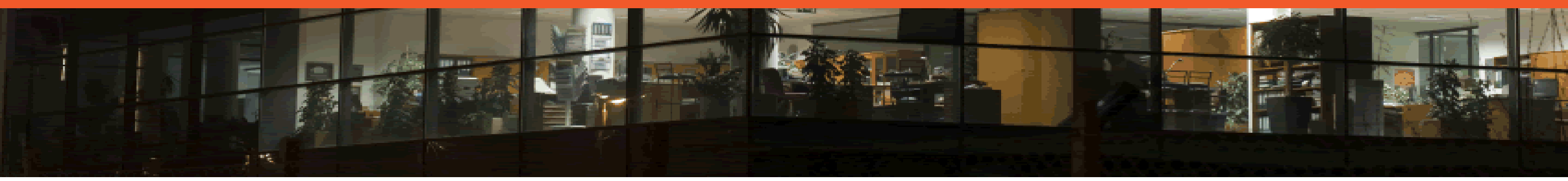

Contract for Difference Feed-in Tariffs

The UK has targets in place to source 15% of energy from renewable sources by 2020 and by 2050 to have reduced CO2 emissions by 80% on 1990 levels. But, at least at present, low-carbon electricity is considerably more expensive than electricity produced using fossil fuels, reducing the incentive to invest.

A number of government schemes already exist to make renewable and other low-carbon sources of power generation more economically viable. But when the market price for power rises, low-carbon generators are better able to cover their costs without this financial support. This means that mechanisms such as the Renewables Obligation (RO) and existing Feed-in Tariffs (FiTs) for small-scale generation have the potential to provide generators with significant windfall benefits at consumers' expense if and when wholesale power prices rise over the medium to longer term.

To address these concerns, the government set out plans as part of *Energy Act 2013* to introduce a new scheme intended to incentive low-carbon generation (including nuclear power and carbon capture and storage as well as renewables), while ensuring better value for money for consumers. Known as the Contract for Difference Feed-in Tariff (CfD FiT) scheme, the new mechanism has been designed to provide revenue certainty to low-carbon generators, while ameliorating the possibility for them to achieve windfall profits.

CfD FiTs will provide a subsidy that tops up any shortfall between the amount that the generator receives per unit of electricity sold and a pre-defined "strike price". This strike price differs by technology but aims to reflect the costs of investing in different low-carbon technologies. Where market prices are less than the strike price, a top up payment is made to the generator. Where these prices exceed the strike price, the generator will be required to pay the surplus back. The result is that generators will not suffer nor unduly benefit from price volatility.

The overall budget for the CfD scheme will be split between three technology groups – one for more established technologies (like onshore wind and solar), one for less established technologies (like offshore wind), and a third for biomass conversions. The government's intention is that the CfD FiT scheme will replace the RO for new plant by 2017, and will apply to all new schemes eligible to receive subsidies under the RO.

Projects wishing to apply for a CfD FiT will have to submit a bid as part of a fixed auction round, representing the lowest strike price per MWh that they would be willing to accept. Those with the lowest bids in each technology group will be allocated CfD FiTs first, continuing with the next cheapest until each budget has been exhausted. The first auctions will take place in October 2014, with an overall funding pot of around £200mn per annum for the period to 2020 once the scheme is up and running.

The costs of subsidising this scheme will be charged to all electricity suppliers from April 2015. Costs will then be passed through to customers in their electricity bills. It is estimated that this levy will add around 10p/kWh in 2015-16 and 20p/kWh in 2016-17 to non-domestic energy bills, but steadily increasing thereafter. Consumers should also note that, until 2035, the RO will continue to add an additional cost to electricity bills.

To ensure the UK's largest businesses are not disproportionately impacted by the introduction of the scheme, the government has set out plans to provide them with relief from CfD FiT costs. In turn to recover these avoided costs, the impact of the relief scheme is estimated to be 20p/MWh on the price of electricity for all non-exempt consumers.

Useful links

Government