



House of Commons  
Committee of Public Accounts

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# Early contracts for renewable electricity

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**Sixteenth Report of Session 2014–15**

*Report, together with the formal minutes  
relating to the report*

*Ordered by the House of Commons  
to be printed 10 September 2014*

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### Committee staff

The current staff of the Committee is Sarah Petit (Clerk), Claire Cozens (Committee Specialist), James McQuade (Senior Committee Assistant), Ian Blair, Sue Alexander and Jamie Mordue (Committee Assistants) and Janet Coull Trisic (Media Officer).

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## Summary

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By awarding early contracts worth up to £16.6 billion to eight renewable electricity generation projects without price competition, the Department of Energy and Climate Change (the Department) failed to adequately consider how to secure best value for consumers. In committing 58% of the total funds available for renewable contracts under these transitional arrangements, the Department has severely constrained the amount available to be awarded under new arrangements through price competition, reducing the opportunity to test the market and secure the best value for consumers. Under the terms of these contracts the Department failed to defend consumers' interest. For example, the risks associated with inflation will be met by consumers with inflation measured on the Consumer Prices Index. At the same time any benefit from excess profits will be retained by the developers as there are no claw-back clauses.

## Conclusions and recommendations

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1. In April 2014, the Department announced the award of contracts to eight renewable electricity projects under an early version of the new 'Contracts for Difference' scheme. Under the new scheme the Department fixes the price which renewable electricity generators can receive for each unit of electricity they produce (known as the 'strike price'). A newly formed 'Counterparty Body' will pay generators the difference between the market price and the strike price for the electricity they generate, where the strike price is higher. If the market price is higher than the strike price, generators will pay the difference to the Counterparty Body. The Counterparty recoups its costs from energy suppliers who in turn may pass on the cost to consumers, so the consumer picks up the bill. This scheme is replacing one which requires electricity suppliers to pay for Renewables Obligation Certificates which give renewable generators a premium over the wholesale price for each unit of electricity they supply, as the government's main method for supporting new renewable electricity generation. The Department awarded these eight early contracts to reduce the risk of a delay in investment in renewable electricity projects during the transition to the new scheme. Two of the contracts are for power plants converted from burning coal to biomass, five are for offshore wind farms and one is for a purpose built biomass plant providing heat as well as power.
2. **We are not satisfied that sufficient consideration was given to securing value for consumers during the transition from the existing arrangements to the new scheme.** To avoid a gap in investment during the transition from the Renewables Obligation scheme to the Contracts for Difference scheme, the Department decided to offer early contracts without price competition. The Department argued that the early contracts were necessary to ensure continued investment and that they provided better value. But its quantified economic case shows no clear net benefit from awarding early contracts compared to allowing competition when the main scheme comes into force in December 2014. It is not clear that choosing to award so many early contracts was the best way to secure value for consumers. As the Department recognises, competition under the main Contracts for Difference regime may well secure better prices and less cost to consumers than those set administratively under the transitional arrangements.

***Recommendation: Before embarking on future major reforms, the Department should consider fully its options for managing the process of transition, weighing up the impact on value for money of different types of transitional arrangements with different scales and durations.***

3. **Most of the budget available for contracts to be awarded under the new arrangements through price competition has already been spent on the early contracts awarded without price competition.** The Department has awarded 58% of its budget for renewable electricity projects from 2015-16 to 2020-21 on the eight early contracts agreed under transitional arrangements designed to prevent a gap in investment in renewable electricity generation. The Department maintains that these transitional arrangements have encouraged project developers to progress their projects and build supply chains to a point where the market may be ready for price

competition under the main Contracts for Difference scheme. But we are concerned that the Department has awarded 58% of the available budget to achieve this effect and that little now remains for the main competitive regime.

**Recommendation: *The Department must now seek to award the remaining funds using price competition.***

4. **The Department had no detailed knowledge and understanding of the developers' costs and estimates. They were too ready to accept arguments put forward by project developers that consumers should bear the risk of inflation in the prices they paid. The Department did not robustly challenge developers who claimed investment would be deferred if the contractors bore more of the risk of inflation. The Department also failed to challenge developers' claims that investors would not come forward if contracts were designed to ensure that consumers shared in higher than expected profits.** The early contracts include strike prices which are fully indexed to the Consumer Price Index (CPI), resulting in consumers rather than project developers bearing the risk of high inflation. The Department argued that this was necessary to avoid project developers demanding higher strike prices. The Department also decided not to include claw-back provisions which would have ensured that consumers shared in any excessive profits achieved by project developers, for example through re-financing gains. The Department asserted that including claw-back provisions would have made the projects 'uninvestable'. However, no evidence to substantiate these assertions was available and in our experience of reviewing public contracts, particularly PFI contracts, claw-back arrangements are essential to protect the interests of taxpayers and consumers.

**Recommendation: *For future Contracts for Difference, the Department should ensure it requires information from project developers on projects' costs and returns and includes contract clauses to allow it the opportunity to claw-back for consumers a share of any excessive profits.***

5. **The Department awarded these early contracts without clearly identifying how much capacity it needed from each technology to keep on track to meet its strategic objectives.** The Department awarded the early contracts to mitigate the risk of not meeting the 2020 renewable energy target and to support the development of renewable electricity. The Department's data shows significant new renewable generation capacity is in construction, awaiting construction, or seeking planning permission. It is not therefore clear that these early contracts were all necessary to meet the 2020 targets. It is also not clear why the Department awarded so many early contracts to offshore wind projects, when offshore wind is currently the most expensive technology to support and other cheaper technologies could be deployed instead. Its early decisions have pre-empted resources and constrained future choices. For example, biomass conversion of coal plants could be an effective way of delivering energy until the next generation of nuclear energy joins the grid.

**Recommendation: *The Department should ensure its future decisions on the budgets for support for different technologies and its process of allocating contracts are based on a clear understanding of how best to achieve the balance of***

*technologies required to meet its strategic objectives at least cost for consumers. In the event of a capacity crunch, clearly consumers will end up paying more.*

6. **The Department awarded these early contracts on the basis of wider benefits which it considered outweighed risks to value for money.** The Department went ahead with the early contracts because it expected them to achieve wider benefits, on which it could not put a monetary value. The Department argued that there would be benefits to the renewable electricity supply chain, that it was necessary to show the new system could work and that early investment was required to meet the 2020 targets. The Department proposes to conduct an evaluation of the benefits from these early contracts.

**Recommendation:** *The Department should ensure it conducts and publishes a robust evaluation of the actual benefits and costs of this scheme. This evaluation should assess the quantified and unquantified costs and benefits against the Department's business case for the scheme and make an evidenced assessment of what it has achieved and whether awarding early contracts has genuinely been worthwhile.*

7. **The government owned Counterparty Body will play a crucial role in protecting consumers' interests.** The Counterparty Body will need to actively manage contracts, to ensure claims for increases in strike prices are reasonable, to identify and apply reductions in strike prices, and to calculate who needs to be paid what and organise those payments. The Counterparty Body should also monitor information from project developers on projects' costs and returns to determine whether returns are reasonable with a view to introducing claw-back clauses in new contracts if there are excessive profits. The Department is in the process of setting up the Counterparty Body. It has appointed a Chair and is in the process of recruiting staff.

**Recommendation:** *The Department must ensure the Counterparty Body is wholly independent of the industry and has the skills, resources and information it needs to manage all Contracts for Difference effectively and hold it to account for ensuring that the interests of consumers are fully protected.*

# 1 The need for early contracts

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1. On the basis of a Report by the Comptroller and Auditor General<sup>1</sup>, we took evidence from the Department of Energy and Climate Change (the Department) on early contracts for renewable electricity. In April 2014, the Department announced the award of contracts to eight renewable electricity projects.<sup>2</sup> These contracts are early ‘Contracts for Difference’ under which the Department fixes the price which renewable electricity generators can receive for each unit of electricity they produce, known as the ‘strike price’.<sup>3</sup> The Contracts for Difference scheme replaces the Renewables Obligation as the Government’s main approach to securing new renewable electricity generation. Unlike the Renewables Obligation which allows all eligible projects to receive support at a fixed rate set by the Department, the Contracts for Difference scheme enables the Department to limit the number and scale of projects receiving support and to allow price competition for contracts.<sup>4</sup> The Department awarded eight early contracts which could in total cost consumers some £16.6 billion over the 12 to 15 year terms of the contracts.<sup>5</sup>

2. The Department launched the selection process to award early Contracts for Difference to renewable electricity generation projects in March 2013, to address the risk of a hiatus in investment in renewable electricity generation during the transition to the main Contracts for Difference scheme, now expected in late 2014.<sup>6</sup> The Department told us that it had considered a number of alternatives to awarding early contracts. It decided in 2011, following discussions with project developers, that doing nothing other than continuing to make the Renewables Obligation available to new entrants to April 2017 would be insufficient to address the uncertainty for investors and the potential investment hiatus. A large number of project developers had suggested extending the Renewables Obligation from 2017 to 2020.<sup>7</sup> The Department told us that it had also considered offering “letters of comfort” that might reassure project developers that their projects would be eligible to apply for a contract in due course. However, its discussions with project developers indicated that full early contracts were necessary for investment to continue.<sup>8</sup>

3. The Department’s economic analysis showed no financial benefit from proceeding to award contracts early, compared to scenarios where the same projects were delayed, and so went ahead under the main Contracts for Difference regime, or were cancelled. The Department explained that it went ahead with the early contracts because it expected them to achieve wider benefits on which it could not put a monetary value<sup>9</sup> including demonstrating the operability of the contracts, mitigating the risk of the UK not meeting

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1 [C&AG’s Report, \*Early contracts for renewable electricity\*, Session 2014-15, HC 172, 27 June 2014](#)

2 [C&AG’s Report, para 1.9](#)

3 [C&AG’s Report, para 1.5](#)

4 [C&AG’s Report, paras 1.6, 3.31](#)

5 [C&AG’s Report, para 1.10](#)

6 [C&AG’s Report, para 1.4](#)

7 [Q 10](#)

8 [Qq 5-11](#)

9 [Qq 95-97](#)



its 2020 EU renewable energy target, and benefits to the renewable electricity supply chain.<sup>10</sup>

4. The Department noted that some of the wider benefits from awarding early contracts were already emerging. It told us that early contracts for offshore wind projects had helped to secure planned investment by Siemens in new wind turbine production facilities in Hull, with knock on effects beyond the Humber region. The Department also noted that Drax, which has received an early contract for one of its biomass conversion units, is also investing in the supply chain and has arranged for the design of new train wagons from UK-based companies.<sup>11</sup> The Department told us it estimated that the early contracts would support 8,500 jobs in and outside the UK, based on project developers' application information and the Department's own wider industry knowledge. The Department expected to monitor actual jobs supported within its evaluation of the early contracts, in liaison with the Department for Business, Innovation and Skills, UK Trade and Investment and project developers.<sup>12</sup>

5. The Department considered that it had needed to move quickly to meet its legally binding renewable energy and greenhouse gas emissions targets. Although it had made good progress on increasing renewable electricity to meet the UK's EU target to produce 15% of its energy from renewable sources by 2020 and it had hit its interim target in 2011-12, the UK has to do better to meet the next interim target.<sup>13</sup> The Department also noted that the UK's EU renewable energy target is for electricity, vehicles and heat. As a result, any underperformance in either heat or vehicles would require more electricity from renewable sources to make up the shortfall. The Department also emphasised that action was needed now to meet challenging long-term targets. The Climate Change Act 2008 target to cut greenhouse gases by 80% by 2050 requires the complete decarbonisation of the electricity sector in the long-term.<sup>14</sup> The Department's data on renewable electricity projects which are under construction, awaiting construction or seeking planning permission suggests there could be much more new renewable generation capacity than is needed to meet the 2020 target. However the Department considered this capacity may not all be built so early contracts were important for supporting the continued development of the renewables industry.<sup>15</sup>

6. The eight early contracts will take up 58% of the budget for all renewable contracts for the period 2015-16 to 2020-21.<sup>16</sup> The Department agreed that if less funding had been devoted to the transitional regime then more would be available for the competitive regime that it is now intending to apply.<sup>17</sup> The Department told us it was currently assessing the demand for future contracts from different renewable electricity projects and the budgets which it would allocate, and it planned to move to competition for all technologies as

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10 [Q 163](#)

11 [Qq 80, 81, 99](#)

12 [Q 189; Department of Energy & Climate Change written evidence](#)

13 [Qq 187-188](#)

14 [Q 72](#)

15 [Q 188](#)

16 [C&AG's Report, para 3.11](#)

17 [Q 52](#)

quickly as possible.<sup>18</sup> It said that without awarding early contracts on this scale it would not have been able to move so quickly to price competition. The Department maintains that its transitional arrangements have encouraged other project developers to progress their projects and build supply chains to a point where the market may be ready for price competition under the main Contracts for Difference scheme. The Department noted, in particular, that they were on track to move faster than anywhere else in the world to compete for offshore wind.<sup>19</sup>

## 2 Protecting the interests of consumers

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7. The Department considered that the early contracts provided inherently better value for consumers than the Renewables Obligation because the Department had set lower strike prices to reflect the lower cost of financing projects with a Contract for Difference.<sup>20</sup> The Department noted that it wanted as many projects to be supported through a Contract for Difference rather than the Renewables Obligation as quickly as possible. The Department had estimated that awarding early contracts to the eight projects would save consumers £2 billion compared to the cost of supporting these projects through the Renewables Obligation.<sup>21</sup> However, only two of the eight projects have target commissioning dates before 2017, so the other six projects might well not have been commissioned in time to have been eligible for the Renewables Obligation, unless it had been extended.<sup>22</sup>

8. The Department recognised that competition was likely to drive better prices for consumers, but it did not believe that it could have gone straight to competition for the early contracts.<sup>23</sup> In particular it did not believe the market for offshore wind was mature enough.<sup>24</sup> Accordingly, it had established a transitional system where the strike prices were administratively set. The Department did not negotiate strike prices with individual projects or attempt to investigate individual projects' costs and returns before it awarded the contracts.<sup>25</sup> The Department told us that the administrative prices had been underpinned by an extensive process in 2011 and 2012 to establish, with external expert input, the long-run costs of renewable technologies.<sup>26</sup> The Department stated that the UK administrative strike prices for offshore wind were lower than prices elsewhere in the world.<sup>27</sup> It accepted that its administrative price setting process meant that some projects might get a greater return than they potentially needed from those prices, but noted that when it released the administrative strike prices in 2013 some project developers had

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18 [Q 122](#)

19 [Qq 52-57, 163](#)

20 [Qq 34, 133](#)

21 [Qq 12-18](#)

22 [C&AG's Report, figure 1](#)

23 [Q 49](#)

24 [Qq 49, 51, 56, 71](#)

25 [C&AG's Report, paras 14, 3.28](#)

26 [Q 24](#)

27 [Q 45](#)

walked away on the grounds that they had not been sufficient to support their offshore wind projects.<sup>28</sup>

9. The Department noted that the UK needed to have a diverse set of generating assets and technologies to decarbonise the electricity sector and said that it was aiming to meet the target at minimum cost to consumers.<sup>29</sup> The Department has set caps on the combined cost of consumer funded schemes which support the development of renewable and other low carbon electricity generation, such as the Renewables Obligation, the Financial Investment Decision enabling for Renewables scheme and Contracts for Difference. The Department caps these schemes through a mechanism known as the 'Levy Control Framework' so that consumers are protected from the cost of supporting renewable electricity rising beyond pre-determined limits.<sup>30</sup> However setting caps does not in itself ensure consumers get the optimum value for money.

10. The Department told us that it had designed the selection process for the early contracts to support a mix of technologies. Five of the early contracts awards were for offshore wind, which at a strike price of £150 per megawatt-hour was significantly more expensive than both onshore wind and nuclear at £95 and £89.50 per megawatt-hour respectively.<sup>31</sup> The Department agreed that biomass conversions were cheaper to support than offshore wind projects and were a good reliable source of renewable electricity. The Department noted that it regarded biomass as a transitional source of renewable electricity, because biomass only reduces carbon emissions by 68% compared to coal, thus providing a lower level of carbon savings than offshore wind to meet long-term decarbonisation targets. The Department hoped that carbon capture and storage on gas or coal plants would be part of the mix, but at present this was considered to be the most expensive.<sup>32</sup>

11. The Department told us that the lengthy process of negotiating the terms of the early contracts, involving a great many advisers and conversations with multiple project developers, had in a sense been market testing of the contract.<sup>33</sup> The early contracts protect consumers by only providing the strike price for electricity produced and paying no compensation to project developers who cannot deliver their projects, for example, because they fail to obtain planning consent.<sup>34</sup> The contracts do not penalise project developers for not delivering the planned capacity, but do require them to come back with revised capacity figures within a year of receiving a contract so the allocated funding can be released for other projects.<sup>35</sup>

12. The early contracts' strike prices are indexed to the Consumer Price Index (CPI) rather than the Retail Price Index used in the Renewables Obligation scheme.<sup>36</sup> The Department

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28 [Qq 155, 58](#)

29 [Qq 70-72](#)

30 [Q 171](#)

31 [Q 70](#)

32 [Qq 80-81](#)

33 [Q 143](#)

34 [Qq 115, 137](#)

35 [Q 138](#)

36 [Q 29](#)

told us that project developers would have demanded higher administrative strike prices had they not been linked to inflation.<sup>37</sup> The Department considered that renewable generation projects were fragile and that passing inflation cost pressures through to consumers rather than project developers had improved the chances of projects going ahead.<sup>38</sup>

13. The Department received representations that claw-back provisions should be included in the contracts to allow consumers to share in any excessive profits. However, the Department decided not to do this as project developers had repeatedly maintained that including claw-back clauses would have been a “red light” for them, something confirmed by independent financial advisers consulted by the Department.<sup>39</sup>

14. We asked the Department what consideration they had given to a claw-back clause for any re-financing gains. The Department considered that such a clause would have made the contracts ‘uninvestable’. The Treasury agreed with the Department’s judgement on this but noted that there was a difference in the risks involved between the first contracts let and those let further into a programme.<sup>40</sup> The Department promised to give further thought to how it should address the potential for project developers to make large refinancing gains through Contracts for Difference.<sup>41</sup>

15. The government owned Counterparty Body will need to actively manage contracts, to ensure claims for increases in strike prices are reasonable, to identify and apply reductions in strike prices, and to calculate who needs to be paid what and organise those payments. The Counterparty Body will also need to ensure that generators record and report their output accurately to protect consumers from paying for more output than is actually provided. For claw-back arrangements to operate effectively, contracts would need to include requirements on project developers to supply information to government on their actual costs and returns. This information would then need to be scrutinised by staff with appropriate expertise. The Department told us that it had recruited a Chair and was in the process of appointing a Chief Executive for the Counterparty Body which will have an independent board, and whose costs will be met by consumers through the Levy Control Framework.<sup>42</sup>

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37 [Q 21](#)

38 [Q 33](#)

39 [Qq 66-69](#)

40 [Qq 87-90](#)

41 [Q 84](#)

42 [Q 180](#)

# Formal Minutes

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**Wednesday 10 September 2014**

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon	Meg Hillier
David Burrowes	Mr Stewart Jackson
Jackie Doyle-Price	Austin Mitchell
Chris Heaton-Harris	Nick Smith

Draft Report (Early contracts for renewable electricity), proposed by the Chair, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 15 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

*Resolved*, That the Report be the Sixteenth Report of the Committee to the House.

*Ordered*, That the Chair make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 13 October at 3.00 pm]

## Witnesses

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The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at [www.parliament.uk/pubaccom](http://www.parliament.uk/pubaccom).

**Wednesday 2 July 2014**

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**Stephen Lovegrove**, Permanent Secretary; **Hugh McNeal**, Director, Office for Renewable Energy Deployment; **Hugo Robson**, Commercial Director, SRO for FID Enabling for Renewables; and **Simon Virley**, Director General, Markets and Infrastructure, Department of Energy and Climate Change

[Q1-189](#)

## Published written evidence

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The following written evidence was received and can be viewed on the Committee's inquiry web page at [www.parliament.uk/pubaccom](http://www.parliament.uk/pubaccom). REN numbers are generated by the evidence processing system and so may not be complete.

- 1 Department For Energy And Climate Change ([REN0001](#))
- 2 Solar Trade Association ([REN0002](#))

## List of Reports from the Committee during the current Parliament

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The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

### Session 2014–15

First Report	Personal Independence Payment	HC 280
Second Report	Help to Buy equity loans	HC 281
Third Report	Tax reliefs	HC 282
Fourth Report	Monitor: regulating NHS Foundation Trusts	HC 407
Fifth Report	Infrastructure investment: impact on consumer bills	HC 406
Sixth Report	Adult social care in England	HC 518
Seventh Report	Managing debt owed to central government	HC 555
Eighth Report	Crossrail	HC 574
Ninth Report	Whistleblowing	HC 593
Tenth Report	Major Projects Authority	HC 147
Eleventh Report	Army 2020	HC 104
Twelfth Report	Update on preparations for smart metering	HC 103
Thirteenth Report	Local government funding: assurance to Parliament	HC 456
Fourteenth Report	DEFRA: oversight of three PFI waste projects	HC 106
Fifteenth Report	Maintaining strategic infrastructure: roads	HC 105