

# PARLIAMENTARY DEBATES

HOUSE OF COMMONS  
OFFICIAL REPORT

Third Delegated Legislation Committee

DRAFT RENEWABLES OBLIGATION  
(AMENDMENT) ORDER 2018

*Monday 2 July 2018*

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**Friday 6 July 2018**

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

*Chair:* PHIL WILSON

- |  |   |
|--|---|
| † Cadbury, Ruth ( <i>Brentford and Isleworth</i> ) (Lab)                 | † O'Brien, Neil ( <i>Harborough</i> ) (Con)                     |
| † Charalambous, Bambos ( <i>Enfield, Southgate</i> ) (Lab)               | † Perkins, Toby ( <i>Chesterfield</i> ) (Lab)                   |
| † Creasy, Stella ( <i>Walthamstow</i> ) (Lab/Co-op)                      | † Perry, Claire ( <i>Minister for Energy and Clean Growth</i> ) |
| † Drax, Richard ( <i>South Dorset</i> ) (Con)                            | Siddiq, Tulip ( <i>Hampstead and Kilburn</i> ) (Lab)            |
| † Francois, Mr Mark ( <i>Rayleigh and Wickford</i> ) (Con)               | † Smith, Nick ( <i>Blaenau Gwent</i> ) (Lab)                    |
| † Grant, Mrs Helen ( <i>Maidstone and The Weald</i> ) (Con)              | † Swayne, Sir Desmond ( <i>New Forest West</i> ) (Con)          |
| † Harris, Rebecca ( <i>Lord Commissioner of Her Majesty's Treasury</i> ) | † Whitehead, Dr Alan ( <i>Southampton, Test</i> ) (Lab)         |
| Hoey, Kate ( <i>Vauxhall</i> ) (Lab)                                     | Nehal Bradley-Depani, <i>Committee Clerk</i>                    |
| † Mak, Alan ( <i>Havant</i> ) (Con)                                      |   |
| † Moore, Damien ( <i>Southport</i> ) (Con)                               | † <b>attended the Committee</b>                                 |

## Third Delegated Legislation Committee

Monday 2 July 2018

[PHIL WILSON *in the Chair*]

### Draft Renewables Obligation (Amendment) Order 2018

6 pm

**The Minister for Energy and Clean Growth (Claire Perry):** I beg to move,

That the Committee has considered the draft Renewables Obligation (Amendment) Order 2018.

It is a pleasure to serve under your chairmanship on this lovely sunny evening, Mr Wilson.

The draft order would amend the Renewables Obligation Order 2015, which, as the Committee knows, provided the detailed legislative framework for the operation of the renewables obligation scheme in England and Wales. The order is designed to control the costs to consumers—something we all care about—of supporting unexpected generation under the renewables obligation from two types of generating station defined in the legislation: biomass conversion stations and co-firing stations.

Biomass conversion stations are former coal plants that have converted to run wholly on biomass. Co-firing stations combine a mixture of coal and biomass. The renewables obligation scheme has been the main financial mechanism to incentivise large-scale renewable electricity generation in the UK. The scheme has now closed to new biomass, co-firing and conversion projects, but existing projects will continue to receive support up to 2027.

Of course, the scheme does not provide cash payments to generators. It operates through a system of tradable renewables obligation certificates. Electricity suppliers have to present a certain number of certificates to Ofgem to support each megawatt-hour of electricity they have supplied to consumers. Ofgem issues RO certificates to generators relative to the renewable electricity they generate. Generators sell the certificates to energy suppliers or to traders as tradable commodities. It is assumed that the cost to electricity suppliers of complying with the regulation is passed on to consumers through their energy bills. The size of the obligation is set each year, based on the number of certificates expected to be issued.

The RO scheme has been highly successful in bringing forward renewable energy, and 25,000 stations across the UK now generate more than 65 TWh of renewable electricity a year, which is equivalent to about 22% of the UK electricity supply market. As to its contribution to decarbonisation, more than 28 million tonnes of carbon dioxide emissions were avoided in 2016-17 alone. However, we must of course keep energy bills as low as possible for consumers while we go through the transition, and since 2015 steps have been taken to control costs; but we need to do more.

It is our view that both co-firing and conversion stations have an important transitional role to play in decarbonising the grid, and they can generate at high levels more or less continuously. However, stations already accredited under the scheme can increase the amount of

biomass they use quickly and without notification to Ofgem, which can, of course, significantly increase support costs. The Government acted in 2014 to discourage that deployment of new generating capacity by removing grandfathering rights for certain sorts of co-firing and biomass conversion generating stations. However, despite those changes, last year evidence suggested that there was significant unforecast generation, which is something we are keen to avoid. Indeed, we think that if we were not to intervene now, there would be an increase in bills of £2 per year per household. For business users, and particularly those with low electricity consumption, there would be increases of up to £140 per year, whereas the bills of energy-intensive industries would increase by up to £53,000 per year.

The reason the Committee is meeting tonight is to control those costs by implementing annual caps on the number of renewables obligation certificates that can be issued for non-grandfathered biomass co-firing or conversion generating stations or units. There are two sorts of stations to which caps will apply: capped and mixed. Capped stations comprise one or more capped combustion units only, which are not protected by grandfathering policy. That means, essentially, that there is a cap on the number of certificates that can be issued to the station in each obligation year, set at 125,000.

Mixed generating stations have both non-grandfathered capped units, and exempt grandfathered units. The order will set a flexible cap, first by estimating the number of certificates likely to be issued for generation at the exempt units. An allowance of 125,000 certificates will then be added for each of the station's capped units. If generators choose to exceed their capped unit capacity, further certificates will be issued for generation only up to the level of the overall station caps. If generators decide to maximise generation at their exempt grandfathered units, there will be no restriction on the number of certificates issued, provided that the capped units remain within their allowance.

The order also makes some technical changes that are unconnected to biomass conversion and co-firing. For example, we are bringing certain combined heat and power stations into line with the existing requirements for other stations, and are requiring a declaration that double subsidies will not be claimed under other schemes. The order clarifies that existing greenhouse gas trajectories in the Renewables Obligation Order 2015 apply equally to electricity-only dedicated biomass power stations and biomass power stations with combined heat and power. The order will also clean up various typos, which do not have a material effect on the legislation.

The Government are committed to keeping energy bills as low as possible for consumers, while cutting greenhouse gas emissions and supporting economic growth. The cap mechanisms implemented through the order take into account feedback from stakeholders. They balance the interests of generators and consumers. The flexibility provided by this approach will allow units to generate more when electricity demand is highest. I commend the order to the Committee.

6.6 pm

**Dr Alan Whitehead** (Southampton, Test) (Lab): It is a pleasure to serve under your chairmanship, Mr Wilson.

As the Minister set out, the order essentially deals with a very narrow point of policy relating to biomass conversions and biomass production. It is about stations

that have converted from coal to biomass and are receiving renewables obligation certificates—in other words, they converted before the ROC period came to an end. As the Minister said, there are no more stations in that category because, although the ROC programme is continuing for another nine years, it has been closed to new applicants since the arrival of contracts for difference on 31 March 2017. The order is about existing conversions that have an expectation of the number of ROCs they would receive as a result of their power generation. It contains a proposal to limit the number of those ROCs. As the impact assessment for the order states,

“The policy objectives are to protect the”

levy control framework

“and limit the costs to consumers of additional unforecast RO spend on biomass conversion and co-firing.”

The Minister made a customarily comprehensive case about the order’s purpose, but I am not sure it is likely to do what it says on the tin. Will it really protect the LCF and limit the costs to consumers of additional unforecast RO expenditure, as described in the impact assessment, the explanatory memorandum and the Minister’s statement? I ask that question because the order is founded on renewables obligation certificates, but it talks about the money potentially spent or saved in relation to the levy control framework. Those are not quite the same things, and I will try to shed a little light on why.

Renewables obligation certificates came into place in 2002. As we have mentioned, no new ROCs are issued now, but during the period of their life, they were created as a result of agreements that were set out with various renewable power plants to provide a varying number of ROCs per megawatt-hour of electricity produced. In that sense, they are a little like bitcoin, inasmuch as they have been mined, produced and then are in existence as a result of the activity of producing energy, but they have no value in themselves. They can obtain value as a result of being bought, as the Minister said, by bodies that are obligated by the ROC system to provide evidence that they have supplied a proportion of their output from renewable power.

Such bodies can do that in two ways. First, they can show at the settlement point a number of ROCs from their own generating activity that coincides with their obligation level—and if they do that, their obligation is met. On the other hand, if they have a shortfall, or do not generate any power from renewable sources, those suppliers would have to meet their obligation via another route, in one of two further ways. Either they pay a buyout price for their ROC shortfall—the price will be administratively set by Government at a substantially higher level than the likely traded prices of ROCs—or they purchase from the companies that have created the ROCs enough ROCs to meet their obligation level.

That, of course, is what gives ROCs their value and places money in the hands of the renewable generators who have invested money in their projects with the expectation that, in part, their project will be underwritten by the proceeds of ROC sales. However, a question then arises: what is likely to be the actual value of a ROC? It is that value that is paid by the supplier and that impacts on customer bills. It impacts on the levy control framework—that is, a controlled total for the amount that can be spent on underwriting for renewables over

successive five-year periods. It is not money that is actually spent, because it is money that is effectively supplied by consumer bills. Of course, that is real money as far as consumer bills are concerned, but it is to be regarded as an imputed tax and spend by the Treasury, so it is as if extra taxation had been raised and then charged against the levy control framework. That levy control framework is the subject of the order, inasmuch as the Government’s imputed tax and spend within that framework has been running ahead of what that framework suggested it should be. Measures have therefore been taken to try to get it within the overall framework.

The next question that arises is whether the way in which ROCs are valued is easily coterminous with what it is the Government are trying to do about maintaining those levy control framework levels. This is the key bit. If the value of a ROC is high, that will result in more putative tax and spend, and hence more cost against the levy control framework. If the value is low, it results in some, but less, cost against the levy control framework.

How does that value rise and fall? Essentially it comes from two elements. First, there is the headroom that the Government have built into the system. That is the level of obligation suppliers have to meet. That is, or should be, adjusted to remain ahead of the supplier ROCs so that they retain value, and so that the generators are rewarded for their efforts. The headroom sits in the system and will have a central effect on ROCs’ values. That is, if the headroom is set very high—10% above the current level of the ROCs—then, with the obligation up to a relatively high percentage of the power supplied by a supplier, the ROCs will gain value, because people will chase more of them to cover their obligation requirement. If the headroom is reduced, the value of the ROCs drops. Furthermore, the more ROCs in the system, even within the obligation level framework, the easier it is for suppliers to obtain them to meet their obligations. In other words, if more ROCs chase a set amount of obligation space, the price will reduce.

How does that relate to what the draft statutory instrument seeks to do? It wants to cap the number of ROCs for particular plants operating biomass and bioliquid methods of producing electricity. That retrospectively alters the terms under which those companies undertook a build for biomass or a conversion to biomass of a plant that previously burned coal. Changing retrospectively the terms of scheme is exactly what caused the 2015 hiatus when the feed-in tariffs for solar were dropped. In this instance the situation is worse, because although dropping those FITs affected the development of new solar, it did not affect the remuneration of existing plants. The draft order seeks directly to affect the planned remuneration of existing plants by shifting the goalposts after agreement has been reached.

That is why a number of affected plants that had converted from coal to biomass told the consultation that the changes would make them—at least for the foreseeable future, and presumably until the Government outlaw coal from the system—produce electricity from coal and not from biomass, since the terms of the altered system are such that it will be economically less advantageous to generate power from biomass and economically more advantageous, relatively speaking, to produce power from coal, which I thought the Secretary of State was against. Indeed, the Minister and I have agreed considerably on the need to remove coal from the system. It would be a particularly perverse outcome

[Dr Alan Whitehead]

of this instrument if we increased, rather than reduced, the amount of coal being used to produce power in the system over the next few years.

That, however, is the collateral damage, as it were, of a less than perfect measure. The Government tell us that the real effect of the cap on ROCs for those companies is that it will take the pressure off the levy control framework. The impact assessment explains at length just how much a cap will save. It suggests that doing nothing means expenditure of between £55 million and £320 million, whereas under this draft instrument the range is between £5 million and £20 million.

It will not, however, necessarily do that. Capping the number of ROCs that can be issued by plants would have a potential effect on the number of ROCs available for purchase. The effect would therefore be to increase the value of the ROCs that will be available. The amount of money paid out for them, which would be regarded as putative tax and spend, would go back into the levy control framework. That would not change the overall effect very much, although that depends on the proportion of the total amount of ROCs available and the plants affected, which the impact assessment does not address.

The fine and detailed calculations made in the impact assessment, which are in the SI and the explanatory memorandum, do not add up to a hill of beans unless done properly against what the countervailing effect of having fewer ROCs in the system would do to the overall cost to the levy control framework. I do not know what the exact effect would be, but it does not appear to have been well worked out. In principle, it possibly delivers the wrong mechanism—saving costs to the levy control framework as far as ROCs are concerned.

Far be it for me to advise the Government on what to do about the ROCs system, which undeniably through its trading mechanisms causes costs to consumers and the LCF total, but in terms of a mechanism that would have an effect on those costs it might be worth—

**Claire Perry:** Will the hon. Gentleman accept an intervention that might provide him with some comfort and save us a bit of time? His suggestion is that if we had a totally free market with an infinite number of ROCs and a price-setting mechanism based on demand and supply, by capping the number of ROCs, prices will go up and the overall value will be the same. However, the obligation is set annually. Therefore, in effect, every year a certain number of ROCs are issued, taking into account that fewer ROCs in the system would have an impact on that level. The ratchet will come down based on there being fewer ROCs in the system. It is not a completely dynamic system—there is that annual setting of the absolute number.

**Dr Whitehead:** I thank the Minister for that intervention. Unfortunately, the annual settlement for the amount of ROCs compared with headroom took place last October.

**Claire Perry:** It happens every year—now until 2027.

**Dr Whitehead:** Indeed, it happens every year, but the system will not rectify itself in any way until about one and a half years after the order is in place. Therefore, if ROCs are fewer in number and increase in value, the workings carried out may not have the effect that the

Minister or the officials who drew them up think they will have, because of how those values relate to scarcity or abundance as far as possible purchases are concerned.

I was going to mention, as the Minister did, the headroom for ROCs. If one looked at the relationship of headroom to the number of ROCs in circulation, one would certainly see that having a depressing effect, but it would have a much wider effect on the whole of the market. As a result of our, I accept, quite lengthy expedition of how ROCs work, work against each other and may or may not work up to the levy control mechanism, does the Minister really think that the order will work as she has described? Given the lack of an assessment of a possible countervailing effect from a reduction in ROCs because of how the system works, might it not be a good idea to take that away and have another look at it, to see whether it will work as well as she thinks and whether any action on headroom figures might have an equal effect, as I have just described? The countervailing effects of the headroom recalculation might be worse than the proposed measure.

I am not drawing any conclusions. I am stating that it does not appear that all the factors relating to how ROCs work have been taken into account in the calculations. I would not like to see us pass legislation that does not do that properly and that possibly draws us into areas where we think we have done something about the system, but actually we have done something rather different.

6.25 pm

**Claire Perry:** I disagree with the hon. Gentleman. The information given to me suggests that the set level of ROCs already factors in cost control measures. The legislation cap takes into account the ROCs that have been issued since April 2018.

The hon. Gentleman is proposing a “do nothing” scenario where we would end up with higher bills and companies continuing to receive unexpectedly high returns from generation. We want to ensure that we achieve our renewables targets, which we can do with the system and a relentless focus on driving down consumer bills. We should not be afraid to say that a system put in place for all the right reasons has not delivered as we thought. Essentially, people will always game whatever system is in place.

I take the hon. Gentleman’s point about ensuring that there is not a policy hiatus, but there is none. We are proposing a sensible change that will stop unexpected levels of generation coming onstream, but the quid pro quo is that we have given the generators flexibility in how they treat their various plants. We have given them the ability to have a bit of management within their own system.

I accept the estimates of the likely savings—I am sorry that the hon. Gentleman does not, because my officials have done an excellent job with the analysis—and the costs that we will not see. It is an extra £1 or £2 for average household bills, an extra £80 to £140 for business users, and up to £53,000 for energy intensive industries, such as steel, ceramics and cement, which he and I know are extremely strategically important and have huge resonance in many of our constituencies.

I am, as always, interested to listen to the hon. Gentleman. I appreciate his detailed combing through of the small print of every SI, but in this case I do not accept that these numbers are wrong. I commend the order to the Committee.

*Question put.*

*The Committee divided: Ayes 9, Noes 6.*

**Division No. 1]**

**AYES**

Drax, Richard  
Francois, rh Mr Mark  
Grant, Mrs Helen  
Harris, Rebecca  
Mak, Alan

Moore, Damien  
O'Brien, Neil  
Perry, rh Claire  
Swayne, rh Sir Desmond

**NOES**

Cadbury, Ruth  
Charalambous, Bambos  
Creasy, Stella

Perkins, Toby  
Smith, Nick  
Whitehead, Dr Alan

*Question accordingly agreed to.*

6.29 pm

*Committee rose.*

