Consumer-funded energy policies

In its 39th Report of Session 2016-17, the Public Accounts Committee recommended that: "The Department and the Treasury should review the governance arrangements for all consumer-funded energy schemes, and write to us with the outcome of the review. Governance arrangements should ensure boards responsible for the schemes meet regularly and include sufficiently senior officials from both departments".

The Department is responsible for six consumer-funded energy schemes. These are: the three schemes covered by the Levy Control Framework Budget Cap i.e. the Renewables Obligation, Feed-In Tariffs and Contracts for Difference; the Energy Company Obligation (ECO) and Warm Home Discount (WHD); and the Capacity Market. In addition, legislation has recently come into force to provide Energy Intensive Industry (EII) Exemptions from the Contracts for Difference and Renewables Obligation schemes, which will increase the costs paid by other consumers under these two schemes. We have reviewed the governance arrangements for all these schemes and can confirm that they each comply with the following general principles highlighted by the Committee:

- A single person (senior official) holds responsibility for each scheme (except for the EII Exemption where two senior officials have clearly demarcated responsibilities)
- There is regular reporting, usually quarterly, to highlight changes in assumptions and spend
- There are regular review meetings with all relevant parties, including the Treasury, represented
- Assumptions and sources are regularly published
Each of the schemes is placed explicitly in the context of overall aims and goals of the Department, which are to deliver secure, affordable energy, while ensuring the UK meets its domestic and international climate targets.

Further details of the individual schemes is contained in the Annex to this letter.

I am copying this letter to the Permanent Under-Secretary of State to HM Treasury, the Comptroller and Auditor General, the Treasury Officer of Accounts and the Chief Executive of Ofgem.

Yours sincerely,

Alex Chisholm
ANNEX – OUTCOME OF REVIEW OF GOVERNANCE OF CONSUMER FUNDED ENERGY POLICIES

BEIS and HMT have conducted a review of the governance arrangements for the consumer funded energy schemes which impact on energy bills. This took into account the National Audit Office report “Controlling the consumer-funded costs of energy policies: The Levy Control Framework” and the Public Accounts Committee recommendations regarding consumer-funded energy policies. This note provides more detailed information on the outcomes of the review.

SENIOR RESPONSIBLE OWNER (SRO)
All schemes have a single SRO (except for Energy Intensive Industries (EII) Exemptions). The SRO responsibilities typically involve being ultimately accountable for the effective governance of the projects, business case ownership, risk and issues management and ensuring adequate resourcing is put in place. For the Capacity Market, the SRO also chairs the governance boards which also include delivery partners (e.g. National Grid and Ofgem). These partners also have legal responsibilities in respect of the Capacity Market for which they are independently answerable.

The EII Programme Board covers a number of different schemes to support EIIIs. Two parts of the Department have responsibility for different aspects of the individual schemes. There are, therefore, two SROs who co-chair this Programme Board: the Deputy Director for Energy Productivity is the SRO for the operation of all the EII Relief Schemes (Renewables Obligation/Feed-In Tariffs/Contracts for Difference/EU Emissions Trading Scheme/Carbon Price Support) and the Deputy Director for Clean Electricity is the SRO for policy development to change the Renewables Obligation and Feed-In Tariffs Relief Schemes from a compensation to an exemption basis.

BOARD GOVERNANCE
Each scheme has its own board governance structure set up to facilitate appropriate oversight of each scheme. For the Energy Company Obligation (ECO) and Warm Home Discount (WHD) schemes, the Fuel Poverty and Obligation Board meets monthly. The project teams update the Board if delivery under either scheme is different to expectations.
Each scheme also has a monthly highlight report and the Board also signs off the highlight reports. In addition to relevant team members, the Board is attended by HMT officials, Ofgem E-Serve (the schemes’ administrator), and BEIS representatives from legal, finance, science and engineering, heat and business.

The Capacity Market Scheme has an Operations Board which meets monthly to review the operational highlight report. This contains key performance indicators relating to the auctions, preparation of capacity for the delivery year and financial payments relating to the delivery year. There is also a Policy Board, which HMT officials attend, and a Regulatory Change Advisory Board (RCAB) which acts as forum for agreeing final recommendations from consultation proposals and assesses the operational impact of specific policy change proposals. The RCAB consists of representatives from BEIS, Ofgem, National Grid and the Electricity Settlement Company.

For the EI2 Exemptions, BEIS policy, finance, legal and analysis teams, HMT, Cabinet Office and the Devolved Administrations sit on the EI2 Programme Board which meets approximately once every two months.

TRANSPARENCY
BEIS publishes delivery statistics on ECO monthly and Ofgem publishes an annual report for the WHD. Information is also communicated in consultation documents, Government responses and accompanying impact assessments.

For the Capacity Market, auction parameters (and the audit trail of analysis that leads to them) are published for each auction cycle; as are auction outcomes.

Examples of publications relating to the annual cycle of auctions include:

- **Electricity Capacity Report (ECR)**

- **Independent Panel of Technical Experts report on the ECR**

- **Auction Guidelines**
For the EII Exemptions, consultations and Impact Assessments have been published setting out the reasoning behind the various schemes and the estimated impacts on consumer bills. In the detailed schemes which are overseen by the Board; guidance (assuming assumptions and forecasts), application forms and lists of those receiving support are published. There are also EU transparency requirements which are met through appropriate means such as reports to the European Commission.

COST CONTROL
Around half of WHD is demand-led but we establish how many people will be entitled based on receipt of eligible benefits each scheme year. Once we know that figure, we set the spending target for the other part of the scheme in line with the overall spending envelope. The total spend attributable to the scheme can therefore be reliably controlled.

ECO is not demand-led. Suppliers meet carbon and bill reduction targets by installing energy efficiency measures. We check our assumptions about the costs of those measures and administration costs through the consultation process. Targets are set so they can be met within the spending envelope. During the delivery phase of the scheme we monitor costs through meetings with suppliers and the brokerage platform which creates price transparency.

Overspending would only occur if the costs of delivering energy efficiency measures exceeded what we had estimated. This would only be the case if the costs of the products, their installation or of finding the eligible households were higher than expected. There is a strong track record of accuracy in projections and a clear rationale for delivery through obligations on energy suppliers who will seek to meet those obligations as cost effectively as possible so as to maintain competitive advantage with other suppliers.

For the Capacity Market, there is a back-stop cost cap imposed on the auctions. In addition there is a specific cost cap imposed on the bids of certain types of participant who might otherwise be liable to be able to exercise market power and affect price outcomes.
Ultimately, costs of the auctions are essentially controlled by a reliability standard which is set in law and the translation of that standard into a target capacity volume which is auctioned off in a free, market-wide competition. There is an extensive and transparent analytic process involving National Grid, Ofgem, BEIS, HMT and an independent Panel of Technical Experts to ensure that the “translation” process is methodologically and evidentially robust. Once costs are established by the auction, they crystallise. Auctions are generally held four year ahead of delivery, at which point payments are made, but almost no variation is possible in the intervening period.

The individual schemes covered by the EII Programme Board have full management arrangements including a working group that currently meets fortnightly to develop policy and monitor delivery of the consumer-funded exemption schemes for EII. Relevant processes will continue to be developed as the new schemes are introduced and begin to have an impact on other consumers’ bills.

ALIGNMENT WITH DEPARTMENTAL GOALS
Both the ECO and WHD schemes are focussed on reducing energy bills for low income and vulnerable households and are currently the main policies in helping to meet the statutory target on fuel poverty. ECO also improves the efficiency of the GB housing stock, thereby reducing carbon emissions and wider costs to the energy market. The key benefits of ECO are that it reduces heating bills for households and reduces carbon emissions. There are also air quality benefits, health benefits and wider energy system benefits. WHD is a redistributive policy which also has health benefits.

The Capacity Market falls squarely within the objective of ensuring that we have a reliable, low-cost and clean energy system.

The schemes managed by the EII Programme Board support the competitiveness of the most energy intensive businesses which provide essential products (such as cement, steel and glass) and help address the competitive disadvantage caused by the relatively high price of electricity for industrial users in the UK.