

## Annex B: Background on Supporting and Transitional Policy Arrangements

### Supporting arrangements in the short term (2014-17)

#### Electricity Demand Reduction

1. Reducing the amount of electricity through being more efficient can help cut energy bills for consumers, reduce costs for businesses and bring down emissions. In November 2012 Government consulted on what more could be done to reduce electricity demand across the UK as part of our mission to realise the energy efficiency potential in the UK economy, as set out in our Energy Efficiency Strategy.
2. In May 2013 the response to the consultation was published, announcing that the Energy Bill would be amended to enable Electricity Demand Reduction (EDR) to be delivered through the Capacity Market. Delivering EDR through the Capacity Market enables demand reduction to be targeted during more valuable peak periods and it allows EDR to compete against supply, ensuring that EDR is rewarded for the value it provides to the system. It also avoids the need to create an additional delivery mechanism for EDR.
3. However, there are a number of uncertainties. The Government has therefore committed to testing the proposed approach via a pilot before proceeding to a final decision on implementation.
4. Government believes that voluntary and informational approaches could also play a role in delivering electricity demand reduction. Further detail will be provided in the 2013 update to the Energy Efficiency Strategy<sup>1</sup>.

#### Pilot

5. DECC has confirmed that at least £20 million will be made available to pilot Electricity Demand Reduction. The pilot will enable us to better understand how efficient and cost-effective financial incentives for EDR are and examine how EDR measures can best participate in the Capacity Market. It will also allow us to test and develop some of the more detailed aspects of design to inform the final scheme.
6. We expect the pilot to start in summer 2014 and to run for two years. A decision on financial support for EDR going forward will be made based on what we learn from the pilot.
7. The development of secondary legislation to enable the inclusion of EDR in future capacity auctions will be conditional on the outcome of the pilot.

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<sup>1</sup> Expected to publish in November 2013

## **Route to Market**

8. The Government's Call for Evidence in summer 2012<sup>2</sup> identified concerns from independent renewable generators that it is becoming harder to secure viable long-term contracts for the sale of electricity (Power Purchase Agreements or PPAs). Such contracts are typically needed to secure project finance.
9. The Contracts for Difference (CfD) mechanism will reduce the risks for independent generators and should improve the availability of PPAs. To accelerate this process, the Government has initiated a 'CfD Market Readiness' project to prepare the market for the introduction of the CfD. Two working groups, comprised of industry representatives, have been established to develop a sample PPA and best practice guidelines that will help to reduce administrative and financial barriers for smaller participants in the PPA market.
10. However, there is a risk that despite these measures, the market in long-term PPAs will remain constrained under CfDs and independent generators will struggle to obtain a route to market. To mitigate this risk, the Government has amended the Energy Bill (clauses 44-48 in the Bill as amended in Grand Committee) to allow for the introduction of an 'offtaker of last resort' mechanism. This would ensure that independent generators have a backstop route to market at a specified price, improving investor confidence. The Government is currently working closely with stakeholders to develop the details of the scheme, and is expecting to consult on final designs in early 2014. More information on the offtaker of last resort mechanism and the CfD market readiness work can be found on the DECC website<sup>3</sup>.

## **Action by Ofgem - Wholesale market liquidity**

11. Rigorous competition in the energy markets is a prerequisite to achieving consumer value and confidence. This applies in the wholesale as well as the retail market.
12. Ofgem and Government have been concerned about barriers to entry to the wholesale market and in particular the impact of liquidity. Liquidity in the

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<sup>2</sup> <https://www.gov.uk/government/consultations/barriers-to-long-term-contracts-for-independent-renewable-generation-investment>

<sup>3</sup> <https://www.gov.uk/government/policy-advisory-groups/electricity-market-reform-emr-cfd-market-readiness-working-groups>

wholesale market is low relative to other European power markets and international commodity markets. It is particularly acute in the forward markets.

13. Wholesale market liquidity is an important feature of a competitive market, and an important enabler of the Electricity Market Reform (EMR) programme. A liquid market facilitates market entry and competition by offering a reliable route to market, allowing participants to manage their risks effectively and providing robust reference prices to base operational and investment decisions on.
14. A liquid market also increases the robustness of the reference price for the CfD Feed-in-Tariff (FIT).
15. Ofgem launched a consultation on a package of reforms to address low liquidity on July. The proposals will implement changes to licence conditions obligating the six largest vertically integrated companies and largest independent generators to trade fairly with small suppliers or face financial penalties. These parties will also be required to report day-ahead trading volumes to Ofgem to ensure recent progress in the day-ahead market does not fall away.
16. Crucially Ofgem's reforms will also impose a market making obligation on the six largest vertically integrated companies meaning they will have to post prices at which they will buy and sell power for up to two years in advance.
17. This will make it easier for independent suppliers to buy power for their customers and will also help independent generators sell their output in the forward market.
18. The new licence conditions will be supported by Ofgem's powers to fine companies if they are in breach.
19. The consultation closed on 9 August. Ofgem is expected to take a final decision on its reforms later this year with a view to full implementation taking place in the early part of 2014. The Government supports the objectives of these reforms and wants to see swift and appropriate action from Ofgem along with positive engagement from industry to facilitate this.
20. Whilst Ofgem remains the primary vehicle to deliver these reforms the Government is taking backstop powers in the Energy Bill to address low liquidity should Ofgem's reforms be delayed or frustrated.
21. If Government intervention is required, a detailed consultation document will be published. The nature of any possible intervention and accompanying consultation is unclear at this stage, but is likely to seek similar outcomes to those sought by Ofgem's proposed reforms.

### **Supporting arrangements in the long term**

## **The Emissions Performance Standard**

22. The Government's commitment to introduction of an Emissions Performance Standard (EPS) was set out in the Coalition Agreement of May 2010; and the Government's intentions for technical design of the EPS were subsequently explained in the December 2011 Technical Update<sup>4</sup>. Provisions relating to the EPS form part of the Energy Bill currently before Parliament and are consequently subject to Parliamentary approval. EPS provisions can be found at Chapter 8, and Schedules 4 and 5, to the Bill.

23. The EPS is designed to act as a regulatory backstop to the amount of carbon dioxide emissions from new fossil-fuel power stations. It will support the planning policy requirement that any new coal-fired power station must have a proportion of its capacity equipped with Carbon Capture and Storage technology (CCS)<sup>5</sup>; sending a clear regulatory signal that any new coal-fired power station must be constructed and operated in a way consistent with the Government's decarbonisation objectives.

24. The EPS will:

- impose an 'emissions limit duty' on operators of all new fossil-fuel power plant, requiring that any such plant should not emit more than the specified amount of carbon dioxide in each year of operation;
- be set at a limit equivalent to 450g/kWh (at base load); and
- provide that plants consented under the 450g/kWh limit will be subject to that limit until the end of 2044. This will provide regulatory certainty; helping to support investment in new gas fired generation which will be needed for the transition to a low carbon electricity system.

25. The Government is committed to reviewing the EPS as part of the process of three yearly reports on decarbonisation under the Energy Act 2010. The Energy Bill also requires a review of the EPS after five years from Royal Assent.

## **EPS Secondary Legislation**

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<sup>4</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/48375/5350-emr-annex-d-update-on-the-emissions-performance-s.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/48375/5350-emr-annex-d-update-on-the-emissions-performance-s.pdf)

<sup>5</sup> The National Policy Statement for Fossil Fuel Electricity Generating Infrastructure (EN-2) requires that any new coal-fired power plant demonstrate CCS on at least 300MW (net) of the proposed generating capacity as a condition of its consent.

26. The Energy Bill also makes provision for arrangements relating to scope, monitoring and enforcement of the EPS to be established by means of secondary legislation<sup>6</sup>. The Government will be consulting on these arrangements. Principal intentions for these arrangements were set out in the EPS Technical Update, and included that:

- annual emissions reporting for the purposes of the EPS should, wherever possible, keep additional regulatory burden to a minimum. For example, it is intended that the system should closely align with existing reporting requirements, such as those already existing under the EU Emissions Trading System;
- the EPS should apply to plant whose main source of fuel is natural gas, coal or oil (or products derived from such substances) for use as a fuel. The EPS will not therefore apply to generation plants that use biomass as a main source of fuel, or to plants that generate electricity from waste;
- emissions associated with the heat production from Good Quality Combined Heat and Power plants (GQCHP) should be excluded for EPS accounting purposes; and
- as an exception to the general principle that the EPS will only be applied to new fossil fuel plants, existing coal plants which undergo significant upgrades or life extension after the EPS regime has come into force would become subject to it. For these purposes, the replacement of any main boiler or the installation of an additional main boiler to a coal plant will trigger application of the EPS.

### **Forthcoming Consultation**

27. The Energy Bill makes provision for the monitoring and enforcement framework supporting the EPS to be established by the appropriate national authorities. In England, this constitutes the Secretary of State, in Scotland, Scottish Ministers, in Wales, Welsh Ministers, and in Northern Ireland, the Department of the Environment (DoE). It will therefore be for the relevant devolved administrations to consult on their proposals for this framework, in due course. The Government is, however, keen to develop a framework that takes into account respective policy preferences and, where possible, is consistent across the UK. It is

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<sup>6</sup> Chapter 8 of the Energy Bill variously provides the Secretary of State, Welsh and Scottish Ministers, and, in the case of Northern Ireland, the Departments of Enterprise, Trade and Innovation and of the Environment with powers to make regulation in support of the EPS in certain circumstances. The terms on which these powers may be exercised, including, where relevant, requirements for consent and consultation are described in Chapter 8 of the Bill.

therefore working closely with the Devolved Administrations in Scotland, Wales and Northern Ireland to achieve this.

28. The Energy Bill provides that only plant consented after the point at which the EPS comes into force will become subject to the new EPS emissions limit. In view of the timings associated with fossil-fuel plant construction, we do not expect operational plants to become subject to this duty until 2017/18, at the earliest.
29. Given these timescales, the Government does not intend to consult on detailed arrangements for the EPS monitoring and enforcement regime applying in England until the Energy Bill has received Royal Assent. DECC intend to consult on proposals for these arrangements next year<sup>7</sup>.
30. Further consultation will focus exclusively on arrangements to be effected through secondary legislation; including EPS scope; monitoring and enforcement.
31. Key components of the EPS monitoring and enforcement regime on which we expect to consult include:
  - the Statement of Policy relating to suspension of the EPS. The Energy Bill provides that the EPS may be suspended<sup>8</sup> where this will avert or reduce the risk of an electricity shortfall. The Statement of Policy will set out the parameters for the exercise of this power;
  - the process by which emissions from plant will be monitored;
  - requirements for the reporting and verification of emissions levels as determined under the monitoring process;
  - arrangements for the submission of an Emissions Report to the Regulator, and associated charging arrangements;
  - the enforcement regime to apply in the event of breach of the EPS; and
  - an appeals process.

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<sup>7</sup>Devolved Administrations also anticipate consultation, where required, consistent with a common implementation date for the EPS monitoring and enforcement regime across the UK.

<sup>8</sup> This power is exercised by the Secretary of State in the case of Great Britain, and by the Department of Enterprise, Trade and Investment (DETI) in the case of Northern Ireland. The DETI will also consult on a Statement of Policy relating to suspension of the EPS in due course.