

**EXPLANATORY MEMORANDUM TO
MODIFICATIONS TO THE STANDARD CONDITIONS OF ELECTRICITY SUPPLY
LICENCES (NO. 3 OF 2012)**

1. 1.1 This explanatory memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament by Command of Her Majesty.

2. Purpose of the modifications

2.1 The Feed-in Tariffs (“FITs”) scheme is the Government’s main policy measure to encourage the deployment of small scale low carbon electricity generation in Great Britain.

2.2 The scheme was implemented in part through the insertion of provisions in the standard conditions of electricity supply licences, requiring electricity suppliers to offer FITs to accredited small scale generators of electricity using an eligible low-carbon energy source. The licence conditions, among other things, specify the tariffs payable to generators for each unit of electricity generated by eligible installations. Those tariffs differ according to the description and capacity of the installation and the date on which it becomes eligible for FITs.

2.3 The modifications in this draft instrument-

- make changes to the generation and export tariffs, and reduce the period of eligibility for FITs from 25 to 20 years, for solar photovoltaic (PV) installations which become eligible for FITs on or after 1 August 2012;
- implement a ‘degression mechanism’ under which, subject to deployment in a prior period exceeding specified levels, generation tariffs for solar PV installations are to be further reduced on 1 November 2012 and every three months thereafter for installations becoming eligible for FITs after the dates of those reductions, with the extent of the reductions dependent on deployment levels; and
- change the threshold above which electricity supply licence holders are required to participate in the FITs scheme from 50,000 to 250,000 customers.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 Not applicable. These are licence modifications and not a Statutory Instrument.

4. Legislative Context

4.1 These licence modifications are to be made in exercise of the powers conferred on the Secretary of State by section 41 of the Energy Act 2008 to modify the licences for electricity suppliers as established under the Electricity Act 1989. They are laid before Parliament in draft in accordance with section 42 of that Act.

4.2 They amend Schedule A to Standard Condition 33 of the standard conditions of electricity supply licences. Standard Condition 33 was inserted with effect from 1

April 2010, and Schedule A was previously amended with effect from 1 August 2011, 3 March 2012 and 1 April 2012.

4.3 Further provision about the administration of the FIT scheme is contained in the Feed-in-Tariff (Specified Maximum Capacity and Functions) Order 2010 (S.I. 2010/678). It is proposed to make amendments to the Order, to come into force at the same time as these licence modifications, to impose duties on Ofgem to publish quarterly tables of the tariffs which will apply to new solar photovoltaic installations under the degression mechanism, and on the Secretary of State to publish quarterly data about deployment of solar photovoltaic installations in the relevant period to be used in calculating those tariffs.

5. Territorial Extent and Application

5.1 The modifications apply to Great Britain.

6. European Convention on Human Rights

6.1 No statement is required.

7. Policy background

- *What is being done and why*

7.1 The market for solar PV has seen dramatic changes in the last two years, with significant and swift reductions in costs leading to deployment far exceeding the levels projected when the FITs scheme was introduced in April 2010. The Government announced a comprehensive review of the FITs scheme in February 2011, and, following previous consultations, has already reduced tariffs in response to those costs reductions, from 1st August 2011 for new larger-scale solar PV installations, and from 1st April 2012 for new small-scale solar PV installations.

7.2 The speed of cost reductions and increases in deployment has shown the need for a cost control mechanism for solar PV, to set tariffs in a transparent and predictable way, and to ensure that they respond to changes in the solar PV market and remain aligned with installation costs.

7.3 Against this background, the Government published a further consultation on solar PV tariffs on 9 February 2012, and this instrument implements its decisions following that consultation. In particular:

- (i) Generation tariffs for new solar PV installations from 1 August 2012 are reduced, for example from 21p/kWh to 16p/kWh for the smallest installations. This reflects evidence that costs of solar PV installations are continuing to fall, and that current tariffs are providing rates of return on investment above the target range of 4.5–8% for many installations. Adjustments are also made to the multi-installation rate (for generators with more than 25 installations on different sites), and to the lower rate for solar PV installations that do not meet the energy efficiency requirement which applies to most such installations attached or wired to buildings.

(ii) A cost control mechanism is introduced under which solar PV tariffs will automatically be further reduced (“degressed”) every quarter from 1 November 2012 if deployment in a previous period exceeds a minimum level. The rate of degression in a quarter (if any) will be between 3.5% and 28%, with rates exceeding 3.5% applying only in the event of deployment in the previous period significantly exceeding projections; if deployment is significantly beneath projections degression will be skipped for up to two quarters. There will be three degression bands (domestic, small commercial and large commercial/utility), with deployment in each band determining the future tariff in that band.

(iii) The export tariff for new solar PV installations from 1 August 2012 is increased from 3.2p/kWh to 4.5p/kWh, to reflect our updated estimate of the value of electricity exported from solar PV installations.

(iv) The tariff lifetime for new solar PV installations from 1 August 2012 is reduced from 25 to 20 years. This will reduce the lifetime costs of the FITs scheme and bring the tariff lifetime in line with that for most other technologies supported by FITs. This has been taken into account when setting the generation tariffs above.

7.4 In addition, this instrument changes the threshold at which electricity suppliers become “mandatory FIT licensees” from 50,000 customers to 250,000, to bring FITs into line with other environmental programmes. This was a proposal in the separate consultation referred to below, the implementation of which has been brought forward to minimise any uncertainty for businesses and consumers affected by it.

- ***Consolidation***

7.5 A separate consultation on proposed changes to tariffs for other technologies and the administration of the FIT scheme concluded on 26 April 2012, and the Department is currently considering the responses with a view to implementing changes later this year. The Department will consider consolidating Schedule A to Standard Condition 33 when it implements those changes.

8. Consultation outcome

8.1 The Government’s consultation on solar PV tariffs took place from 9 February to 3 April 2012, and a total of 244 consultation responses were received. The Government has decided to proceed with many of the proposals set out in the consultation document, but has made significant changes reflecting responses to the consultation.

8.2 The consultation set out three different proposed levels of generation tariffs for new solar PV installations from July 2012, and proposed that the decision on which of those levels to adopt should be based on levels of deployment in March and April 2012. The majority of respondents disagreed both with the proposed new tariff levels, and the proposed basis for choosing between them. We remain convinced that given the evidence on reductions in solar PV installation costs, a further tariff reduction is necessary in order to keep the average rate of return on investment within the target range of 4.5–8%. However, in light of consultation responses we have set the new

tariffs on the basis of evidence as to costs, rather than deployment levels in March and April. The new tariffs are close to, or greater than, the highest of the three alternative levels proposed in the consultation. We have also decided to delay the introduction of the new tariffs to 1 August 2012, in recognition of low levels of deployment since 1 April and views expressed in the consultation.

8.3 The consultation proposed that tariffs for solar PV installations should be reduced every 6 months, or at more frequent intervals if deployment exceeded specified levels. There was some support for this approach, with 39% of respondents agreeing with the principle, although many respondents preferred the dates of degressions to be fixed so as to provide greater certainty. However, 83% of respondents disagreed with the proposal that the rate of degression should be 10% every 6 months, with some suggesting smaller tariff reductions at more frequent intervals. There was also a strong view that any contingent degression mechanism should also make provision to respond to under-deployment of solar PV as well as over-deployment. The idea of applying different deployment triggers to different tariff bands was largely supported. We have taken these views on board in the design of the degression mechanism, as a result of which this instrument provides for quarterly tariff reductions on fixed dates, with smaller reductions (except in the event of exceptionally high deployment), and provision for there to be no reduction in the event of low deployment.

8.4 A range of views was expressed on the questions relating to other elements of tariff design. In particular, 63% of respondents agreed that the current level of the export tariff does not fairly represent the value to suppliers of exports from FITs generation; 61% of respondents disagreed that the tariff lifetime for new entrants to the FITs scheme should be reduced from 25 to 20 years; and 84% of respondents considered that tariffs should continue to be index-linked, with 59% of respondents favouring retention of RPI as the appropriate index for the whole tariff lifetime. In line with these views, we have decided to increase the export tariff and retain RPI indexation of generation tariffs. We have decided to shorten the tariff lifetime to 20 years, but have taken this into account when setting generation tariffs so the rates of return on investment are not affected.

8.5 A more detailed analysis of the consultation responses and policy decisions is presented in the Government's response to the consultation on Phase 2A of the Comprehensive Review of Feed-in Tariffs, available on the Department of Energy and Climate Change's website at http://www.decc.gov.uk/en/content/cms/consultations/fits_rev_ph2a/fits_rev_ph2a.aspx

9. Guidance

9.1 Ofgem already provides detailed guidance for suppliers and potential participants in the FITs scheme (FIT generators) in a variety of forms. That guidance will be updated to take account of this instrument.

10. Impact

10.1 An Impact Assessment is attached to this memorandum and will be published on the Department of Energy and Climate Change's website.

11. Regulating small business

11.1 The legislation does apply to small business.

11.2 There are no impacts for firms employing up to 20 people as no electricity supply companies employ 20 or fewer people.

12. Monitoring & review

12.1 The modifications to the licence conditions are a product of the ongoing monitoring of the FITs scheme to ensure that delivery of the scheme is as envisaged by the policy consulted on in 2009 and introduced in April 2010. This ongoing monitoring is designed to ensure that the objectives of the FITs scheme are delivered in a way which ensures value for money, particularly to consumers who ultimately pay. The degression mechanism in particular will be regularly reviewed in consultation with the PV industry, to ensure that it is operating as intended.

13. Contact

13.1 Alasdair Grainger at the Department of Energy and Climate Change, email: fits@decc.gsi.gov.uk, can answer any queries regarding the instrument.