Department for
Business, Energy
& Industrial Strategy

RESPONSE TO THE LEVY CONTROL FRAMEWORK LESSONS LEARNED REPORT

November 2016

Response to the LCF Lessons Learned Report

1. Expenditure on policies to support the deployment of renewable and low carbon electricity generation is managed through the Levy Control Framework (LCF). The LCF allows Government to manage public expenditure paid for through consumers' energy bills, and reflects the importance Government places both on keeping bills affordable and supporting renewable and low carbon electricity generation. It sets an annual budget for projected costs of all the Government's low carbon electricity levy-funded schemes until 2020/21. The annual budget rises year on year to £7.6bn in 2020/21 (in 2011/12 prices). Due to the high degree of uncertainty attached to future projected expenditure, LCF limits are subject to 20% headroom in a given year. However, if the LCF budget is projected to be exceeded in any year, the Department[1] needs to produce a plan to bring spending down, unless the projected overspend is temporary whereby BEIS and HMT may agree that no action is necessary[2].

2. In July 2015 the Office of Budget Responsibility (OBR) published a forecast for the LCF of £9.1bn in 2020/21 (in 2012 prices), based on BEIS analysis. This represented around £1.5bn above the 2020/21 cap. Although the projected spend remained within the "headroom" () it was nevertheless significantly over the cap of £7.6bn. The reasons for the increase in forecasts from those published previously were because of a drop in wholesale electricity prices, a greater than expected increase in deployment through the demand led schemes (i.e. the Feed-in Tariffs and Renewable Obligation schemes) and higher load factors than forecast for some technologies.

3. Since the LCF budget was forecast to exceed the cap of £7.6bn, action was taken by the Government on two fronts: (i) to control costs under the LCF by curtailing subsidies and (ii) to examine why the LCF forecasts changed between January to April 2015 and what lessons the Department should learn from that.

4. In light of the projected overspend in 2020/21 the Government made a number of key policy decisions to control LCF future spending. The former Department of Energy and Climate Change undertook a major programme of work to control the costs of its renewable electricity support schemes. This involved curbing the high-spend and fast-deploying technologies (solar, wind and biomass) under the Renewables Obligation, whilst reducing tariffs and introducing a cap under the Feed-in Tariff scheme. These measures are expected to save around £500m of LCF expenditure in 2020/21 and remove a risk of additional increased future spend.

5. The Government is committed to bringing forward more low carbon electricity after 2020, taking action to protect consumers whilst protecting existing investment. Work

[1] On 14 July 2016 the functions of the former Department for Energy and Climate Change (DECC) were merged into the new Department for Business Energy and Industrial Strategy (BEIS)- https://www.gov.uk/government/organisations/department-for-business-energy-and-industrial-strategy

[2] For background see http://webarchive.nationalarchives.gov.uk/20130129110402/http:/www.hm-treasury.gov.uk/d/control_framework_decc250311.pdf and https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/48244/3290-control-fwork-decc-levyfunded-spending.pdf

is underway to achieve this and move to a low carbon economy, stepping away from demand-led to competition-led schemes, while giving the renewables industry greater certainty over future support. In March 2016[3], the Government announced that the government will auction Contracts for Difference of up to £730 million this Parliament for up to 4 GigaWatts of offshore wind and other less established renewables[4], with a first auction of £290 million. Support for offshore wind will be capped initially at £105/MWh (in 2011-12 prices), falling to £85/MWh for projects commissioning by 2026.

6. As well as taking action to control costs since May 2015[5], the Department has taken steps to understand the reasons why the projected LCF spend increased, in particular between January and April 2015. The then Permanent Secretary asked one of the Department's Non-Executive Directors, Tom Kelly, to carry out a "lessons learned" exercise to look at the Department's treatment of assumptions that led to the projected overspend being identified. His final report[6] contained nine recommendations. The Department accepted his recommendations and developed an implementation plan to ensure their delivery, which has led to a significant improvement of the Department's forecasting ability and the overall management of the LCF. This includes:

- putting in place strengthened governance for the LCF to ensure there are LCF projections and reporting on projections and risks through to BEIS' Executive Boards (recommendations 2, 3 and 4);

- further improving the internal reporting and the quality of data these reports contain. This includes a more detailed understanding of the uncertainties associated with the projections. Each of the LCF models has been reviewed in accordance with BEIS' established principles and best practice for the quality assurance and audit of models and full assumptions logs for each of the LCF models have been completed (recommendations 3, 4 and 7);

- developing the Department's LCF models to allow more detailed scenario planning, a wider range of sensitivity analysis and a better understanding of uncertainty across the schemes (recommendations 4 and 7);

- ensuring transparency by publishing LCF projections routinely every six months by the OBR. These projections are presented in a way to ensure they do not reveal commercially-sensitive information. A comprehensive description of the LCF has also been published in the Consumer Funded Policies Report[7] to give greater transparency of the LCF projections as well as other BEIS levy scheme policies. The schemes are linked to BEIS' key

[3] https://www.gov.uk/government/publications/budget-2016-documents/budget-2016
[4] For delivery years 2020/21-2025/26
[5] Action taken since May 2015 has included closing the RO early to small scale solar, removing grandfathering for biomass conversions under the RO and introducing caps for future spend on FiTs. Other proposed action includes the early closure of the RO to onshore wind and the re-banding of RO PV solar.
[6] https://www.gov.uk/government/publications/levy-control-framework-lessons-learned-report-and-government-response
[7] https://www.gov.uk/government/publications/consumer-funded-policies-report

objectives, and publication of the Report enables Parliamentary scrutiny and stakeholder challenge (recommendations 1, 5 and 8);

- continuing to monitor the out-turn of actual deployment and generation. BEIS routinely publishes statistics on deployment on Feed-in-Tariff scale projects and Renewable Obligation generation. Data on Feed-in-Tariff spend and generation are collected by OfGem at a lag of 6-9 months (recommendations 3 and 4); and

- improving our methodology on load factors to better monitor technological improvements and using cohort-specific load factors for stations (e.g. updating assumptions for 'existing' and 'new build' plants more frequently). To inform these load factors, we draw on actual generation data, information from generators, developers and external reports. This evidence is then reviewed and assessed within BEIS by a range of specialists (recommendations 3 and 4).

7. The competitive process for awarding generic Contracts for Difference ensures that consumers benefit through lower strike prices where developers' load factor assumptions are higher than BEIS'. We have considered whether we should also introduce generation caps or a gain share mechanism to mitigate the LCF impact of higher load factors, and concluded that such an approach would not be deliverable for the next allocation round. We are looking at options for future rounds. (recommendation 6).

8. Mr Kelly's report cited the 2012 Caroline Mawhood Report on the Feed-in Tariff scheme between 2007 and 2011[8]. BEIS made progress in each of these areas through Head of Profession led improvements, corporate initiatives, and most recently through a 2015/16 change programme in the former DECC, focussed on further improving the way in which the Department works to deliver its objectives. Aspects of this change programme included strengthening the way information was managed, facilitating more effective prioritisation at all levels of the organisation, and ensuring that those prioritisation decisions were aligned with the Department's Single Departmental Plan[9] (recommendation 9).

[8] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/48487/6124-feedin-tariffs-lessons-for-the-future-report.pdf ,
[9] https://www.gov.uk/government/publications/decc-single-departmental-plan-2015-to-2020