House of Commons

Energy and Climate Change Committee

Levy Control Framework: Parliamentary oversight of Government levies on energy bills

Eighth Report of Session 2013–14

Report, together with formal minutes relating to the report

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The Energy and Climate Change Committee

The Energy and Climate Change Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department of Energy and Climate Change and associated public bodies.

Current membership

Mr Tim Yeo MP *(Conservative, South Suffolk)* (Chair)
Dan Byles MP (*Conservative, North Warwickshire*)
Ian Lavery MP (*Labour, Wansbeck*)
Dr Phillip Lee MP (*Conservative, Bracknell*)
Rt Hon Mr Peter Lilley MP (*Conservative, Hitchin and Harpenden*)
Albert Owen MP (*Labour, Ynys Môn*)
Christopher Pincher MP (*Conservative, Tamworth*)
John Robertson MP (*Labour, Glasgow North West*)
Sir Robert Smith MP (*Liberal Democrat, West Aberdeenshire and Kincardine*)
Graham Stringer MP (*Labour, Blackley and Broughton*)
Dr Alan Whitehead MP (*Labour, Southampton Test*)

The following members were also members of the Committee during the Parliament:
Gemma Doyle MP (*Labour/Co-operative, West Dunbartonshire*)
Tom Greatrex MP (*Labour, Rutherglen and Hamilton West*)
Laura Sandys MP (*Conservative, South Thanet*)

Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

Publication

Committee reports are published on the Committee's website at www.parliament.uk/ecc and by The Stationary Office by Order of the House.

Evidence relating to this report is published on the Committee's website at www.parliament.uk/ecc

Committee staff

The current staff of the Committee are Farrah Bhatti (Clerk), Vinay Talwar (Second Clerk), Tom Leveridge (Committee Specialist), Jack Rowbotham (Committee Specialist), Shane Pathmanathan (Senior Committee Assistant), Joe Strawson, (Committee Support Assistant) and Nick Davies (Media Officer).

Contacts

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What is the Levy Control Framework?

1. The Government has placed the obligation of financing a number of its energy and climate change policies onto energy companies, rather than funding the schemes directly through general taxation. Energy companies then in effect recover the cost of these levy-funded schemes from consumers through bills.

2. The Levy Control Framework (LCF) was established by the Department of Energy and Climate Change (DECC) and HM Treasury (HMT) in 2011 in order to cap the cost of levy-funded schemes and ensure that DECC "achieves its fuel poverty, energy and climate change goals in a way that is consistent with economic recovery and minimising the impact on consumer bills".[1] HMT has put a limit on the amounts that can be raised and spent through this mechanism. The limit for 2013-14 is set at £3.184 billion, but is set to rise to some £7.6 billion by 2020-21.[2] There are currently three components to the LCF:

- Renewables Obligation (RO);
- Feed-in-tariffs scheme (FITs); and
- Warm Home Discount (WHD).[3]

The RO and the FITs scheme are DECC initiatives to increase the use of low-carbon technologies to generate electricity. The WHD is designed to help low-income and vulnerable households meet energy costs. DECC has yet to clearly define the future scope of the LCF and whether or not it will include other levy-funded schemes such as the "capacity mechanism", which aims to provide an insurance policy to reduce the likelihood of future blackouts and to ensure a reliable electricity supply to consumers.[4]

Accounting for Levy Control Framework spending

3. The Office for National Statistics (ONS) has classified the largest element within the LCF–the RO–as notional (or "imputed") taxation and public expenditure, even though the money does not at any point directly pass through government hands. This is because such spending, and the revenues which are raised to support it, share features common to other forms of taxation and public spending. Essentially the levies and the nature of the spending are obligations imposed on energy companies–and ultimately the consumer–by government.

1 HM Treasury, Control framework for DECC levy-funded spending, March 2011, para 1.1

2 DECC, Control framework for DECC levy- funded spending: Questions and Answers, December 2011, p 4; and DECC, Annex D: Levy control framework update: extending the framework to 2020/21, July 2013, p 2

3 DECC, Control framework for DECC levy- funded spending: Questions and Answers, December 2011, p 4

4 Q 6 (John Fiennes, DECC)

4. The ONS decision led the Government, from 2011–12, to include spending within the LCF (and related revenues) within both DECC's Annually Managed Expenditure (part of Treasury's budgetary totals for government) and the DECC Main Estimates (the Parliamentary approval mechanism). However, the National Audit Office (NAO) has taken the view that including these items within the end year Departmental Accounts, which report on all spending authorised by the Estimates, would be inconsistent with International Financial Reporting Standards and likely to lead to delays or qualifications to the Departmental Accounts.[5] For these reasons in each year since 2011–12, DECC has subsequently obtained a derogation from HMT to remove the expenditure and revenues from its Supplementary Estimates and hence has not reported on either this spending or these revenues in the Department's end year Accounts.

5. The Chief Secretary to the Treasury wrote to us and to other interested committees, including the Liaison Committee, on 5 November 2013 about this issue proposing an alternative way forward. The Chief Secretary proposed that LCF spending and revenues should continue to be included within Annually Managed Expenditure, but should not in future be included in Main or Supplementary Estimates or Departmental Accounts. Instead DECC would report levy spending and revenues in other reports to Parliament, and ensure that these reports are accessible to and relevant to those who wish to use them. These reports would also be audited.

6. We responded to the Chief Secretary's proposals on 18 December 2013. While recognising the difficulties that continuing inclusion of LCF spending and revenues within Estimates would cause for the Departmental Accounts, we made a number of suggestions, building on the approach proposed by the Chief Secretary, for enhanced future reporting and approval of spending under the LCF. These suggestions are now reproduced in this report as follows.

7. ***There should be a single annual report covering all the DECC levy-funded schemes along with other Government initiatives which affect energy bills but which fall outside of the Levy Control Framework (LCF), such as the Energy Companies Obligation (ECO). This report should contain:***

- ***Future plans, and comparisons of agreed budgets and final spend (outturn) for each funding stream and/or programme and energy company;***

- ***Easily identifiable "costs per customer" for each scheme on a consistent basis across years and between reports, including information on the impact that government decisions have upon requirements over time. This information is not provided currently; and***

- ***Measurable outcomes achieved through spending, including as a minimum the progress made against carbon targets and any other specified objectives of the***

5 NAO, The Levy Control Framework, November 2013

schemes, and the impacts on consumers. This should include an appraisal of the relationship of the LCF to its overall policy targets.

8. ***We consider that the effective spending and taxation proposed should be subject to some level of Parliamentary authority before it arises. While we understand the difficulties that including the items within Estimates could cause for the Departmental Accounts, we believe it would be highly desirable that there should be a means for Parliament to express its views from time to time on the sums involved and the purposes for which they are intended, despite the fact that no monies are actually issued from, or surrendered to, the Consolidated Fund. The Government should look further into how this might be achieved.***

Wider assessments of the LCF

9. On 27 November 2013, the NAO published a report reviewing the operation of the LCF assessing "its effectiveness for providing control and accountability to Parliament for levies and levy-funded expenditure".[6] The NAO's overall conclusions and recommendations are reproduced below:

> **Overall conclusion**
>
> In establishing the Framework, the government has rightly recognised the importance of monitoring and controlling the considerable cost of energy schemes that consumers fund through their energy bills. The Framework has prompted the Department to monitor actual and expected costs closely and consider its response to unexpected increases in costs of schemes charged to consumers.
>
> However, the operation of the Framework has not been fully effective in some key areas. The joint Treasury and departmental governance board for the Framework has not strongly linked spending and outcomes in its deliberations. Reporting on Framework schemes has not supported effective public and parliamentary scrutiny of the overall costs and outcomes from levy-funded spending. The Framework does not cover the consumer-funded Energy Companies Obligation scheme and it is not yet clear whether it will cover the new Capacity Market scheme, including Electricity Demand Reduction measures. As consumer-funded spending increases and new schemes are introduced, the Department needs to assure Parliament and the public that it has robust arrangements to monitor, control and report on all consumer-funded spending, and the outcomes it is intended to secure.

6 NAO, The Levy Control Framework, November 2013, Summary, para 3

Recommendations

Coverage

The Department and HM Treasury should keep in mind the underlying objective of the Framework and aim for transparency and accountability when deciding which schemes to include within the Framework. The Department has processes in place to monitor costs to consumers of the Energy Companies Obligation and is considering measures to control the cost of the Capacity Market scheme. If these schemes are not covered by the Framework, the Department should explain how it will control the aggregate costs of consumer-funded schemes and assess whether together these schemes are achieving the outcomes needed to meet its objectives.

Forecasts

The Department should develop its testing of the modelling results used to inform the Framework and develop the capability to allow more sophisticated analysis of the probability of different scenarios. The Department should continue to address weaknesses in its quality assurance of the forecasting model. This should include a review of the outputs from the most recent version of the model to gauge its accuracy against known outcomes and explain any discrepancies.

Controls

The Department must ensure that it monitors the risk of under- or over-allocating available budgets for Contracts for Difference. In particular, it will need to consider:

- how to allocate budgets over time so that best value is achieved from the available budget; and
- the continuing risk of breaching its spending cap if the wholesale price falls.

Reporting

The Department and HM Treasury are proposing to supplement existing public reporting on individual Framework schemes by reporting routinely to Parliament on spending on levy-funded schemes. These reports should cover past and future spending across all the schemes within the Framework and the outcomes achieved or expected. This reporting should also provide appropriate independent assurance on reported figures and the effective operation of controls. In particular, the Department should do the following:

- Establish a bespoke process allowing Parliament to scrutinise actual and forecast committed levy-funded spending, since it falls outside the established financial accounting and reporting framework for the Department.

- Conduct or commission appropriate independent assurance of the robustness of data on actual and forecast Framework spending and outcomes.
- Indicate how and when controls have been applied and the impact on outcomes and costs.
- Ensure that any costs reported under the Framework can be reconciled with those reported by government-owned counterparty or settlement bodies for the same schemes.[7]

10. On 28 November 2013, we held an oral evidence session with DECC officials to discuss publicly some of the concerns raised in the NAO's report. The full transcript of the session is published on our website.[8]

7 NAO, The Levy Control Framework, November 2013, Executive Summary

8 Energy and Climate Change Committee, Oral evidence: Levy Control Framework, HC 872, Thursday 28 November 2013

2 Conclusions

11. **The Levy Control Framework (LCF) limit is due to increase significantly from £3.184 billion in 2013–14 to £7.6 billion by 2020-21. The funds raised and spent via the LCF will soon surpass DECC's departmental budget. There must be transparent arrangements which ensure that Parliament has adequate oversight of how these funds are raised and spent, particularly in the light of public concern over the cost of energy bills.**

12. **We have produced this short report ahead of Parliament's consideration of the Supplementary Estimates 2013–14 in order to draw to the House's attention the annual derogation obtained by DECC from HMT to remove LCF-related expenditure and revenues from its Supplementary Estimates. The current situation has led to an absence of LCF-related reporting in the Department's end year Accounts. We will look for an opportunity to debate in the House:**

- **the implications of DECC's levy-funded schemes along with other government initiatives which affect energy bills but which fall outside of the LCF; and**
- **the current inadequate reporting arrangements relating to LCF spending and revenues; and the developing plans for improving these arrangements and enhancing Parliamentary oversight in the future.**

Formal Minutes

Thursday 13 February 2014

Members present:

Mr Tim Yeo, in the Chair

Dan Byles
Mr Peter Lilley
Dr Alan Whitehead

Draft Report (*Levy Control Framework: Parliamentary oversight of Government levies on energy bills*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 12 read and agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Written evidence was ordered to be reported to the House for publishing with the Report.

[Adjourned till Wednesday 26 February at 9.15 am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at www.parliament.uk/ecc.

Thursday 28 November 2013

Question number

John Fiennes, Director, Energy Strategy, Networks and Markets, **James McEwen,** Head of Financial Strategy, and **Neil Bush,** Head of Energy Economics and Analysis, Department of Energy and Climate Change — Q1-61

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at www.parliament.uk/ecc.
The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

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Second Report	UK Deepwater Drilling–Implications of the Gulf of Mexico Oil Spill	HC 450 (882)
Third Report	The revised draft National Policy Statements on energy	HC 648
Fourth Report	Electricity Market Reform	HC 742 (1448)
Fifth Report	Shale Gas	HC 795 (1449)
Sixth Report	Ofgem's Retail Market Review	HC 1046 (1544)
Seventh Report	A European Supergrid	HC 1040 (1684)
Eighth Report	The UK's Energy Supply: Security or Independence?	HC 1065 (1813)
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Third Special Report	The future of Britain's electricity networks: Government Response to the Committee's Second Report of Session 2009–10	HC 629

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First Special Report	The Future of Marine Renewables in the UK: Government Response to the Committee's Eleventh Report of Session 2010–12	HC 93
First Report	Draft Energy Bill: Pre-legislative Scrutiny	HC 275
Second Report	The road to UNFCCC COP 18 and beyond	HC 88 (633)
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Fourth Special Report	Low-Carbon Growth Links with China: Government Response to the Committee's Third Report of Session 2012–13	HC 748
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Sixth Report	Building New Nuclear: the challenges ahead	HC 117
Seventh Report	The Impact of Shale Gas on Energy Markets	HC 785

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First Report	The Green Deal: watching brief	HC 142 (HC 607)
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Second Special Report	The Green Deal: watching brief: Government Response to the Committee's First Report of Session 2013–14	HC 607
Third Special Report	The Impact of Shale Gas on Energy Markets: Government Response to the Committee's Seventh Report of Session 2012–13	HC 609
Third Report	UK oil refining	HC 340 (718)
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Fifth Report	Energy Prices, Profits and Poverty	HC 108 (717)
Sixth Report	Local Energy	HC 180 (749)
Seventh Report	Pre-appointment hearing with the Government's preferred candidate for Chair of Ofgem	HC 645