January 2013

CCSA Briefing Paper
Energy Bill 2012-13

Introduction

The Carbon Capture and Storage Association welcomes the release of the Energy Bill and the associated Electricity Market Reform (EMR) package. This is an important step forward for this critical piece of legislation and for the future of Carbon Capture and Storage (CCS) in the UK.

A number of CCS project developers have entered into the DECC CCS Commercialisation Programme (launched in April 2012) and further clarity on which projects will be taken forward is expected in early 2013. For those projects not supported under the Commercialisation Programme the arrangements contained in the Energy Bill are critical to enable their further development. Of particular importance to all UK CCS projects – whether they are part of the CCS Commercialisation Programme or not - are the proposed Feed in Tariff with Contracts for Difference (FiT CfDs) and its precursor, the Investment Contract, as these will support CCS as well as other forms of low carbon generation.

The importance of CCS to the UK should not be underestimated. With the closure of 35GW of existing electricity generation capacity over the next few decades, fossil fuels will continue to dominate our energy mix going forward. Only with CCS can this use of fossil fuels be compatible with UK climate change objectives and mandatory targets. Successfully deploying CCS can also bring real benefits to the UK economy. Modelling by the Energy Technologies Institute suggests that CCS dramatically cuts the annual cost of meeting carbon targets potentially saving around £42 billion per year by 2050. In addition the global market for CCS is expected to be worth trillions of pounds by 2050, and the UK share has been estimated at £6.5billion per year by 2030, supporting more than 100,000 jobs.

The Energy Bill

The CCSA strongly supports the Energy Bill and believes that it provides a good basis from which to move forward. The Government has listened to many of the concerns previously raised in relation to the Draft Energy Bill (published in May 2012) and sought to address these in the much-improved Energy Bill. Moving forward, the CCSA has a number of key points it would like to raise on the Energy Bill, including;

Timing of Royal Assent: It is critical that progress of the Energy Bill is not delayed. Any significant delay risks undermining investor confidence, delaying early investment decisions and jeopardising the Government's goals for early CCS deployment from 2016 onwards. Early CCS deployment is achievable but requires Investment Contracts to be signed from 2013. The CCSA is concerned that Royal Assent of the Energy Bill is not expected until the end of 2013 and believes that this should be viewed as the very latest acceptable date. Timely progress is also required for the secondary legislation which will implement the details of EMR.

Emission Performance Standard (EPS): The Energy Bill no longer contains the EPS exemption for CCS demonstration plants which means that all new fossil fuel plants, including those fitted with CCS, will have to operate under the new EPS regime. Concerns were raised previously that the EPS exemption might be seen to provide an opportunity for new fossil fuel plant to operate unabated for decades. The CCSA does not believe this is a real risk, but recognises the argument for the removal of the blanket EPS exemption.

However the CCSA believes that the EPS should not be applied to a CCS project until the project has been through a full commissioning and proving period. The commissioning of a CCS project is a lengthy and complex process and will take some considerable time and potentially even a number of years for all of the components of a new CCS project to operate to their designed limits and be completely integrated. The imposition of an EPS during this period places an additional regulatory restriction on the project developer which may indeed make it more difficult to complete the commissioning and integration effectively.

The CCSA therefore proposes that the Energy Bill be amended so that the EPS is applied to CCS projects once a agreed and clearly defined (e.g. a three-year time limited or defined performance criteria) "commissioning and proving window" has passed. This removes the regulatory burden of the EPS for project developers while still preventing plants from operating unabated for decades.

CfD Counterparty and Supplier Obligation: The effectiveness of the CfD to support investment in low-carbon power generation is largely contingent upon the establishment of a robust, legally-enforceable contract between the generator and a single, credit-worthy counterparty. The CCSA welcomes the progress that the Government has made on the CfD payment model issue, in particular the move from the 'virtual' counterparty that was previously proposed to the single counterparty model in the Energy Bill. There is still concern that the Energy Bill provides for there to be multiple CfD counterparties which could risk undermining the robustness of the payment model.

However, there are also concerns that the 'pay when paid' principle set out in the CfD Heads of Terms will introduce a significant revenue risk to generators. This means that the CfD Counterparty is not held liable for funds owed to the generator unless the counterparty has received these funds under the Supplier Obligation.

To help mitigate these risks the CCSA recommends that the Energy Bill is amended to;

a) **Provide the CfD Counterparty with the powers and duty to enforce the Supplier Obligation to ensure that it is fully funded.**

b) **Require the CfD Counterparty to make full and timely payments under the CfD contract to the electricity generator.**

c) **Provide legal recourse for the generator in the event of default by the CfD Counterparty.**

d) **Ensure that only one CfD counterparty is established to manage all CfD contracts.**

Investment Contracts: Investment contracts may be required to support the first CCS projects developed under the CCS Commercialisation Programme or FID enabling process as well as providing early support for other low-carbon technologies. However, to enable investment decisions in capital-intensive projects to be made the investment contracts must provide a high level of confidence that the terms agreed in the contract will persist.

The Energy Bill provides the Secretary of State with extensive powers to transfer the investment contracts at a future point in time to the CfD counterparty (or another counterparty) at which point the CfD funds might be paid under a different payment model. This creates a significant and potentially unacceptable risk for early investors that could be forced to accept future terms that are inconsistent with those originally contained in the investment contract. **The CCSA recommends that the Energy bill should be amended so that the transfer only occurs with the consent of the electricity generator that has entered into the investment contract, subject to this consent not being unreasonably withheld.**

Decarbonisation policy: The CCSA supports the recommendation by the Committee on Climate Change that the power sector will need to be largely decarbonised by 2030 if the UK is to meet its target to reduce greenhouse gas emissions by 80% by 2050. A reference included in the Energy Bill to this objective, would not only reassure potential investors by lowering the perceived political risks, but could also reduce the cost of capital for decarbonising the power sector. The CCSA notes the Government's proposal for an amendment to the Energy Bill that references a decarbonisation policy to be decided on in the next parliament and will follow these discussions closely.

The EMR package

Alongside the release of the Energy Bill DECC also published a number of updates on the detailed design of the EMR mechanisms. The CCSA is committed to working with Government as this work is developed in the coming months to ensure that the needs of the CCS industry are met. Key issues include;

2013 Delivery Plan: The Delivery Plan must send a clear investment signal to CCS developers, investors and the supply chain to provide them with the confidence to make the large pre-investments necessary to develop projects for the first EMR delivery period. Therefore the 2013 Delivery Plan must provide clarity on the Government's CCS objectives and set out the allocation process for CCS CfD contracts. These signals need to provide a degree of confidence equivalent to that provided to other technology classes.

Contract for Difference Feed in Tariffs: CfDs have to be an investable instrument for each of the low carbon technologies in order to meet EMR's core objectives. More work is still needed on the design of CfDs to enable these to support CCS projects. The CCSA looks forward to working with Government to resolve outstanding issues including, CfD contract length, indexation of the strike price e.g. to global fossil fuel prices and the appropriate reference price for CCS projects.

Capacity Market: The CCSA welcomes the Government's commitment to consider the contribution of CCS plant to the Capacity Market. This includes the option of turning off the CO_2 capture unit for periods to enable increased electricity output when the market is tight.

The view expressed in this paper cannot be taken to represent the views of all members of the CCSA. However, they do reflect a general consensus within the Association.