PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Second Delegated Legislation Committee

DRAFT RENEWABLES OBLIGATION (AMENDMENT) ORDER 2021

Tuesday 9 March 2021

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not later than

Saturday 13 March 2021

The Committee consisted of the following Members:

Chair: †Hannah Bardell

Andrew, Stuart *(Treasurer of Her Majesty's Household)*
Burgon, Richard *(Leeds East)* (Lab)
Butler, Dawn *(Brent Central)* (Lab)
Byrne, Liam *(Birmingham, Hodge Hill)* (Lab)
† Caulfield, Maria *(Lewes)* (Con)
Davies, David T. C. *(Parliamentary Under-Secretary of State for Wales)*
Fletcher, Mark *(Bolsover)* (Con)
Jones, Mr Marcus *(Vice-Chamberlain of Her Majesty's Household)*
Levy, Ian *(Blyth Valley)* (Con)
† Mann, Scott *(North Cornwall)* (Con)
Morris, James *(Lord Commissioner of Her Majesty's Treasury)*
Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Trevelyan, Anne-Marie *(Minister for Business, Energy and Clean Growth)*
Twigg, Derek *(Halton)* (Lab)
† Whitehead, Dr Alan *(Southampton, Test)* (Lab)
Yasin, Mohammad *(Bedford)* (Lab)

Hannah Bryce, *Committee Clerk*

† attended the Committee

Second Delegated Legislation Committee

Tuesday 9 March 2021

[Hannah Bardell *in the Chair*]

Draft Renewables Obligation (Amendment) Order 2021

9.25 am

The Chair: Before we begin, I remind Members about the social distancing regulations. Spaces available to Members are already clearly marked, and unmarked spaces must not be occupied. I see Members have taken their appropriate seats, but the usual convention of a Government side and an Opposition side is waived on this occasion, so Members may sit anywhere. *Hansard* colleagues would be very grateful if Members sent any speaking notes to hansardnotes@parliament.uk.

The Minister for Business, Energy and Clean Growth (Anne-Marie Trevelyan): I beg to move,

That the Committee has considered the draft Renewables Obligation (Amendment) Order 2021.

The draft order, which was laid before the House on 3 February 2021, relates to the renewables obligation and the renewable electricity support scheme. The renewables obligation was introduced in 2002 to provide subsidy for electricity generation from renewable sources. It covers onshore and offshore wind, solar, hydro, biomass and so on. The scheme is closed to new applications, though support for existing stations continues. The scheme will finally close in 2037.

The scheme was part of a programme of measures aimed at stimulating the renewables industry to enable ambitious climate change targets to be met. Without subsidy, the nascent renewables sector would have struggled to make headway in a market dominated by the established heavyweights of coal, gas and nuclear. The renewables obligation had an initial target of 10% renewable electricity by 2010, but today about 30% of electricity supplied in the UK is supported under the scheme. Of course, the scheme needs to be paid for, and that falls on electricity suppliers, who currently provide almost £6.5 billion of subsidy a year to renewable generators. Those costs are passed on to customers via their bills, adding about £70 a year to the average domestic electricity bill. Costs will fall from 2027 as generators start reaching the end of their period of support and exit the scheme.

The draft statutory instrument deals with a technical matter that relates to supplier payment default. More specifically, it aims to prevent electricity suppliers from being unduly exposed to the unpaid bills of competitors who fail to meet their obligations. The renewables obligation comprises three separate but interlinked schemes: the renewables obligation, covering England and Wales; the renewables obligation Scotland; and the Northern Ireland renewables obligation. The Scottish and Northern Irish Governments are responsible for their own schemes; the UK Government cover the England and Wales scheme. The matter under debate relates to the England and Wales scheme only.

The renewables obligation is a traded scheme that places an obligation on electricity suppliers to obtain a number of green renewables obligation certificates in proportion to the amount of electricity they supply to their customers. Certificates are issued to renewable generators for free by Ofgem in relation to the amount of renewable electricity they generate. Suppliers typically buy those certificates, providing generators with an income stream over and above electricity sales revenues. Certificates are usually in short supply, so suppliers may make a cash payment, called a buy-out payment, in lieu of each certificate. The buy-out price is about £50 per certificate for the current renewables obligation year, and about 10% of the scheme is met in that way. At the end of the scheme year, the cash fund is recycled back to those suppliers who met their obligations with certificates, which gives certificates additional value over and above the buy-out price.

In recent years, an increasing number of suppliers have defaulted on their obligation under the scheme. Payment default leaves a shortfall in the cash fund, meaning recycle payments are lower than they would otherwise have been. That lowers the value of certificates, which ultimately impacts generators' returns. The scheme therefore features a mutualisation mechanism that offers protection against payment default. Under the mechanism, shortfalls in the cash fund are recovered from all other suppliers and recycled back to those suppliers who met their obligation with certificates. The mechanism is triggered when the shortfall exceeds a £15.4 million threshold.

Mutualisation has been triggered in each of the past three years. In total, £173 million has been mutualised across suppliers in England and Wales. Electricity suppliers and their customers are understandably unhappy about the situation, so in December 2020 the Government consulted on a proposal to amend the mutualisation threshold so that it would be less easily triggered. It was proposed that the £15.4 million threshold should be replaced with a new threshold calculated annually as 1% of the cost of the scheme, which is broadly equivalent to the arrangements that were in place when mutualisation was first introduced into the scheme in 2005. Since then, the threshold has been gradually eroded in relative terms and is now equivalent to just 0.25% of scheme costs. Mutualisation can therefore now be more easily triggered. In other words, the risk associated with supplier payment default has become increasingly tilted away from generators and towards other suppliers.

Our proposal and the draft statutory instrument seek to redress the balance of risk. In the first year, the threshold will rise to about £62 million. That will ensure that suppliers and their customers are not unduly exposed to the unmet renewables obligation bills of other suppliers. Generators will face an increased risk that unmet obligations will remain uncovered. That will have a small impact on the value of certificates, but the new level of risk is broadly equivalent to what it was in 2005. In that respect the SI can be considered to be restorative.

The draft instrument makes minor technical changes to the Renewables Obligation Order 2015 so that a fixed £15.4 million threshold is replaced with a threshold that is calculated on an annual basis. The new threshold is determined as 1% of the forecast scheme cost for the year ahead. It also places a new requirement on the scheme's administrator, Ofgem, to calculate and publish the threshold ahead of each obligation year.

The emergence of payment default and cost mutualisation under the renewables obligation has become of increasing concern to electricity suppliers. Through no fault of their own, those suppliers have become increasingly exposed to the unmet obligations of their competitors, whereas renewable generators have seen their returns increasingly protected.

The draft instrument will restore the original balance of risk between generators and suppliers. It will make it harder for mutualisation to be triggered, so suppliers will be less likely to be exposed to the unmet obligations of other suppliers. That is good news for consumers; they should benefit because the likelihood of mutualisation costs being passed on to them will be lower.

The legislative changes need to be effective on 1 April to enable them to take effect in respect of the next renewables obligation year, which runs from April 2021 to March 2022. Consequently, and subject to the will of Parliament, the draft instrument will enter into force on 31 March 2021. I commend the order to the Committee.

9.31 am

Dr Alan Whitehead (Southampton, Test) (Lab): The SI is, frankly, three years too late. It could be described as more of a disaster relief fund arrangement than anything else because there is a significant alternative history behind the measure in terms of the changes to mutualisation and the ROCs market.

The explanatory notes that were kindly sent out with the SI state:

> "The mutualisation threshold has failed to keep pace with the growth in the scheme. When the threshold was introduced in 2005, it was equivalent to about 1% of the cost of the scheme."

The Minister mentioned that when the scheme was first introduced in 2005 it was equivalent to 1% of the cost of the scheme, but that now it is equivalent to about 0.25%. All that is true, but those figures conceal an alarming story.

When the threshold was first introduced, it was never considered that it would be breached; it was regarded as a very, very long backstop for RO payments and repayments. The Minister has set out how the RO works, and how it distributes fund back to suppliers after putting money in the fund in the first place. Until about 2015, the issue of shortfalls was pretty much an academic issue and the mutualisation levels had not been breached. There were occasions on which generators received a slight shortfall on what they might have received, but that was nothing serious in terms of what they expected to receive as their reward for creating renewables obligation certificates in the first place which were then presented by a supplier for a scheme to proceed. I am not sure that we need to debate the complications of the renewables obligation scheme, but it is quite complicated in terms of how it works.

The point we ought to focus on is the period 2015 to 2016, when new licence arrangements were put in place by Government for entrants to the electricity supply markets. Those arrangements have been described thus:

"Energy suppliers could get a licence with little or no capital and no relevant industry experience."

Licences were literally given away to people who turned up and said that they would like to set up an electricity supply company. That meant an explosion of supplier companies. Indeed, by the end of 2017, there were 73 supplier companies in the market—an increase from just 32 in December 2015. In the course of two years, the number of supplier companies in the market doubled. It was fairly inevitable that because of the lax licensing procedure arrangements, a number of those companies then proceeded to go bust—22 companies have gone bust in the last three years or so. Just this year, two further companies covering some 400,000 customers have gone bust. A total of 1.8 million customers have switched their accounts, not because they wanted to but because they had to. The supplier of last resort—another interestingly complicated device—has come in and customers have been transferred to companies that have not gone bust.

Over the past three years, supplier companies that have done their job properly, have ensured their customers are properly protected and, most importantly, paid their renewables obligation requirements have, quite naturally and not surprisingly, increasingly voiced their concerns. They have observed that companies were coming into the market, undercutting those companies that had acted responsibly, and hoovering up customers but then were unable to sustain the momentum of those efforts and were going bust. The people who paid the money were those energy supply companies that actually did their job properly. That was an extremely unjust outcome and one should have great sympathy for those suppliers that found themselves in that situation having done their job properly. For that reason I am in complete agreement with the thrust of the motion, but the problem has not just arisen. In the last three years, there has been an exceptional new development; not only has the mutualisation threshold of £15.4 million, which the Minister mentioned, been breached but it has been breached at an astonishing level. There was a shortfall of £53.4 million in 2018; £88 million in 2019; and £31.4 million in 2020. Those sums are way over the theoretical and academic mutualisation threshold originally set in 2005.

Of course, something has to be done about it. The measure will ensure that the mutualisation threshold increases substantially, as the Minister has mentioned. That does mean that generators will bear some of the results of any shortfall and suppliers to a much lesser extent. The level of mutualisation means that, probably, it will not be breached in the near future but, as we can see from the figures, even that new level was breached in two of the past three years.

I hope the Minister will acknowledge that what I have recounted is not just an alternative history, but, substantially, the history behind this particular SI. It is a measure to retrieve the disastrous situation that the Government have got themselves into by allowing the market to go in a wild west way, underpinned by the changes to the licensing arrangements in 2015 to 2016.

The Opposition will certainly not oppose this measure today, because it is the right thing to do given the situation we now find ourselves in, but I would like the Minister to reflect for a moment on the history of how we got here and to indicate to the Committee whether she has confidence that the new thresholds in place will take us back to that semi-academic position of theoretical mutualisation arrangements—mutualisation arrangements that would not be breached. I must say, however, that the signals that came out at the beginning of this year were not good: 400,000 further customers forcibly switching and confidence going down.

[Dr Alan Whitehead]

As we all know, last year Ofgem introduced tougher entry tests for energy suppliers, and I would be grateful were the Minister to reflect briefly on whether she thinks those new tougher tests will substantially ameliorate the problem that we saw between 2018 and 2020. If those tougher tests do not work and we have continuing large-scale failure of companies, as we have seen in the past three years, this measure will simply not work.

I hope that the Minister will give us a brief thought on what confidence she has that the measure will work and that the number of failures we have seen in recent years will be reduced. Will the market return to some semblance of balance in the relationship between what generators have to bear—insofar as far as shortfalls in ROs are concerned—and what suppliers have to bear in mutualisation?

For the past three years, in effect, every September a stern note has been put out by Ofgem to say, "The following companies are on notice because they have not paid their ROs by now." Indeed, we got to the point where, regularly, that was the canary in the coalmine, when energy companies started to signal, "We're in trouble." Some got out of that by paying their ROs and coming to arrangements with Ofgem, but for others—regrettably in very large numbers of cases—that notice was followed shortly by the company going bust and abdicating its responsibility for the RO payments.

That has been happening for three years now. I would have thought that the Government might have spotted that and taken action to deal with the issue rather earlier. I therefore welcome the change—although it is really two years too late and a lot of damage has been done in the process—but it is incumbent on the Minister to assure us that she thinks that the measures in the draft order will really work and will put us into a new era for RO payments, restoring that balance between the concerns of the suppliers, customers and generators, which has been given as the purpose of this SI. We want to get back to a stable environment in which all such concerns are properly met.

9.45 am

Anne-Marie Trevelyan: I thank the hon. Member for Southampton, Test for his valued contribution and for his depth of knowledge—this is an opportunity to put that on the record. It is always a pleasure to discuss such issues, albeit across the Floor, because he has an extraordinary depth of understanding and a commitment to the consumer and to those who are generating our electricity.

I welcome the support of Members, who recognise that the draft SI will ensure that electricity suppliers and, by association, their customers will no longer be unduly exposed to the onerous obligations of other suppliers. I hope that my responses have provided the necessary assurances for the Committee to approve this statutory instrument.

In reply to the hon. Gentleman, I am confident that the new Ofgem tests will rebalance and therefore reduce the risk of supplier failure. The SI, alongside those changes, will therefore strike the right balance between the needs of renewable generators on the one hand and of electricity suppliers and their customers on the other. I commend the draft order to the Committee.

Question put and agreed to.

9.46 am

Committee rose.