The United Kingdom Introduces Feed-in-Tariffs

Background

An EU-wide framework for renewable energies was introduced in 2009 under the Renewable Energy Directive (Directive). This legislation created a legally binding commitment for Member States to achieve the Directive requirement that 20 percent of the European Union's overall energy consumption come from renewable sources by 2020.

As part of its own commitment to the Directive objective, the United Kingdom is obliged to produce 15 percent of its energy supply from renewable sources by 2020. In light of this requirement, the UK Department for Energy and Climate Change (DECC) published the Renewable Energy Strategy (RES) in 2009, which sets out the approach for meeting the Directive target.

To ensure that the United Kingdom reaches the 15 percent renewable figure, the DECC Strategy anticipates that the following will have to come from renewable sources:

- 30 percent of the electricity supply;
- 12 percent of the heat supply; and
- 10 percent of the transport energy supply.

Given that in 2009 the DECC estimated that only 5.5 percent of the United Kingdom's electricity supply and 2.6 percent of the transport energy supply came from renewable sources, a key element for delivering these ambitious targets are the government-backed schemes that aim to incentivise investment in renewable energy.

The principal schemes that seek to stimulate renewable energy development in the United Kingdom include:

- The Renewable Obligations scheme (began 2002);
- The Feed-in-Tariffs (FITs) scheme (began April 2010); and
- The Renewable Heat Incentive (due to begin April 2011).

This article focuses on the introduction of FITs in the United Kingdom.

FITs in the United Kingdom

The FITs scheme was introduced to encourage the uptake of small-scale renewable and low-carbon electricity generation. The focus on smaller generating installations is one of the elements of FITs that distinguishes the scheme from the existing Renewables Obligation (ROO) scheme, which is aimed at larger generators.

Microgenerators (installations with capacity less than 50kW) can only apply to join FITs, while small generators (those with capacity between 50kW and 5MW) have a one-off choice of joining either FITs or ROO.

The decision of which to join will probably be influenced by another of the critical differences between the schemes: the method by which payments are made. In the ROO scheme, the price paid for the generated energy is determined by market rates. FITs payments, however, are pre-determined by the government, giving FITs generators much more certainty about the return they will get from the energy they produce.

In addition, two payments are available to FITs generators, one for every kWh generated (the generation tariff) and another for every kWh fed back to the electricity grid (the export tariff). The generation-tariff amount is fixed according to the type of technology being used. The technologies supported by FITs include:

- Anaerobic digestion;
- Solar;
- Hydro;
- Wind; and
- Combined heat and power.

Some technology types are subject to degression. This means that the amount paid for each kWh generated will reduce where the price of the technology is expected to become cheaper as volumes build. Tariffs for some technologies, including solar, will begin to degress in 2012.

Once set, the generation tariff remains the same (subject to changes in the Retail Price Index, to which it is linked) for the period that the installation is entitled to receive payments. The export tariff is the same for any project (irrespective of the technology type) and is currently 3p/kWh. FITs generators can opt not to receive the fixed export tariff when they apply for accreditation under FITs and instead sell their electricity on the open market.

FITs Opportunities

The level and duration of payments made to a FITs generator varies depending on the type of technology being used. The generation tariffs are therefore calculated on the basis of the current and expected set-up costs for each type of supported technology, as well as the level of encouragement the government wishes to give to particular methods of renewable generation. The key technologies receiving the most interest from UK investors are solar and anaerobic digestion (AD).

FITs accredited solar technology is eligible to receive support for 25 years, more than the 20-year eligibility period under the ROO scheme. FITs generation payments for solar installations are also some of the highest of any FITs-supported technology type. AD has a payment lifetime limited to 20 years and is subject to less generous payments (electricity from AD installations with a capacity over 500 kW are paid 9p/kWh compared to 29.3p/kWh for an equivalent-sized solar installation). However, unlike solar, AD is not subject to tariff-level degression.

The 2012 milestone is also significant for being the year that the government will conduct its first review of the rate of FITs tariffs. The government will reassess the costs of technologies and electricity price projections and revise tariff levels accordingly. This price adjustment has come into sharper focus recently following the publication of the government's *Spending Review* on 20 October 2010. The DECC has indicated that while FITs tariffs will be rebalanced at the next formal review, the changes will be implemented sooner if "higher than expected deployment requires an early review." It is therefore crucial that renewable generators and investors looking to take advantage of FITs act quickly to secure the highest rates of return on their energy production.

Expectations

In 2009 the Department for Environment, Food and Rural Affairs (DEFRA) published *Anaerobic Digestion – Shared Goals*, a clear statement of intent for the promotion of AD in the United Kingdom, endorsed by more than 60 stakeholders. Since then, changes made to the environmental permitting regime have been designed to ease the path towards setting-up AD installations.

To complement the existing exceptions for certain AD plants, in April 2010 the EA introduced new standard permits, making the application process simpler and quicker. The EA, in conjunction with Waste & Resources Action Programme (WRAP), also published a Quality Protocol for digestate. The protocol makes clear what installation operators need to do in order that digestate is no longer considered waste, and is therefore not subject to further regulatory control, and can be supplied into other markets. This option has been made more attractive and economically viable following recent increases to the level of landfill tax on waste.

The results of two consultations that propose further streamlining of the procedures for permits and further reduction to the regulatory requirements for AD plants are due in early 2011. These, coupled with proposed reform to planning permission regulations that would see certain installations become "Permitted Developments," and therefore not subject to planning permission, means that the uptake of AD installations under FITs is expected to flourish in the immediate future.

The Anaerobic Digestion and Biogas Association (ADBA) estimates that the number of AD plants in the United Kingdom will grow to 1,000 over the next 10 years. The rise of AD is set to continue with the government recently confirming their commitment to introduce the Renewable Heat Incentive in 2011-12, a scheme that will reward each kWh of renewable heat produced.

It is clear that astute renewable investors have recognized the potential that FITs offer and are moving fast to secure the most valuable FITs tariffs. The United Kingdom has already seen national offerings to homeowners from organisations that offer the free installation of solar equipment and free electricity supply to their property, in return for handing over the revenue from FITs payments. The initial set-up costs for individual homeowners are thus overcome and renewables investors doing this at a high volume will realise significant returns on their initial outlay.

Law practices at the forefront of this new market place are pioneering tools that enable their clients to realise the potential of FITs. This includes all aspects of FITs solar projects, from ensuring suitable agreements are in place to innovating financial models that deliver the funding required to consolidate and expand based on future guaranteed FITs revenue. In addition to this, they are also helping clients with extensive commercial and industrial property portfolios (for example, warehouses and distribution centres) who are looking to diversify their income stream through the deployment of large-scale solar installations under FITs.

On taking office, the current administration made much of its determination to be the "greenest" yet. The implementation of RHI and the outcome of recent consultations will be a test of their green credentials. The impetus for green growth may also come from elsewhere. Following the recent news that a major energy supplier will be raising their domestic tariffs from December this year, impacting millions across the United Kingdom, there is greater likelihood that more homeowners be encouraged to seek out alternative power sources and take advantage of FITs. The guaranteed income that FITs offer, combined with a government and public with an appetite for increased use of renewable energy, undoubtedly makes FITs a very attractive scheme for renewable energy investors.

For more information about this subject, please contact the author.

Michael Hutchinson
+44 20 3130 3164
mhutchinson@mayerbrown.com

Mayer Brown is a leading global law firm serving many of the world's largest companies, including a significant portion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest investment banks. We provide legal services in areas such as Supreme Court and appellate; litigation; corporate and securities; finance; real estate; tax; intellectual property; government and global trade; restructuring, bankruptcy and insolvency; and environmental.

OFFICE LOCATIONS AMERICAS: Charlotte, Chicago, Houston, Los Angeles, New York, Palo Alto, São Paulo, Washington DC
ASIA: Bangkok, Beijing, Guangzhou, Hanoi, Ho Chi Minh City, Hong Kong, Shanghai
EUROPE: Berlin, Brussels, Cologne, Frankfurt, London, Paris
TAUIL & CHEQUER ADVOGADOS in association with Mayer Brown LLP: São Paulo, Rio de Janeiro
ALLIANCE LAW FIRMS: Spain (Ramón & Cajal); Italy and Eastern Europe (Tonucci & Partners)

Please visit our web site for comprehensive contact information for all Mayer Brown offices. www.mayerbrown.com