

# PARLIAMENTARY DEBATES

HOUSE OF COMMONS  
OFFICIAL REPORT

Fifth Delegated Legislation Committee

## DRAFT ELECTRICITY SUPPLIER PAYMENTS (AMENDMENT) REGULATIONS 2016

*Tuesday 1 March 2016*

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**Saturday 5 March 2016**

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**The Committee consisted of the following Members:**

*Chair:* SIR EDWARD LEIGH

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|---|---|
| † Adams, Nigel ( <i>Selby and Ainsty</i> ) (Con)  | † Morris, Grahame M. ( <i>Easington</i> ) (Lab)                 |
| † Dowden, Oliver ( <i>Hertsmere</i> ) (Con)   | † Phillips, Stephen ( <i>Sleaford and North Hykeham</i> ) (Con) |
| Elliott, Julie ( <i>Sunderland Central</i> ) (Lab)                                      | † Quince, Will ( <i>Colchester</i> ) (Con)                      |
| Godsiff, Mr Roger ( <i>Birmingham, Hall Green</i> ) (Lab)                               | Smith, Angela ( <i>Penistone and Stocksbridge</i> ) (Lab)       |
| † Holloway, Mr Adam ( <i>Gravesham</i> ) (Con)  | † Smith, Julian ( <i>Skipton and Ripon</i> ) (Con)              |
| † Jones, Mr David ( <i>Chwyd West</i> ) (Con)   | † Timms, Stephen ( <i>East Ham</i> ) (Lab)                      |
| † Knight, Sir Greg ( <i>East Yorkshire</i> ) (Con)                                      | † Whitehead, Dr Alan ( <i>Southampton, Test</i> ) (Lab)         |
| † Leadsom, Andrea ( <i>Minister of State, Department of Energy and Climate Change</i> ) |   |
| † McCaig, Callum ( <i>Aberdeen South</i> ) (SNP)  | Katy Stout, <i>Committee Clerk</i>                              |
| † Maynard, Paul ( <i>Blackpool North and Cleveleys</i> ) (Con)                          | † <b>attended the Committee</b>                                 |

## Fifth Delegated Legislation Committee

Tuesday 1 March 2016

[SIR EDWARD LEIGH *in the Chair*]

### Draft Electricity Supplier Payments (Amendment) Regulations 2016

2.30 pm

**The Minister of State, Department of Energy and Climate Change (Andrea Leadsom):** I beg to move,

That the Committee has considered the draft Electricity Supplier Payments (Amendment) Regulations 2016.

Sir Edward, it is a pleasure to serve under your guidance. This instrument amends regulations concerning the contracts for difference scheme and the capacity market. As a reminder to hon. Members, these two schemes were key elements of the electricity market reform programme that was introduced in the previous Parliament. Both the CfD scheme and the capacity market are designed to incentivise the significant investment required in our electricity infrastructure to keep costs affordable for consumers and to help meet our decarbonisation targets, while keeping our energy supply secure.

Contracts for difference, or CfDs, provide long-term price stabilisation to low carbon generators, allowing investment to come forward at a lower cost of capital and therefore, at a lower cost to consumers. The capacity market provides regular payments to reliable forms of generation in return for such capacity being available when needed, thus ensuring that enough capacity is always in place to maintain security of supply. In both schemes, participants bid for support via a competitive auction, which ensures that costs to consumers are minimised.

As hon. Members will be aware, the first CfD allocation round was held in October 2014, delivering 25 large-scale renewable generation projects at a significantly lower cost than the renewables obligation scheme, which is being phased out. The first capacity market auction was held in December 2014, with a second auction held last December, securing 46 GW of capacity at a price of £18 per kilowatt per year, along with a recent transitional auction for demand-side response held earlier this year.

Hon. Members will be aware that the Government today announced a number of changes to the capacity market framework to ensure that it remains fit for purpose to meet our security-of-supply needs, including bringing forward delivery by holding a new early auction for delivery in winter 2017-18. A consultation on those changes has been launched and we will make final decisions in due course.

However, the regulations that we are considering today have a different purpose. The Government are simply seeking to make a number of technical amendments relating to how money is collected from electricity suppliers in Great Britain in order to fund the schemes. Specifically, the proposed amendments would improve the efficiency with which CfD costs are recovered from electricity

suppliers, which will ultimately reduce costs to consumers, and set the rates for the operational levies relating to both schemes.

**Sir Greg Knight (East Yorkshire) (Con):** The Minister has indicated that the amendments are largely technical. Will she tell the Committee whether her Department has received any objections to what is proposed, and if so, the nature of such objections?

**Andrea Leadsom:** There has been consultation with industry and respondents have been largely supportive of the proposals. They are technical in nature and are not controversial.

The instrument under consideration builds on the instrument that established the CfD supplier obligation mechanism. The CfD supplier obligation is levied on all licensed electricity suppliers in Great Britain to meet the costs of the support received by generators that hold a CfD. That levy on electricity suppliers in Great Britain is set on a quarterly basis by the Low Carbon Contracts Company, which is a Government-owned company that acts as the counterparty to CfD contracts. The Low Carbon Contracts Company sets the levy and a reserve amount based on forecasts of payments to CfD generators, which are then reconciled against actual payments in arrears.

This instrument makes a number of minor and technical amendments to improve the efficiency and transparency of the supplier obligation to minimise costs to suppliers, and ultimately, to consumers. The most significant aspects of the amendments are as follows. First, the regulations amend the calculation of the levy that is paid by electricity suppliers on each unit of supply, so that it is a better reflection of suppliers' likely actual liabilities. Secondly, they allow the levy to be reduced without notice when the Low Carbon Contracts Company anticipates collecting significantly more than required, in order to reduce the likelihood of electricity suppliers paying more than they need to pay. Thirdly, they require the Low Carbon Contracts Company to forecast CfD costs for at least the next 12 months and to publish the date from which each generator is expected to begin receiving CfD payments. That is to provide greater transparency on the costs that electricity suppliers and consumers will face in future.

All the proposals implemented by the instrument were consulted on publicly, and received a largely favourable response. We estimate that the changes, in addition to further regulations which we plan to lay in due course, will reduce the costs to consumers of CfDs by approximately £38 million over the period 2016-20. This instrument also sets the annual operational cost levy for the Low Carbon Contracts Company, as well as setting the settlement costs levy that funds the annual budget of the Electricity Settlements Company, which is responsible for collecting and making payments to capacity providers under the capacity market. The amendments revise the levies for 2015-16 to reflect the operational requirements and objectives of the companies in 2016-17. Both levies were subject to public consultation, giving stakeholders the opportunity to scrutinise and test the key assumptions in the budgets and, importantly, ensure that they represent value for money.

Subject to the will of Parliament, the changes to the CfD supplier obligation, the operational costs levy for the Low Carbon Contracts Company and the settlement

costs levy for the Electricity Settlements Company are due to come into force by 1 April 2016. Finally, I would like to assure all hon. Members that the Government will continue to evaluate and monitor the reforms following implementation, ensuring that the measures put in place remain effective and continue to represent value for money for the consumer.

2.37 pm

**Dr Alan Whitehead** (Southampton, Test) (Lab): It is a pleasure, Sir Edward, to serve under your chairmanship this afternoon. The Minister has set out the reasoning behind the proposals in the statutory instrument. At first sight, these appear to be fairly minor changes in the regulations and their consequences for capacity market bodies, but there is broader point to be made about the CfD counterparty body, and, to a lesser extent, about the settlement body for capacity payments.

With the indulgence of the Committee, I shall spend a moment reflecting on how the CfD counterparty body came to be and consider the thorny question of how to undertake the operation of 15-year CfDs for generators. Over that period, we have to have a known supply of money to reward those generators under the terms of the CfD, we need to ensure that there is money from the suppliers to fund the levy, and that the generators can have confidence that they will secure that levy funding to underpin their operation over the period. When the Energy Bill from which this legislation is derived was going through the House there was a considerable debate about what the counterparty should consist of.

In many people's eyes, the counterparty should simply have consisted of a Government guarantee that those payments were anticipated and we be passed on, and if there was any problem or shortfall the Government guarantee would step in. That has indeed been the case in similar arrangements over the years. On this occasion, it was felt there could be no such Government guarantee and that an alternative procedure that looked as close as possible to being a Government guarantee should be adopted. That was how the CfD counterparty body came to exist. It is a company limited by shares: it is owned wholly by the Government, empowered under section 7 of the Energy Act 2013, but it is a freestanding company that does not have any Government guarantee as such. Among other things, that means that money passing through the Treasury does not have any public borrowing implication and also that the Government are not liable for the success or failure of those counterparty operations.

In order to make sure that the company is as close as possible to a guarantee, various things have had to be built in. Not only is a levy charged to cover payments to generators based on suppliers' market share at the time of the payment—it has been a quarterly payment—but a reserve fund has had to be set up through the counterparty body to cover the possible costs of default by the supplier. It is effectively a travel agency bond, so that if a supplier defaults there is a reserve fund to cover the costs and ensure there is sufficient money in the settlement body to ensure that payments are made.

There is a lump sum quarterly payment to cover the operational costs of the counterparty body, which are around £14 million a year. Three separate components

are required to take the place of a simple guarantee from the Government. None of those would be necessary if there were a Government guarantee body. The changes in this statutory instrument effectively cover all those areas of the original operating arrangement for the counterparty body. Those changes have been made in the light of a consultation that took place when the counterparty body was first set up. There was a consultation with industry as to whether the arrangements that I have described really were fit for purpose and sufficient to do the job that it was thought the counterparty body would do.

The consultation led to substantial concern about the costs of the arrangements as they related to suppliers, particularly small independent suppliers. If a small independent supplier is supposed to issue a bond to cope with possible default, and if it is supposed to make a lump sum payment for the operational costs of the body, in addition to what it is paying based on its market share, as well as putting money into a reserve fund, that is an onerous burden. It was just such companies that the Government were keen should succeed in order to widen the market and encourage switching, with benefits for people in changing how their supply works. The consultation suggested how the counterparty system would work: in principle, it would be possible to introduce working capital from Government sources which, without a full Government guarantee, would underpin the security of the reserve fund.

Strong representations were made during the consultation, but they were not acted on by the Government: as the levy was an industry arrangement it was considered that it should remain entirely within the industry. Those concerns have not gone away and, one way or another, the changes in the regulations accentuate them. I certainly welcome the change in the notice period for an interim rate to go down—it will be immediate—and the 30-day period for the interim rate to go up. That is a sound idea, and the industry has welcomed it substantially. Changing the date by which notice has to be given to suppliers about the reserve fund from the date on which the amount was determined to a later date means that for suppliers, particularly small suppliers, there is less certainty about the sum and how long they have to raise it.

The totals allocated for the running costs of the CFD counterparty and the settlement body for capacity auctions appear to have been increased. The allowance for the CFD counterparty will go up, according to the measure, from £14.2 million per annum to £14.4 million per annum. I have a query about an anomaly in the costs of the settlement body. Regulation 24 appears to suggest that the operation obligation in the Electricity Capacity (Supplier Payment etc.) Regulations 2014 rises from £3,891,000 to £4,283,000. The explanatory notes suggest that the total obligation for the two bodies for operating costs remains the same, and that the total for the settlement body for capacity payments goes down from £4,474,000 to £4,283,000. There appears to be a discrepancy in those figures.

If we look at the figure in the measure, and the question of costs for the CFD counterparty, it appears that the total costs for administration have increased by a substantial amount. Alternatively, the total budget, which is £18,690,000, stays the same, but there has been a change. Given the changes that are going to be introduced,

[Dr Alan Whitehead]

all of which create additional pressure and problems for suppliers in meeting the terms of the counterparty, has the Minister reconsidered the points that were made in the consultation when the bodies were set up? In particular, has she reconsidered working capital arrangements to deal with the question of the reserve fund in the middle of the counterparty arrangements? Is she confident that the additional costs that are being placed on small suppliers will not discourage the widening pool of supply participants, as we are all anxious that that should not happen?

Lastly, if the costs of the counterparty continue to rise, and administrative costs are automatically defrayed against the levy supply provided to supply companies, what constraints are there on the activities of the counterparty body to ensuring that its costs stay within reasonable bounds? Or is it the case that there is an automatic relationship, as may appear to be the case in the measure? If those costs increase are they just passed on, through the levy, to the suppliers? As this is effectively a Government-owned company, does the Minister have any way of keeping those costs within reasonable bounds and can she guarantee that we will not be here in a year or two passing a further measure with a further increase in costs and a further levy, to the inconvenience of those smaller supplier companies in particular?

2.51 pm

**Andrea Leadsom:** I am grateful to the hon. Gentleman for his review of how this all came about. I can tell him that, in this consideration, we have not gone back and reviewed the original proposal to set up the Low Carbon Contract Company, or the Electricity Supplier Payments Company, because it was agreed at the time of implementing electricity market reform that it would be an industry-led and managed arrangement as far as possible. I note the hon. Gentleman's point that a Government guarantee would be much simpler, but he will recognise that that introduces an element of taxpayer risk as well as implications for the public sector balance sheet and so on. This was always intended to be an industry-led arrangement.

In answer to the hon. Gentleman's specific question about whether small energy companies would be discouraged, the evidence is that they have not been discouraged. As he will be aware, there are considerably more energy companies supplying to the UK market than there were in 2010. If my memory serves me correctly, there are well over 20—I am thinking 28, but I will have to confirm that number for him. Certainly, there is no evidence to suggest they have been put off by these arrangements. This measure seeks to simplify and improve the capacity of supplier obligations to be actualised so that they are not made in anticipation of payments but are much more closely related to the actual costs.

The hon. Gentleman asked whether there was any means to control costs. As he would expect, costs are scrutinised very carefully. He will also be aware that a number of contracts for difference and a number of capacity market bids have been undertaken, although payments have not been made. Nevertheless, there is a big burden of contractual work that needs to be undertaken and that is where those operational costs have increased, but only by a small amount: in fact, it will be around

20p in additional operational costs on household electricity bills in 2016-17 at 2014 prices. As the hon. Gentleman would expect, we are very alert to the need to keep costs down—both the companies concerned and the Department of Energy and Climate Change—as well as to the importance of public consultation, and to scrutiny and debate in Parliament. We do not expect further significant increases in either budget, based on our expectations of current and future duties over the next couple of financial years.

**Dr Whitehead:** I would be grateful if the Minister wrote to me to confirm, ideally, or otherwise explain the true position on the overall costs of the counterparty body and the settlement body as far as capacity payments are concerned. As I have said, there seems to be a discrepancy between what is in the measure and what appears to be the total set out in the explanatory notes. It would be good to have that cleared up at the earliest possible stage.

**Andrea Leadsom:** I will certainly write to the hon. Gentleman on that point.

**Stephen Phillips** (Sleaford and North Hykeham) (Con): I note that regulation 16 amends regulation 23 of the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 by increasing the operational costs levy from 0.0397p to 0.0509p. That is a significant increase, and if the Minister is going to write to the Committee, I would like her to explain what that increase relates to, as it is a levy in relation to the operational costs of the CfD counterparty, and what she will do to bear down on that increase and make sure it does not go any further.

**Andrea Leadsom:** I do not think it is necessary to write to hon. Members, but I am happy to do so if my hon. and learned Friend would like me to. As I have explained, the purpose of the Low Carbon Contracts Company is to be the counterparty to contracts for difference. As those CfDs have begun to be allocated, the contractual work that the company is undertaking has escalated significantly. The operating costs have been reviewed closely by DECC and by the companies, and through parliamentary scrutiny, so further significant increases are not expected. However, as my hon. and learned Friend would expect, with the establishment of contracts and the potential for new contracts coming on board all the time, there has been an adjustment. I am happy to write to the Committee if my hon. and learned Friend would like me to—[*Interruption.*] He would like me to do so, so I certainly will.

As I am sure Members are aware, a key objective of the Government's energy policy is to keep costs as low as possible as we transition to a low-carbon economy. The changes we are seeking to make forward that objective by implementing a series of technical and administrative amendments that ensure the CfD scheme and the capacity market continue to operate with best value for money for consumers. I commend the order to the Committee.

*Question put and agreed to.*

2.57 pm

*Committee rose.*