity suppliers to non-EIIs;
- at least 15% of the electricity supplied by licensed electricity suppliers to eligible EIIs (whilst in most cases we expect EIIs will be eligible for the full 85% exemption, there may be cases where the level of relief is lower).

20. Again, these changes are equivalent to those being made by the UK Government in respect of the RO in England and Wales.

21. The exemption will come into effect in Great Britain from 1 January 2018, subject to the publication of a revised obligation level by 31 October 2017. As required under the ROS, we published on 1 October 2016 the obligation level for the 2017/18 obligation period, calculated in accordance with the current methodology (i.e. not taking into account the changes needed to implement the exemption)[2]. We have also published, as part of the Scottish Government's response to the consultation on this policy, an estimate of how the 2017/18 obligation level would be adjusted to account for the EII exemption. We intend to publish a revised obligation level which has been calculated in accordance with the exemption methodology by 31 October 2017.

22. The RO exemption is intended to be available to the same EIIs that will be eligible for the CfD exemption scheme. Administration of the RO exemption, including the EII application and certification process, will be based on the processes set up for the CfD exemption.

Consultation

23. The Scottish Government consulted on proposals to implement an exemption for EIIs from the indirect costs of the Renewables Obligation Scotland, as part of GB-wide arrangements, between 19 May 2016 and 13 June 2016[3]. The consultation elicited twenty responses and the Scottish Government's response was published on 21 April 2017[4.]

24. The UK Government also consulted on proposals to implement the exemption for EIIs from the indirect costs of the Renewables Obligation in England and Wales and Feed-in Tariff Schemes across Great Britain between 1 April and 27 May 2016[5]. The UK Government's response was also published on 21 April 2017[6].

State Aid

25. The European Commission's Energy and Environmental Aid Guidelines[7] allow Member States to provide relief for energy intensive businesses from the indirect costs of renewable energy subsidies. Member States have to notify the European Commission of any proposals to provide state aid and can only grant it after approval. State aid approval has been received.

Financial Impacts

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2 https://www.gov.uk/government/publications/renewables-obligation-level-calculations-201718
3 https://consult.scotland.gov.uk/energy-markets/renewables-obligation-exemptions
4 http://sh45inta/Publications/2017/07/8547
5 https://www.gov.uk/government/consultations/implementing-an-exemption-for-energy-intensive-industries-from-the-indirect-costs-of-the-ro-and-the-fits
6 https://www.gov.uk/government/consultations/implementing-an-exemption-for-energy-intensive-industries-from-the-indirect-costs-of-the-ro-and-the-fits
7 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52014XC0628(01)

26. The RO creates additional costs for electricity suppliers, which they can then pass through to industrial, business and domestic consumers as part of their electricity bills.

27. The costs of the RO exemption for EIIs will be redistributed to domestic and non-eligible business users, increasing their bills between 2017/18 to 2027/28. Analysis[8] by the Department for Business, Energy and Industrial Strategy estimates the impact of the RO exemption to be less than 1 per cent increase on average electricity bills across all affected groups.

28. The impact on eligible EIIs will be an exemption from a proportion of the indirect costs of the RO through their electricity bills. The estimated average value of the exemption to EIIs is £200m per annum over 2017/18 to 2027/28 (in 2016 prices).

Scottish Government
Energy Industries Division
Energy and Climate Change
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8https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/630246/EII_Exemption_RO_and_FIT_IA_Final_Stage_V1.6_3_.pdf