Public Accounts Committee

Oral evidence: Early contracts for renewable electricity, HC 454-i

Wednesday 2 July 2014

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Members present: Margaret Hodge (Chair); Mr Richard Bacon; Mr David Burrowes; Jackie Doyle-Price; Chris Heaton-Harris; Meg Hillier; Stewart Jackson; Andrea Leadsom; Mrs Anne McGuire; Austin Mitchell; John Pugh; Justin Tomlinson

Sir Amyas Morse, Comptroller and Auditor General, National Audit Office; Gabrielle Cohen, Assistant Auditor General, NAO; Jill Goldsmith, Director, NAO; and Richard Brown, Treasury Officer of Accounts, HM Treasury, were in attendance.

Witnesses: 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, gave evidence.

Chair: Welcome. Can I formally welcome Richard Brown to his first meeting here as with us as the Treasury Officer of Accounts? We might be throwing one or two questions your way today, so I hope that is all right with you. Can I also welcome Andrea Leadsom, our new Minister, who I hope reads some of our Reports? Andrea, I will give you an opportunity to say something at the beginning.

Andrea Leadsom: There are three brief points I want to make, if I may. First, I wanted to congratulate the Committee because it builds on a very long tradition of ensuring value for money. As a Treasury Minister, I fully support your role and I certainly agree that we should work together to deliver better value for money in all areas of Government expenditure. And many congratulations because, as I understand it, 90% of the recommendations made by the Committee are followed through by Government Departments. I am sure that you are also aware of that statistic.

Chair: I think, if you hear the hearing today, there will be some frustration that not enough learning takes place, but we welcome that.

Andrea Leadsom: Good, thank you.

My second point is that I am sure the Committee knows that Departments already respond on whether they will accept or reject Committee recommendations through a Treasury minute and annually through a Treasury minute update. For your information, the Treasury enforces this quite strictly, as we certainly take the Committee's recommendations very seriously and accept them in the majority of cases. Of course, the National Audit Office also carries out follow-up studies, in part to check progress with implementing Committee recommendations, and these reports are placed before the Committee. I think all of that accountability is incredibly important.

My third and final point is that I entirely agree that the Treasury should increase the transparency of public spending information. That way we can improve accountability to the House and to the general public, while generating value for money and delivering on our programme for efficiency. I certainly welcome the NAO's recognition of the Treasury's continuing commitment to improving whole of government accounts, in terms of timeliness and content. The Treasury has taken steps to make the disclosures in whole of government accounts more detailed and transparent, hopefully to the benefit of the general public.

Chair: Thank you for that and we look forward to continued co-operation. I think we have got the permanent secretary in front of us on Monday next week to talk about some of these issues; how we can use the centre and particularly the Treasury to enhance the impact of some of the recommendations that we make here and have that shared learning, so thank you very much.

Mr Bacon: Chair, may I point out, while so many congratulations are flying around, that congratulations are due to you as the new "tax personality of the year"? That is an oxymoron, by the way.

Q1 Chair: The same people called me "tax prat of the year" last year, but thank you very much indeed, Richard.

Right, on to the hearing: who is in charge of this one, who is the accountable person out of you four—the actual person who is taking all the decisions?

Stephen Lovegrove: I am the accounting officer.

Q2 Chair: Who is the actual person who is taking all the decisions?

Stephen Lovegrove: The decisions are obviously made through a variety of the Government's mechanisms in the Department, but Hugo Robson is the senior responsible officer for FID Enabling for Renewables.

Q3 Chair: You are the person and you have been working on this programme for—

Hugo Robson: Since 2011.

Q4 Chair: Since 2011. So you are the senior responsible officer?

Hugo Robson: Since July 2011, correct.

Q5 Chair: Can I start by saying that you set this programme up to deal with investor uncertainty—that was the rationale for it? Can I ask you what alternatives you looked at to prevent a loss of investor confidence? What were the other alternatives, apart from this, that you examined before you settled on this one?

Hugo Robson: In July 2011, when the White Paper was published in relation to electricity market reform, we recognised at that point that there was a potential for a hiatus of investment leading through to the set up of the enduring regime in 2014. At that point, there was at least a three-year gap before—

Q6 Chair: Can you answer the question. What alternatives? I understand the rationale for doing it. What were the alternatives that you examined?

Hugo Robson: We looked at a number of alternatives—

Q7 Chair: What?

Hugo Robson: Which included, for example, giving letters of comfort to generators, in terms of giving them comfort that we were moving towards a—

Q8 Chair: Money?

Hugo Robson: In terms of an enduring regime and the CfD—that was at one level.

Q9 Chair: Sorry, I don't understand those—

Hugo Robson: What electricity market reform is about, in terms of putting a contract for difference in place—what generators and developers did not know back in 2011 was precisely what form that CfD would take. The contract had obviously not been drafted at that point. It was a concept at that point in this process.

Q10 Chair: I understand that. I'll ask you the question again. I understand there was uncertainty in the market because we were moving to a new system. The purpose of this particular scheme, of which I have to admit I think many of us are very sceptical, was to deal with a hiatus. I am trying to get out of you what alternatives you looked at apart from this scheme to try to deal with what you thought was investor uncertainty.

Hugo Robson: Clearly, one possibility was a do nothing scenario, which is to wait for the enduring regime. That was not considered satisfactory because we were very concerned it would create a hiatus of investment. At the other end of the scale was talking to developers and working with them, which we were doing anyway in relation to putting together electricity market reform and developing the contracts for difference. It was very much a case of working with developers in terms of what they were going to need. At one point, we considered that we would potentially not have to offer a full contract. But it quickly became clear that, for people to have the confidence to move forward, we would need to offer an investment contract, which is effectively the same thing as a CfD. The contracts we have signed—the 8 investment contracts—are essentially the same instrument as a CfD, but just an earlier form.

Q11 Chair: My understanding, from that answer, is that you looked at doing nothing and decided you couldn't. I don't quite understand that, but we will come back to it. You then negotiated, in effect, with the suppliers to find a scheme they thought was satisfactory. Am I putting words in your mouth?

Hugo Robson: It was not a case of negotiating a scheme, in terms of moving forward with and developing the contracts for difference. Initially, when there was the uncertainty in 2011, a large number of developers actually thought the alternative route, in terms of avoiding a hiatus of investment, was to extend the existence of the RO through to 2020.

Q12 Chair: That brings me neatly on to my next question. It would be really helpful if you didn't use—

Mr Bacon: TLAs: three letter acronyms.

Chair: Thank you.

The renewables obligation is open until April 2017—six years. Why was that not enough? Why, in your assessment, did it need any interim scheme?

Simon Virley: Could I pick that up?

Q13 Chair: Why you?

Simon Virley: Because I was chairing the work on electricity market reform at the time so can perhaps elaborate on what Hugo said. We were, of course, thinking in 2010 about how to improve value for money for consumers and had come to the view that we could do that by moving to a new regime and away from the renewables obligation, which was the previous regime.

Q14 Chair: I think we understand that. Just answer the questions, because we have loads of questions for you.

Simon Virley: One option was to just stick with the renewables obligation, which we discarded. It then became a question of how we transitioned to a more cost-effective regime. We discussed whether we could move straight to competition and didn't think we could move straight to competitively allocated—

Q15 Chair: I repeat my question. They can use the renewables obligation until April 2017. Why was six years not enough for them to move to the new regime without a hiatus and without having to introduce an interim system—in other words, move to full competition, which you are now not having?

Simon Virley: We are going to be moving towards competition.

Q16 Chair: Very little, because you've spent most of the money. Anyway, we'll come on to that.

Simon Virley: The answer to your question is that we wanted to move people as quickly as possible out of the renewables obligation.

Q17 Chair: Why was six years not enough? They knew in 2011 that you wanted to move to contracts for difference. They have—you are frowning, so I might have misunderstood this—until April 2017 to commission new schemes under the renewables obligation. That is six years. Why was that not enough to prepare for the transition?

Simon Virley: Because I think it was beneficial to consumers to get as many of those projects into the new regime as quickly as possible, and that is what the transitional arrangements helped to do.

Q18 Chris Heaton-Harris: Was it anything to do with state aid as well, because under European law you have 11 years where you can have this sort of subsidy before you run into state aid issues, and the renewables obligation, I think, overran by a tiny bit of time? Were you not worried about the state aid issues?

Simon Virley: No, it was a decision made on the basis of how we could best meet our legally binding obligations in a way that was the most cost-effective for consumers. I think we have provided figures showing that for the eight projects we are now taking forward, we are saving something like £2 billion-worth of support costs. That is about a 17% reduction in costs to consumers over the lifetime of those projects.

Q19 Chris Heaton-Harris: How do you know that, because the Report says you do not actually know what the costs of any of these projects are? You have no sight over any of the transactions that go on to build a project up; you have got no idea of what the costs to the developer are. So how can you say that?

Simon Virley: Those are on the best estimates of what we think the support costs are going to be.

Q20 Chris Heaton-Harris: So it is a best estimate of what you are saving the consumer?

Simon Virley: Yes.

Q21 Chair: We will come back to that. Littered through the Report are references to the contractors and the consumers. I think the one that offended me the most was when you say you were looking after the interests of consumers on page 38, paragraph 3.20. As part of your developing the new scheme and bringing in an inflation index, you say there that, "The Department allowed inflation indexation because consumers are thought to be better placed to absorb the impact of high inflation than generators." I just want to think how on earth you can justify those extra costs to my constituents. I think you should come and face them, and tell them that you think that looking after the generators was more important than looking after their interests. Right the way through this Report, the idea that the consumer interest was uppermost in your mind just does not shine through.

Hugo Robson: If I could make a point on that, in terms of the inflation indexation, it is this: had we not had any indexation, the prices here would have been significantly higher. One of the benefits of being able to have indexation is that you can keep the up-front costs, in terms of the contract for difference. So the prices of £150 and £140 a megawatt are for the offshore wind, and they would not have been at prices that we could have had if we had had no indexation at all. Therefore, the consumer—

Q22 Chair: How do you know? We are back to Chris's point—how do you know that?

Hugo Robson: Because it is a basis on which you look at the potential returns on the projects, and the potential returns on the projects are either looked at on an inflation basis or a real basis. So, ultimately the developer will be looking to get—

Q23 Chair: But you don't know the costs, because you have not asked.

Hugo Robson: We do know the costs of typical projects, so we—

Q24 Chair: You don't. How do you know? You haven't asked. You didn't ask for that information. You didn't even protect consumers by having the courtesy of actually investigating the real costs.

Simon Virley: Well, there was an extensive process in 2011 and 2012 to try to understand the so-called levelised costs, the long-run costs of these technologies, and that work was all done with the support of external experts and published at the end of 2012.

Q25 Chris Heaton-Harris: Were any of the external experts from outside the industry itself?

Simon Virley: Yes.

Q26 Chris Heaton-Harris: I do not expect you to have that information here, but if you could give us a note on who they might have been, that would be great.

Simon Virley: Certainly.

Q27 Mr Bacon: Why did the Department think that, in the words of the Report, "consumers are thought to be better placed to absorb the impact of high inflation than generators"?

Hugo Robson: It is not high inflation—

Q28 Mr Bacon: I am just reading from the Report, which is an agreed Report. It says, and the Chair has already quoted this, "consumers are thought to be better placed to absorb the impact of high inflation than generators". Why did you come to the conclusion that "consumers are thought to be better placed to absorb the impact of high inflation than generators"?

Hugo Robson: I would have preferred to have deleted the pejorative word, "high", and called it, "better placed to deal with—"

Q29 Mr Bacon: I did not ask you which words you would like to have deleted. Mr Robson, we do not have a huge amount of time and we have a lot to cover, so instead of redrafting the Report for us, because it is an agreed Report, could you just answer the question? Why did you think that "consumers are…better placed to absorb the impact"—that is, the impact of costs going up—"than generators"?

Hugo Robson: With the costs, in any case we were looking at an existing renewables obligation scheme, which is index-linked to RPI. The move into the contract for difference was also looking at preserving that indexation for generators. We introduced it to consumer price indexation as opposed to retail price indexation. We think that is a good indicator of what general inflation within the country is.

Q30 Mr Bacon: You are talking about indexes—or I should say indices—but you are not answering my question. I don't want to put words into your mouth, but I may have to. The answer should be, "We thought consumers were better placed than generators to absorb the impact of high inflation because—" and then you finish the sentence. Why did you think consumers were better placed than generators to absorb the impact of costs going up?

Hugo Robson: I would say again I'm afraid that I believe that consumers are well placed.

Q31 Mr Bacon: I am not asking you whether they are well or badly placed. The sentence compares and contrasts—on the one hand consumers, on the other hand generators. It says that consumers are better placed than generators.

Stephen Lovegrove: Mr Bacon, may I have a stab?

Q32 Mr Bacon: You may have a crack at it.

Stephen Lovegrove: Obviously, in any industry, ultimately higher costs are going to be passed through to the end consumer where they can be—

Q33 Mr Bacon: Not necessarily. You might have permanently lower profits. There are lots of possible answers to that. You used the word "obviously" and it is not obvious. You might have permanently low profits.

Stephen Lovegrove: In the vast majority of industries where there are higher costs, those get picked up ultimately by the end consumer. That is the case certainly in energy, famously so. We know that higher energy costs have been passed through to the consumer. There has been a great deal of debate about that. This kind of project is quite fragile. The judgment of the Department was that allowing the normal mechanism of passing that kind of cost pressure through to consumers would be safer for the projects to go ahead at all, than to ask the developers to carry it.

If we had asked the developers to carry it, consumers would have had another type of deleterious effect, which is that the consumers would have had to price in the risk in a way that meant that the strike price would have had to have gone up. On the one hand, you can argue that the consumers are exposed to price indexation; on the other hand, you can say that they are protected from the higher strike prices that the developers inevitably would have charged for these businesses.

Q34 Chair: That would all work if I and other Committee members had confidence that you were negotiating on our behalf the best strike price. To take the issue of indexation, most of these developers were borrowing. We have seen it on PFI contracts. That is the frustration of this Committee; we have seen it on endless contracts. We actually saw it on the electricity transmission contracts, which we had as an early issue coming out of DECC before you were in post.

In this particular one, they borrow at fixed interest rates, as far as I can tell, so there is not an automatic inflation built into their borrowing for developing this capability in the electricity market. Yet they get this added bonus from their investment of inflation guaranteed, while my constituents have to pick up the tab in a regressive form of taxation that impacts on them perhaps more than others. I see no justification in a situation where you do not have sight of the costs and benefits. You don't have it; it says so in the Report. You know they are borrowing at fixed interest rates. They automatically get a rise on inflation because you want to protect their interests more than those of consumers in our constituencies. I don't get it, and we do not have that confidence in you, I'm afraid.

Stephen Lovegrove: The whole move to the contract for difference type of support mechanism for these renewable technologies is in a sense designed to protect consumers. They are demonstrably, as the Report says, better value because the cost of financing them is considerably lower.

Q35 Mr Bacon: Because they are so low risk. They are already amazingly low risk. The whole purpose of this is to create an environment of certainty for the investors, isn't it?

Stephen Lovegrove: It is to create an environment in which investors can get a return. It is not to over-compensate investors; it is to create an environment in which developers can develop projects that we need to meet our legally binding climate change obligations.

Q36 Austin Mitchell: There is no money left over. You've doled out 50%, so that's not creating a sustainable environment for other people.

Stephen Lovegrove: There is money left over.

Q37 Chris Heaton-Harris: There is an odd thing on this, looking at the consumer. Throughout this process, was an estimate done of how many extra people might be pushed into fuel poverty because of these decisions?

Simon Virley: Not specifically in terms of this programme's impact on fuel poverty, but the overall impact of DECC's policies on fuel poverty has been assessed.

Q38 Chris Heaton-Harris: But that is the assessment that says that there is a benefit to people, but only if they buy a new washing machine or fridge freezer—white goods that the poorest in society cannot necessarily afford. I am interested in this project, because if you are looking at what is going to be best for the consumer, surely you think that you are going to be guaranteeing a lump of money here and the consumer—the person in paragraph 3.20—is going to be paying. How much would that be for the consumer? How is it going to reflect on people's bills?

Hugo Robson: All I can say is that we looked at what prices we would need to be offering in the event that we did not have any indexation. They were considerably higher than the prices here. With indexation, the prices are lower at this point. Yes, we did look at the effect on what the price would be.

Q39 Chris Heaton-Harris: So you had specific meetings about fuel poverty and the cost to consumers?

Hugo Robson: Sorry, I am just saying that naturally the effect of higher prices—

Q40 Chris Heaton-Harris: I know what you are saying, because the answer is obviously no, you didn't look at the effect on consumers and how many people would be pushed into fuel poverty.

Simon Virley: The answer I gave earlier is that for the eight projects we signed up, we think we have saved about £2 billion-worth of support costs.

Q41 Chair: You think?

Simon Virley: That is about a 17% reduction.

Q42 Chris Heaton-Harris: You know you can't quantify that.

Simon Virley: Well, that is our best estimate.

Q43 Mr Bacon: Without understanding the costs of the project?

Simon Virley: You have to make a best estimate of what you think the costs will be.

Mr Bacon: When you say you have to, what you could have done is mandate that you understand the costs of the project, otherwise you don't get any subsidy, strike price or support.

Q44 Chris Heaton-Harris: Paragraph 3.18 says that in 2013 "NERA analysis for the Department showed that investors in similar renewable electricity projects elsewhere in Europe had accepted lower returns." So elsewhere in Europe, there are people looking at these projects in slightly different ways and negotiating in a slightly different fashion. Is that a fair thing to say?

Hugh McNeal: That is not true for the prices for offshore wind. Sorry, I know the Report is agreed.

Q45 Chair: Well then, why did you agree that paragraph of the Report?

Hugh McNeal: I will try to think of a way of saying that. The point about prices for offshore wind in Europe and elsewhere in the world is that in Japan they pay approximately double what we are paying—this is independent analysis from Bloomberg New Energy Finance, not from the Department—in France they are paying about a third more and other European countries are paying similar rates to what we are paying now, but we are at the bottom end when we move to the £140 strike price. Our projects are in deeper water than those in some of the other European countries.

Q46 Chair: You are taking about offshore, but I have the article in the *FT* about nuclear, about which you have had a 68-page initial assessment. The article says: "The commission questions whether the deal addresses a genuine market failure and suggests the terms will overpay EDF, shield it from almost all operational risk and crowd out alternative sources of energy supply."

Simon Virley: The deal on nuclear—I assume it is referring to the Hinkley Point project—is currently being considered by the European Commission through the state aid process. It put out the questions it wants us to answer, and we have answered those points.

Q47 Chair: A 68-page initial assessment?

Simon Virley: We have responded with evidence to the effect. So the strike price for nuclear from the Hinkley contract, as you will be aware, is £89.50 per MWh. That compares favourably with some of the renewable technologies that are currently more expensive; but we hope to get down in terms of costs as the scale of those industries builds up.

Q48 Chair: And what they say is potentially wasting up to £17.6 billion of taxpayers' support on the plant.

Simon Virley: We don't agree with that view. We have provided robust evidence to challenge it.

Q49 Chair: I shall be amazed. I bet it is right.

Sir Amyas Morse: May I just make a couple of points referring back to the conversation we were just having? The saving that you rightly quote is by comparing the old RO-X regime with a transitional regime. It does not compare what you might have achieved if you had not let as many of these transitional regime contracts and subjected more to competition, of course. That is true. I think it is worth just making that point.

On the question of inflation, it is quite true in my view, and worth saying to the Committee, that if you are constructing assets over a period of time then inflation will operate on the input costs of those assets. That is quite true. I can understand that you wanted to protect these companies from having inflation because it would have driven a higher price. The other bit about consumers being more able to is the more unfortunate leg of the equation, but I understand that inflation is bound to operate on the underlying costs. It is just worth reminding the Committee of that.

Stephen Lovegrove: May I respond to the first part of that observation? It is, of course, true that when the market is more mature, competition is likely to drive better prices for consumers. There is no doubt about that. We don't believe—we didn't believe then and don't believe now—that it was a tenable position to adopt that we could go straight to competition.

Q50 Chair: Why?

Stephen Lovegrove: Because the technologies, the developers were all too immature to be in a position where we felt that we could go straight to a competitive allocation.

Q51 Chris Heaton-Harris: How long has offshore wind been producing energy for the United Kingdom?

Stephen Lovegrove: I don't know about that. These are vastly bigger projects. They are very different from your standard PFI contract and very different from—

Q52 Chair: Which? is hardly a lefty organisation. They think, on the offshore wind, you should be competing now.

Sir Amyas Morse: Can I just be clear? I was not suggesting that there shouldn't be a transitional regime. I am sorry if I gave you that impression mistakenly. I was saying that if less funding had been devoted to the transitional regime then more would have fallen into the competitive regime that you are now intending to apply.

Stephen Lovegrove: That is self-evidently true.

Sir Amyas Morse: Good.

Stephen Lovegrove: However, we do not believe that we would have been able to move so quickly to a competitive regime if we had not had this scale of transitional regime.

Chair: Chris, do you want to come back on the offshore stuff?

Q53 Chris Heaton-Harris: I think it is paragraph 3.7 which says: "it is not clear that the full scale of these commitments was needed so soon".

Hugh McNeal: The answer, just in terms of the detail of where we might be this autumn, to answer the question about competition, is that to take an offshore wind project and to meet the criteria to be eligible for a contract, whether it is competed for or not competed for, costs tens of millions of pounds.

Q54 Chris Heaton-Harris: Do you know that for a fact?

Hugh McNeal: Yes. It is to do with all of the surveys that must be done. It is to do with the surveys around birds, mammals and we can do you a note on that. The question is where are we now in terms of where we might have been without FIDeR? Without going into commercial confidences, there are perhaps up to seven offshore wind farms that might be looking for a CfD this autumn. Of those seven, five have been part of this process. Of the two that have not, last autumn when the decisions on budgets and other things were taken one was absolutely clear that it wanted to come forward under the RO and the other one has only just got planning consent. So from where we sit, the fact that we have had this process has enabled us, faster than anywhere else in the world, to move to a position where we are going to be competing for offshore wind. If you look at international comparisons, our prices, as administratively set, are already lower.

Q55 Chris Heaton-Harris: Actually, you are just picking a winner and throwing loads of money at it. It is not a surprise that you are in that position, because you are just chucking taxpayers' cash at these things.

Hugh McNeal: We can have a back and forth about the pros and cons of offshore wind. The case for has three points—

Q56 Chris Heaton-Harris: How do these offshore wind turbines do when the wind is not blowing? Have you calculated how much carbon is not saved because of the gas turbines turning in the background? We can have this to and fro, but I just don't believe that you have looked seriously at the alternatives. You could have gone for competition, but you chose not to because that was easier.

Hugh McNeal: The argument I have just presented to you is that we do not believe—obviously you can disagree—that there would have been the volume to have competition. Nor do we believe, if you look at what other countries were paying and how much people would have had to spend to get the projects ready to enter into the competitive process, that anyone would necessarily have entered into the auction. Of course—

Q57 Chair: Do you disagree with Which? when it says, "We see no compelling reason why offshore wind developers should not at least compete with other offshore wind developers for subsidy to help drive down support costs"? Why is that wrong? It goes through figures of how much is currently provided by the total installed offshore wind capacity—

Hugh McNeal: It is 3.7 GW right now and 1.4 is GW in construction.

Q58 Chair: It is 3.5 GW at present, rising to 7.5 GW by 2020 and then 15.9 GW by 2025. Its view is that the market is sufficiently well developed to allow immediate competition. You took a different view. We want to understand why and whether that was justified, because there was an additional burden on consumers in Barking and Dagenham and elsewhere.

Hugh McNeal: As I have said, we may well see competitive pressure in the way that I have just described this autumn. If that is the case, we will be leading the world.

The argument against it is the incumbency in offshore wind. We have about 3.7 GW currently built. The renewables industry always complains when we release prices, and you would expect them to, but when we released the administrative strike prices last year, they actually followed through. SSE said, "We're not going to take any more FIDs for offshore wind." Centrica sold Race Bank and RWE said, "We're not going to do any more." The people who are now entering our market are expanding existing businesses who work in oil and gas, such as Repsol.

Q59 Chris Heaton-Harris: But what did the industry do when you reduced the feed-in tariff for solar? I seem to remember it saying that there would be no future investment in solar in the UK and I was written to by solar companies in my constituency who said that that was their market completely blown to pieces. What happened after that?

Hugh McNeal: I completely accept that point. Of course, the industry is always upset with us when we set prices, but we are used to that. The difference here was that the companies who we had previously relied on to drive the market left it—they put their money where their mouth was and said, "We don't want to invest here any more."

Q60 Chris Heaton-Harris: They left it for how long?

Hugh McNeal: We will see.

Q61 Chair: Who are the five people who you have got on this? There are obviously people around doing it.

Stephen Lovegrove: Not the UK ones.

Q62 Chair: But there are five people.

Stephen Lovegrove: Yes, but an important point is that there is no market in the world at the moment where there is competitive pricing for offshore wind. The UK is going to be the first. That probably tells you that we are moving as quickly as we possibly can—much faster than any other territory in the world—to competitive pricing, which is what we want to do.

Simon Virley: If I could add to that, in terms of where we were in 2011, it is unrealistic to think that we could have said to the industry, "We will run some auctions in 2014, in three years' time. Keep developing your projects." We didn't have the Energy Act, the contracts or the strike prices. To spend the tens of millions that Hugh was referring to would have been unrealistic for most developers if we had said back 2011, "Come back in three years time and we will run an auction."

Q63 John Pugh: Going on to the developers, I have an app on my phone at the moment that says it is a surprisingly good day for wind generation, with 9% of all our electricity currently going to the national grid coming from wind sources. It can go down to 0.5%, which shows that, in order to get investment in, you need an element of predictability. You are obviously trying to build a strong element of predictability into the system through the deals that you have done. Am I right about that?

Stephen Lovegrove *indicated assent*.

Q64 John Pugh: Our concern, and the genuine concern of any elected representative, is that you are providing too good an assurance of profit and return for the developers themselves. Clearly, a market does not do that and you are trying to balance two things out. Lack of predictability has led to lack of investment, which has led to slow development and so on. Given that there is a possibility of excess profits being made through getting the strike price or the initial decision contract wrong, did you not consider at some point in modelling this having some sort of clawback or profit-sharing arrangement that would have mitigated the potentially huge profits that some of these developers could make?

Stephen Lovegrove: We looked into the particular subject of clawback very closely, took a great deal of advice on it and consulted pretty widely. We took the view that, for the projects that were coming forward underneath FIDeR, a clawback arrangement was not going to be possible.

Q65 John Pugh: Why not?

Stephen Lovegrove: I will tell you. It was a new and unfamiliar instrument for financiers. There is a long contract, which is 800 pages now, but it wasn't actually developed at that point. These are projects that have a great deal more risk associated with them, certainly construction risk, than your average PFI.

Q66 John Pugh: But the clawback of excess profits doesn't add anything to the risk to the developer, does it?

Stephen Lovegrove: We repeatedly heard—and spoke to independent financial advisers on this particular subject as well—that putting in clawbacks would have been a complete show stopper. It would have been a red light. The projects would not have come forward.

Q67 John Pugh: But they would say that, wouldn't they?

Stephen Lovegrove: That is why we went to independent financial advisers.

Q68 Chair: Did you consult consumers or any consumer organisation?

Stephen Lovegrove: I don't know. Did we consult any consumer organisations?

Simon Virley: Consumer groups were involved throughout the process in terms of electricity market reform.

Q69 Chair: You consulted consumers and they said, "Don't put in a clawback"?

Simon Virley: No, there were representations to say we should have clawback and that was obviously weighed up in the consideration.

Stephen Lovegrove: The other thing I should say is that putting a clawback in would have been another upward pressure on the strike price.

Chair: The whole way you argue suggests to me that you are completely captured by the industry. If I were the industry, of course I'd threaten, "Don't give me inflation or I'll shovel the money up. Don't give me clawback or I'll shovel the price up." Of course they are bound to do that. You are there to protect our interests as consumers in a much tougher way than we think you have done.

Q70 Austin Mitchell: I get confused by all this comparative pricing. You are saying, here we are, leading the world, a first for Britain kind of thing, but what are the comparative strike prices for these projects: the one-off EDF deal that the Government has also come to, the land generation of wind power, which is not under these deals, and coal-fired power? Which is the most expensive and why?

Simon Virley: Certainly at the moment offshore wind is the most expensive of the ones that you listed. The strike price for offshore wind is currently about £150 per megawatt-hour. It will be coming down as we publish over the next few years and we expect to come down further when we move to auctions, to competitive processes. That compares with the strike price for nuclear I mentioned earlier that we have agreed with EDF of £89.50 per megawatt-hour—onshore wind is about £95 per megawatt-hour. Those are the current prices we have for the low-carbon technologies that are currently providing a considerable amount of Britain's electricity.

Q71 Austin Mitchell: Okay, but what I don't understand is: why the rush? You say, "We're going to lead the world," and that kind of thing, but you've rushed into these contracts. You've given away 58% of the dosh that is going to be needed for future contracts, so there's going to be more risk attached to them, and you've done so without price competition, and you've done so with a guaranteed price for the producer and when some of the projects haven't got planning permission. What is the rush, particularly before we have the capacity in this country to build the big wind generation units that will be needed offshore? That's another dimension—another technology really, they're so big—so why the rush? Why not wait?

Stephen Lovegrove: Two reasons—although colleagues will wish to chip in, I'm sure. We absolutely do not believe that we would be able to get to a world-leading position on price competition without the FIDeR process. We believe that we need to have FIDeR in order to be able to develop the industry so that we can get to competitive pricing and allow the competitive dynamic to drive down prices for consumers. That's the first thing; the second thing—

Q72 Chris Heaton-Harris: Sorry, could you just confirm that FIDeR is the final investment decision?

Stephen Lovegrove: I apologise: this is another TLA. FIDeR is Final Investment Decision Enabling for Renewables. We absolutely believe that we needed to have this scheme in order to get to a competitive place. The second point, I would say, is that as well as the industrial factors, we clearly have very ambitious decarbonisation, greenhouse gas and renewables targets in the UK. They are legislated for and they are legally binding. We have to get to 15% of our energy consumption being provided by renewables by 2020. If we do not move aggressively, particularly in the electricity generation sphere, we will break those legally binding objectives. In particular—you talked about the different range of technologies that we've got and the fact that they have different strike prices and so on—our main target is the one from the 2007 Climate Change Act, under which we have to cut our greenhouse gases by 80% by 2050. For us to be able to do that, we basically have to be able to completely decarbonise the electricity sector and we have to have a diverse set of generating assets and technologies which are low-carbon; so this is a long-term game and there is no room for complacency. We need to move quickly.

Q73 Austin Mitchell: But even the Chancellor has said he doesn't want consumers to be burdened with the high costs of reaching green targets before it's necessary. The rush to reach the targets is very nice, but the costs will come down. In particular, we shall generate more jobs when we have the capacity to make these big wind turbines in this country. The Siemens plant isn't yet established in Hull. There are alternative plants we're hoping to get—the Able UK operation on the other side of the Humber is nowhere near planning permission—and there's every advantage to delay until we can build the big generators in this country.

Stephen Lovegrove: We feel confident and pleased about the Siemens plant, and I certainly hope that there will not be a delay in Siemens coming forward. It is an incredibly important part of the supply chain in the UK for offshore wind.

With respect to the Chancellor's position about wanting to do the whole of the decarbonisation agenda on the least-cost pathway, that is one that we absolutely share; but decarbonising the UK's economy is not a cost-free exercise. It is going to cost something and—

Q74 Chair: We want to minimise the cost.

Stephen Lovegrove: I agree, and so do we, Chair.

Q75 Jackie Doyle-Price: Key to minimising the cost is my favourite renewable, which is coal converted to biomass stations, and I am quite interested in what the Report tells us about that. Figure 1 brings home quite nicely just how much value for money there is in pursuing that, which is why it is quite disappointing that we've only got Drax and Lynemouth funded. Paragraph 1.11 also says that Drax is getting a loan from the Government green investment bank and a guarantee for £75 million. Bearing in mind that figure 3 also tells us that there are six initial expressions of interest in biomass conversion, we would end up with only those two, and Drax has all that extra support. Can you explain why that is?

Hugo Robson: We were keen that there should be a mix of technologies coming through the process. In terms of what was able to come forward, we set an affordability envelope. That was carefully run through, and in order to get that mix of technologies, we essentially ensured that the top project in each category of the four technologies would be assured to get a contract for difference. So we had this quartile test, so the top 25% of the projects, as ranked, would be assured a project. After that, we then needed to run a process that looked at the projects that ranked best out of the others, and that in effect filled up the budget that we had set.

In terms of the process, the fact that in effect we ended up with three biomass and five offshore wind determines that this was a good mix of projects, but it was not, in any way, we had to, as we have just been discussing, look at the affordability of these, particularly given that the biomass conversion projects tend to use up the levy control framework money that is available earlier on in the process, and we had agreed the basis of the levy control framework with the Treasury, and that, in effect, made bringing all of the biomass conversion projects on early unaffordable.

The other point that I would make is that biomass is obviously a transition technology. Therefore, in terms of looking at the mix, we wanted to bring forward a good mix, not just reliant on a—

Chair: Why did they get the extra money?

Q76 Jackie Doyle-Price This is the whole point. You have answered the question, but without picking up the real point, which is what is so special about Drax? I have been lobbying the Department in favour of other biomass schemes, yet not only does it get one of these contracts, but everything else as well.

Hugo Robson: Apologies for not getting directly to the question, but in terms of the availability for other projects, in terms of supporting the green investment bank, or an IUK guarantee—the guarantee for IUK was given to Drax at the corporate level, as opposed to for the specific project—those schemes are available to all other investors.

Q77 Chair: But they are extra subsidy, aren't they?

Stephen Lovegrove: IUK is totally separate from this process.

Q78 Chair: Again, if I can say to the Treasury, for goodness' sake, this is taxpayers' money. You want to look across Departments and if there is extra subsidy going into this, is it justified? You clearly did not look at that.

Hugo Robson: It is not for us necessarily to speak to the guarantee scheme—

Chair: It doesn't matter. The project gets money from Government. It doesn't matter if it is not DECC.

Hugo Robson: The IUK guarantee scheme is at commercial rates. It is not a subsidy.

Q79 Jackie Doyle-Price: It looks like favouritism to me, and I am sure I am not the only person who thinks that.

Figure 3 tells us that we had a biomass conversion that was disqualified. Can you explain why that was?

Hugo Robson: They did not meet the eligibility criteria.

Jackie Doyle-Price: Right, which again is why I say it looks incredibly like favouritism.

Hugo Robson: Sorry, I think we are talking about the Drax unit. There was a single Drax unit.

Jackie Doyle-Price: That was part of Drax.

Stephen Lovegrove: That decision is being reviewed at the moment.

Hugh McNeal: We are in court today on that decision.

Q80 Jackie Doyle-Price: Right. So that will be in court today. We are talking about a technology that delivers energy in considerable volume. Mr Pugh has just told us that we have 9% generated by wind today, but it can be a lot lower. Obviously, biomass is a much more reliable technology.

Part of building the market that you have described—a competitive market—is that you need to let more people in. Effectively, what we have is a pretty limited impact on the supply chain. Surely we should be doing a lot more to encourage this technology.

Simon Virley: Biomass is a transitional technology, as Hugo mentioned. We are capping support for biomass at 2027, because we do not foresee that biomass will play a part in the decarbonised economy beyond that period.

In terms of supply chain benefits, the key development has obviously been to try build up the offshore wind supply chain. We have seen the results of that through the investment that Siemens has made.

On biomass, there are significant costs. If we had taken more biomass projects through in the short term, we would have added to the cost to consumers and broken the levy control framework.

Q81 Jackie Doyle-Price: You were talking about up until 2027, but we are talking about the fact that we do not have enough investment coming on quick enough for things such as nuclear, so we are still needing that good, reliable supply. We have a coal plant that is easy to convert. It’s a no-brainer, surely. We are going to achieve better value for money by doing that. What's this Beatrice wind farm? It is more than double the price in terms of power. Surely it is going to be beneficial to consumers if, for this decade, we focus on maximising the impact of biomass conversions.

Hugh McNeal: I agree with, certainly, some of that. You don't get the same carbon savings in a biomass plant, so in terms of our longer term targets, biomass is not as beneficial to us as offshore wind would be.

We are seeing some supply chain investments. It is great that Drax has arranged for the design of—now to be built—new train wagons from UK-based companies. It is great that investment is going in—imminently, we hope; I think I am allowed to say that, even though they are in court today. But ultimately, when you look at our sustainability standards—obviously that is very important, and our standards are going to be legally binding, and they are going to be as stringent as they are anywhere in Europe—we only make a saving in greenhouse gas terms of 68% against coal. It is not the same in terms of the carbon savings that you get from offshore wind.

The trade-off is, as you say, that you get more dispatchable power. It is quite difficult to handle biomass. We have seen that, haven't we, with the fires? People are still learning about how to use it. It is not the same as coal. We have put quite a lot of effort into supporting biomass in recent years.

Stephen Lovegrove: Looking a long way ahead, the electricity generating scene in the UK is likely to be dominated by nuclear, which is base load, and you can't turn it up and down very much; and very intermittent renewables, which are absolutely understood. We spent a lot of time with National Grid talking about that.

In order to make it sufficiently flexible as a system, we will have to have fossil fuels and plants that look like gas, coal or biomass plants. After 2027, we will not be providing support for biomass. Our longer-term approach to that part of the mix is carbon capture and storage, so that we can have gas plants and possibly even coal plants if it is sufficiently effective, which can run, but we can capture the carbon. That is the longer-term technology. Of all these technologies, probably CCS is the longest term and, at the moment, probably the most expensive.

Jackie Doyle-Price: As I said, I look forward to the day when coal is brought back into favour.

Chair: I have every confidence that they can predict what will happen in 2027.

Q82 Chris Heaton-Harris: I got hold of a company update from Bank of America Merrill Lynch on the Drax group. It is entitled, "Summer of Certainty". Just a couple of the points directly relate to today's hearing. One of the subtitles is, "CFD is preferable but ROC is still attractive." I cannot work out why that should be if the CfD gives better value for money for us than the ROC. In making your choice and, in this case, by giving Drax—I have no problem with Drax. It is a good company and very efficient in what it does, but there is a valuation scenario of what their share price would look like with the various subsidies. Two units of ROC, one CfD base case: £8. Three units of ROC, one CfD: £8.70. Three units of ROC, worst case: £7.25. Four units of ROC: £7.95. One ROC, two CfD: £8.70. One ROC, three CfD: £10. The current price is about £6.25. These are all court case pending and state aid ruling pending. That is quite a jump in the value of this company you have picked off the shelf to do this. Give us some assurance that you are aware of this.

Stephen Lovegrove: We are certainly aware of the fact that decisions made as a result of processes we have in the Department can affect the value of companies on the other side of the trade. There is absolutely no question about that. As you may know, I was an investment banker for a long time and am very aware of the impact on the cash flows and therefore the valuation of these kinds of decision. I can give you absolute assurance that the process we have gone through has been as rigorous and even-handed as we could possibly make it.

Q83 Chair: But we would say that the outcome, which suggests that the process as you devised it was maybe wrong, suggests there is a greater benefit to this particular company—I agree with Chris that it is probably very efficient —than to the consumer. There must be; that is what all those figures suggest. You, as an investment banker, must see that.

Stephen Lovegrove: I refer you to the point Simon made earlier. If you take the models we have for these particular projects at the moment—accepting that we have not done the absolute nth degree of diligence in those models because that is not the way we set this up; we set it up so that there is a generic contract. If you take those models and run them underneath the funding costs to the consumer under the CfD, and then run them underneath basically running on the ROC, the cost to the consumer of the process we have adopted is 17% lower and is a saving of £2 billion. Clearly, you can flex that up and down if you decide that the model is a different one. But the point is that they are off the same base so it will always be a saving of 17%. That is an important point.

Q84 Chair: It isn’t always. You have no certainty about that.

Simon Virley: If I could answer the question about how this is of benefit to consumers if it is also of benefit to investors—the key point here, and the whole basis of electricity market reform, is to try to lower the costs of this financing, which is the certainty the contract provides in terms of a stable strike price. That lowers the cost of the financing for these very capital-intensive projects. It is good for investors and ultimately good for consumers, because we can lower the prices. That is the basis of the model.

Hugh McNeal: The final thing to add—we touched on it earlier—is about the supply chain and industrial benefits. One frustration in a role like this is the inability to leverage the support we have to secure supply chain benefits for the country. Under the new regime and these transitional contracts, we are able to do that. If we get on to that, I can give you some examples.

Sir Amyas Morse: If these companies are able to more readily obtain cheaper finance and, at some point in the future, refinance themselves and realise they spot gain—as, after all, we saw happening a great deal under PFI—that is just their gain, is it? Have you considered that?

Simon Virley: I think Stephen answered that point earlier. If we had introduced clawback provisions at the start of a new instrument, that would have made this proposition completely uninvestable for any developers.

Sir Amyas Morse: It is very odd that you take that as given, based on the high prevalence of clawback in PFI. It doesn't seem to prevent people from doing PFI contracts.

Stephen Lovegrove: The construction risks associated with, for instance, a deep offshore wind farm are vastly greater.

Sir Amyas Morse: I got that. But not the potential for making a spot gain on re-financing. Frankly, you should think about it a bit more. I am concerned that if this does happen in future there will be embarrassment; if the construction is carried out so the construction risk is gone—same as in PFI—and then subsequently, because I know it would not happen before then, there is a refinancing operation and a significant spot gain is achieved. Let's say you have a performing asset that is sold off to a new type of investor, which we have seen in PFI, because this is all the experience we have had up to our eyeballs in the public sector, there is a question mark about how that is going to play. If it goes that way, what is the argument going to be for why that was such a good thing?

Stephen Lovegrove: We can take that away and think about it. We should think about it. Of course, there is a recent example with the way in which Ofgem is dealing with the OFTO regimes at the moment. As you say, that is refinancing after the asset class has been established and built and we are not in that place at the moment.

Q85 Mr Bacon: Yes, and just so that I am not mistaking what you are saying, you used the word "uninvestable"; that if we had included a refinancing clause it would have been uninvestable. Is that your position?

Stephen Lovegrove: Yes it is our position.

Q86 Mr Bacon: So if, and only if, the thing comes through successfully, washes its face, is up and running and built, and therefore represents a much lower risk and capable of being refinanced with a significant degree of profit; if in those circumstances you were to include, as you did not do for many of the early PFI contracts, a refinancing clause, you are honestly saying that unless you had abjured from having such a clause it would have been uninvestable.

Stephen Lovegrove: It would have been uninvestable at anything like the kind of strike prices that we have set at the moment, which have already come in for quite a lot of criticism for being too high.

Q87 Chair: Does Treasury concur with that view, with all your experience of PFI?

Richard Brown: I think that there is a lot of difference between the initial types of contract that one might enter into and similar contracts when you have got further down the road. The amount of risk that people are taking initially is not the same as that people are taking when they are several years into a programme of development.

Q88 Chair: But does Treasury concur with the view expressed by DECC that there should not be a clause in here that enables the consumer to recoup any benefit should there be excess profits? Do you concur with that view?

Richard Brown: The judgment would be that you have to take account of the professional call that DECC made about whether it would be possible to get the projects away if you had included a provision for clawback in these contracts.

Q89 Chair: You concur with their view?

Richard Brown: Yes.

Q90 Mr Bacon: Despite the fact that there have been dozens and dozens of PFI contracts. On this Committee we have examined at least 63, because I have counted them, and there are probably more than that now.

Richard Brown: There is a difference in the risks involved between the first contracts that you let and the contracts that you let further into a programme.

Sir Amyas Morse: That is perfectly fair comment; I understand that. But you would imagine that would have a bearing on the number of contracts that you let in that initial group and the amount of value associated with them, wouldn't you? If you saw this primarily as a test bed rather than a very large exercise, you would imagine you would approach it differently.

Richard Brown: If that were the only thing that you were concerned about, that might be the case. In the discussion that we have had so far we have also referred to the existence of what are extraordinarily stretching targets for renewables, which we have simply got to achieve.

Chair: This is £16.5 billion of money.

Q91 Mr Burrowes: Can I look at the approval of the business case at paragraph 2.11? There has been a balancing exercise of the potential benefits that have not been monetised outweighing the potential risks to value for money. The benefits have been outlined, but can someone outline the risks to value for money at that stage?

Simon Virley: Shall I kick off, then people might want to add in? You are right to say, as paragraph 2.10 does, that it was not possible to monetise all the costs and benefits. We therefore added in qualitative judgments that are listed against the objectives in paragraph 2.11. We would argue that the three key points there, showing that the contracts—

Q92 Mr Burrowes: I am not looking at the benefits; I am looking at the risks to value for money.

Simon Virley: I am answering by saying that I think they show that we assessed those risks, in terms of whether the process was going to demonstrate that the new contract system could work, that it could deliver supply chain benefit and that it was going to keep us on track to hit the renewables target. Our answer today, as it was then, is demonstrably yes.

Q93 Mr Burrowes: So the risks are effectively a negative of those three points. Those were the only risks to value for money of not proceeding in that manner, in terms of the business case.

Simon Virley: We looked at the risks of not proceeding against the inverse, and whether we could have moved straight to competition, as we discussed before. We looked at whether there was any slack in the renewables target, for example, or whether we could have secured the supply chain benefit in another way. We did not think that was possible.

Q94 Mr Burrowes: So the risks to value for money are the tramlines of those three points, effectively.

Hugo Robson: That is right. Clearly, in any project, you have a risk register.

Q95 Mr Burrowes: Did you quantify in any other way the risks to value for money?

Hugo Robson: Not other than through the process that we did. As we said, for the main purpose, it came out broadly neutral. We then looked at non-monetised benefits, which, by definition, are non-monetised.

Q96 Mr Burrowes: Right. Can you explain “broadly neutral”? How did you work that out?

Hugo Robson: In terms of the benefits of the scheme versus the costs of the scheme.

Q97 Mr Burrowes: The balancing exercise came out neutral. Obviously, there was a balance. Can you give more detail about how the balance was on the side of the non-monetised benefits?

Hugo Robson: Basically, it was broadly neutral. In order to be satisfied that this was right so we could move forward, the focus was on the non-monetised benefits. As we said earlier, the principal value for money on the project was the move from the existing renewables obligations scheme into the contracts for difference. That was the primary value for money of the overall project, and that had already been taken into account when we looked at the effect of the timing of the various different projects and when they come through, which really has the main effect on value for money.

Q98 Mr Burrowes: Okay. We have got those three bullet points. If the legal obligations were taken out and it was left to a market decision, would that have an impact on the weighing exercise—whether, on balance, the benefits outweighed the risks?

Stephen Lovegrove: Perhaps I can sum it up in a different way. The financial analysis and the cost-benefit analysis at the back end of 2013 was neutral, and these factors were strongly positive. Unfortunately, it is not possible for us just to ignore the legal obligations we are under, but I take your point. Nevertheless, it is still the case that because of the fundamentally better structure of the CfD it would be better to proceed with the contracts as CfDs than to continue with ROCs.

Q99 Mr Burrowes: I appreciate that you can’t ignore the legal obligations, but from a market position, in terms of investment, it would still have been the appropriate course of action.

Hugh McNeal: Looked at from now?

Mr Burrowes: Yes, and from then.

Hugh McNeal: Just to give a bit of flavour, I was working on the Siemens deals—there were two investments—and we tried very hard to land that deal last summer. Lots of people across all political parties worked very hard on that, and there are two new factories. We tried to land that deal last summer before the decisions on this scheme were made, and we were not able to do so. After Dudgeon made its decision to go ahead with purchasing 67 turbines in January from Siemens, we were able to leverage that and other things. It does not matter who had been successful through this process to get some leverage and to finally land that £310 million deal in March. The knock-on effects are not just in the Humber region. Siemens have added another 150 staff in Newcastle. They have 900 people there now and 85 apprentices. That is going to be servicing the Dudgeon contract. At least on that one point, we can now say that some of those benefits are starting to be realised.

Jill Goldsmith: I want to come back to the cost-benefit analysis. The cost-benefit analysis in paragraph 2.10 talked about being broadly neutral. We observed that was on the basis that all went ahead or all were delayed or cancelled. There was not an analysis of a different scale of the scheme at that time.

Q100 Mr Burrowes: Are there milestones that may lead to a review of that business case?

Hugo Robson: The business case was during 2013.

Chair: It's a yes or no.

Mr Burrowes: Are there milestones or triggers that will lead to a review of the business case?

Hugo Robson: There were triggers in terms of—

Stephen Lovegrove: The business case leads to a go or no-go decision, basically, and it is a go decision.

Q101 Mr Burrowes: Okay, but it is based on a cost-benefit analysis that it will all go ahead as planned. If there are changes or problems along the line, will that lead to a review of the business case?

Stephen Lovegrove: That particular business case—no, it won't because—

Q102 Mr Burrowes: So it is fixed, whatever happens?

Stephen Lovegrove: The business case was designed to inform a go or no-go decision for Ministers to take.

Q103 Mr Burrowes: So it is go, go, go, whatever?

Stephen Lovegrove: These eight contracts are go, yes.

Hugo Robson: We move on to an evaluation. We will monitor the eight projects.

Q104 Chair: But you have spent 58% of the money.

Hugo Robson: Those are the additional stages post the business case, where we need to monitor the projects.

Q105 Mr Burrowes: At the time of the business case approval, there were no clear monetised benefits. When will there be clear, monetised benefits?

Stephen Lovegrove: I have to take you back. The monetised benefits arise from the fact that the CfD is a greatly better instrument than the ROC.

Q106 Chair: That is the assertion. It is not proven yet. That is an assertion.

Stephen Lovegrove: It is in the document from the NAO. There is a list of the hurdle rates. It shows that the hurdle rates are lower.

Jill Goldsmith: Potentially at a higher cost you might have got a competitive—

Q107 Chair: If, if, but, but.

Stephen Lovegrove: Yes, but we would not have got to a competitive allocation without—

Q108 Mr Burrowes: Aside from the rationale, have you planned this in terms of the business case and the plan? Will there be a date when there will be clear, monetised benefits?

Stephen Lovegrove: I am wondering which counterfactual we would have to try to assess that against.

Q109 Mr Burrowes: Let's put it a different way—is it part of the planning that there will come a stage when you are clearly able to benefit—to monetise the benefits and the value to the taxpayer?

Stephen Lovegrove: We need to be clear about what the business case was trying to answer. We have no problem coming back to you and demonstrating to our best ability that the CfD has, indeed, proved to be a better instrument that the—

Q110 Mr Burrowes: When could that realistically be?

Stephen Lovegrove: When do you think we might be able to come back to the Committee and give some further information about that?

Hugo Robson: I would have thought probably in about six months, in terms of the next stages of reviewing the projects. We can come back with an evaluation plan immediately and give you some more information, but in terms of being able to start monetising those, it will take a considerable amount of time before one is able to look back.

Q111 Mr Burrowes: Let's say in six months you can come back with clarity on the monetised benefits. Would that lead to any change of direction of the go, go, go—if we have go the eight contracts—or will it affect the wider plan in relation to allocation processes?

Stephen Lovegrove: There are effectively eight projects that are underneath the FID-enabling for renewables banner—that is, the contracts in here. All things being equal, we will not be revisiting the decision to award investment contracts to those projects.

Q112 Mr Burrowes: That is definitely fixed, whatever happens?

Stephen Lovegrove: Not all of the contracts have been signed. Contracts are never signed until they are actually signed. It is our intention to sign these contracts.

Q113 Chair: Have they all got planning permission?

Hugo Robson: They are all signed and they still have conditions outstanding.

Q114 Chair: Have they all got planning permission?

Hugo Robson: They don't all have planning permission.

Q115 Chair: So if they don't get planning permission you have signed a contract, what then? No doubt we will cough up money—

Stephen Lovegrove: You've been saying that we only have 42% left. That money would not become part of the 58%; it would become part of the 42%, as it were.

Hugo Robson: We only pay the money when they are producing electricity. So if they fail to get planning permission at that point the contract falls away.

Q116 Mr Bacon: The contract has no clause whereby you would compensate them in circumstances where they failed to get planning permission.

Hugo Robson: If they get planning permission—

Q117 Mr Bacon: No, if they fail to get planning permission does the contract not have any clauses where you would compensate them because of the failure to get planning permission?

Hugo Robson: No, it doesn't. We would pay no compensation in those circumstances.

Q118 Mr Bacon: We were looking at some waste incinerators last week where failure to get planning permission triggered substantial compensation of tens of millions of pounds. We were not quite sure why, but it did. We were assured that it did. You are saying there is no such compensation.

Hugo Robson: There is no compensation—

Q119 Mr Bacon: I want to be clear about this. You are saying that it is possible to do a project, a project of such hideous complexity that PFI looks simple by comparison, pace Mr Lovegrove, and yet not have any compensation if there is a failure to get planning permission. That is correct?

Hugh McNeal: Yes.

Mr Bacon: Thank you.

Q120 Mr Burrowes: As we move to next year in the allocation process, is there a commitment to have a comprehensive review to ensure that maximum value for money for the consumer is delivered? Secondly, is there a wider roadmap that will ensure that there is increasing competition in the CfD allocation process which includes contracts for nuclear generation?

Simon Virley: Do you want to do the first bit on evaluation and then I'll pick up the question on competition?

Hugo Robson: In terms of the evaluation of this scheme, as we have said, it has now effectively been completed subject to state aid approval and is moving through post-state aid approval. We will monitor not only the eight projects that have been successful but will also work closely with the counter-party body which is there to manage the contracts. We will be looking to get as much information from those—

Q121 Mr Burrowes: I am sure you will be monitoring but will there be a comprehensive review? *[Interruption.]*

Chair: You have to say yes or no as we have a Division.

Hugo Robson: There is no specific date for a review.

Sitting suspended.

On resuming—

Q122 Mr Burrowes: So we had no to a comprehensive review. The second part was whether there would be a clear road map towards increasing competition in the CfD allocation process, which will include contracts for nuclear generation.

Simon Virley: The plan is to move to competition for all technologies as quickly as possible. We are looking at the numbers now for whether we can move to competition for the first allocation round this autumn, and that is a possibility. We are still working through the numbers and Ministers have to make some final decisions, and it is dependent on the number of applications that come forward, but the long-term trajectory here is to move to competition for all technologies. It is just a case of how quickly we can get there.

Q123 Mrs McGuire: I want to come back on Richard's point about compensation, so that we are clear what the word "compensation" does and does not cover. Will there be any recompense, which can be quite different from compensation, for development costs, fees and anything that is associated with the bid for planning consent, so that we can be utterly clear and do not have to come back in a year's time and say, "Well, actually that is not covered by compensation"?

Hugh McNeal: They don't get coverage now, and they won't get it in the future. People know that they take forward projects under the RO at their own risk, although they know that they will get a contract at the end—

Q124 Mrs McGuire: So they are taking all the financial risk.

Hugh McNeal: Yes.

Q125 Austin Mitchell: When you were going on about our success in achieving EU targets on green energy, I thought that we might get the spectacle of Jean-Claude Juncker coming over to kiss the Prime Minister on both cheeks—possibly all four cheeks—to congratulate him. But I see that paragraph 3.2 says, "The European Commission is currently considering whether contracts for difference, and individual early contracts, are compatible with EU state aid rules." Was that not checked before we started?

Simon Virley: It is the normal process for the—

Q126 Austin Mitchell: Is that the normal process for everything?

Simon Virley: Yes, it is a totally normal process to put the specific proposals to the Commission for their consideration.

Q127 Austin Mitchell: What is your legal advice?

Simon Virley: Our legal advice is that we have to have a condition in the contract that says, "These contracts are subject to state aid approval."

Q128 Chair: So when the EU competition chief recently wrote that a contract for difference "seems to provide the utmost certainty of a stable revenue stream, under rather lenient conditions. . .that is conceived to entirely eliminate market risks from the commercial activity of electricity generation" for 35 years, what was your comment?

Simon Virley: We do not agree with that comment and we have put evidence in to the Commission to explain why we disagree.

Q129 Chair: What happens if you do not get approval for state aid?

Simon Virley: The contracts could not go forward on that basis, but we are—

Q130 Chair: So what happens to your plans then?

Stephen Lovegrove: The one you are talking about is obviously for Hinkley—it must be because that is 35 years and these contracts are for 15 years. If state aid approval is not given for these contracts or for Hinkley or, indeed, the capacity market that we are aiming to run at the end of the year, we will not be able to take those projects forward. We are confident that we will get state aid approval, but, of course, we have not received it yet.

Q131 Mr Bacon: So Jean-Claude Juncker could save us money.

Stephen Lovegrove: I suspect that we will get an answer from the Commission before Mr Juncker takes up his post.

Q132 Chair: I take the point on Hinkley, but it seems to me that these are very negative comments. What is your plan B?

Stephen Lovegrove: We have taken these projects forward with a high degree of confidence that they are state aid compatible.

Chair: Have you got a plan B?

Stephen Lovegrove: If we cannot take forward these low carbon generation contracts, it will certainly set us back on our low carbon targets and we will have to think very hard about what we do then.

Chair: You haven't got a plan B.

Simon Virley: It would raise questions about whether you reverse the decision to close the renewables obligation scheme, which is already approved by the Commission. Of course, the prices under the contracts for difference are lower than they are under the renewables obligation and, as I said in response to a previous question, we are moving to competitive allocation. So we are confident that we are meeting the requirements of the Commission's guidelines and, therefore, confident of our case.

Q133 Chris Heaton-Harris: Couldn't you just reduce the renewables obligation value?

Stephen Lovegrove: The CfD has a variety of distinct advantages over the renewables obligation, which meant that it was clear that the CfD was better—we talked about the hurdle price—and one of them is that the contracts for difference are for 15 years rather than 20 years. Perhaps very, very importantly, from the point of view of consumer protection, we have an ability to control how many contracts for difference we give out, whereas the renewables obligation effectively had to be given out to any eligible scheme. It was always clear to us that the CfD was a better structure than the renewables obligation certificates.

Hugh McNeal: It takes a long time to set a renewables obligation. There are a lot of people working on it and, in effect, the impact on consumers is set on 1 October, 6 months before it is felt by consumers. You have to make a calculation looking at hundreds of projects, how much they might generate, whether or not there is going to be an outage, or a biomass fire, how windy it might be—in terms of project control, it is not ideal.

Q134 Austin Mitchell: Moving on, most of the technology employed in these initial projects is imported—foreign wind power generation and so on—but one that isn't is biomass conversion. That did not get included in these early projects. I assume that is the Drax project for biomass conversion. They had one accepted and one rejected. Why was that one rejected?

Stephen Lovegrove: We touched on some of this a little earlier. The Drax project conversion that was rejected and fell at the last hurdle did not meet the eligibility criteria. I am not really at liberty to talk—

Austin Mitchell: It's British shit for British conversion.

Stephen Lovegrove: I am not at liberty to talk about that too much at the moment because we are in court today and being judicially reviewed by Drax on the basis of that decision. I think it is probably better if I remain relatively silent on it for the moment.

Q135 Austin Mitchell: So they have had it now: there is no chance of coming again.

One final question. This will be a 5% contribution to achieving our targets in 2020—

Hugh McNeal: Just to correct that, it is a 14% contribution.

Austin Mitchell: Yes, but these contracts will be 5%.

Hugh McNeal: No, these contracts will contribute 14% of the electricity—

Austin Mitchell: The early contracts can provide 5% of total electricity in 2020.

Hugh McNeal: Yes, 5% of the UK's electricity generation in 2020, but 14% of the electricity part of the target.

Q136 Austin Mitchell: Okay. The question still arises because the developers can actually change their contracted capacity by as much as 36% either way. That is quite a big change and it would substantially reduce the contribution to the targets if all of them decided to change.

Stephen Lovegrove: It would. I think that is a very good point. These targets are extremely challenging. We are on track, as of 2012, by hitting 4% of renewables; we have got to get to 15% by 2020. We do not want to see these projects doing anything other than producing electricity at their maximum. Clearly, if they don't produce electricity at their maximum—we have a lot of work to do on the electricity target, the vehicles target and on the heat target as well.

Q137 Chair: Why did you not put a penalty clause on that issue? You are allowing them to redefine the capacity—I can't remember, but there is a point at which they could redefine—but they then only need to produce 85% of whatever it is. Why not put a penalty in?

Stephen Lovegrove: I will hand over to Hugo, but it is important to realise that the consumer is not going to feel any disbenefit if they don't produce because they only get paid for the amount of electricity that comes out.

Chair: They will if the lights go off. Why not a penalty clause?

Hugo Robson: In essence, it would be a penalty upon a penalty. Clearly, if they don't produce the 100% they are aiming to produce then they don't receive the returns they are looking for.

Q138 Chair: But we want the supply.

Hugo Robson: Absolutely, which is why we have also put in measures to ensure that there are points at which they have to come back. It is absolutely right to say they can produce 36% less without any penalty, but the first 25% of that has to be done within a year, in terms of when they have to come back and say that they are now going with x or y, and that is the point where you can then release the money to other projects. So there are staging posts at which they—

Q139 Chair: But why not a penalty clause?

Hugo Robson: Because it would be a penalty upon a penalty.

Q140 Chair: It is not a penalty upon a penalty.

Hugh McNeal: There is no penalty there. It comes back to what we were talking about earlier. How much money will they already have spent in order to enter the position to get a contract, whether it is competed or not? If a company has spent, say, £50 million to get to that stage—we will follow up on that point—do you want them to have to have done twice as much spend to get exactly the right size of the wind farm, to have optimised everything and to have set out all the contracts? That is what it is about.

What is the right balance between how much they have to put in the game in order to get a contract and when would you allow them to just—? At the moment, they can do whatever they want. Right? Under the RO, they maximise what they get through the planning system and they adjust, and there are no penalties and no issues under it at all. Under the new regime, at least we have put some controls in.

Q141 John Pugh: It is the simple question about timing that is bothering me. All the way through this session, there have been suggestions from members of the Committee that the contract could have been tightened up by clawback, refinancing clauses, profit-sharing or whatever. If I understand your response to that, it has been to say that those changes to the contract would have been fatal to the project, or would have led to strike price going appreciably higher than you wanted it to go. Am I correct in thinking that?

Hugh McNeal: Yes.

Q142 John Pugh: And in any case you had independent advice that persuaded you that what you were doing—the way you were writing the contract—was correct. But it appears to me that you would have had time—clearly, there was a worry that the investors would walk away from the table—to do some market testing, wouldn't you? You could simply have said, "That is the deal", and just seen who was still around when you put the deal in those particular terms. Why did you not consider the possibility of some sort of market testing, rather than simply accepting that what your independent advisers told you was the full and last truth?

Stephen Lovegrove: I will hand over to Hugo, but I think the whole process of negotiating the contracts with these multiple parties is a very lengthy one, involving a great many different advisers and conversations with the various developers, and that, in a sense, was market testing. Everything was tested—

Q143 John Pugh: But it is not really tested until you actually put an offer out and you see if there were any bidders left, because—

Stephen Lovegrove: Ultimately, what we ended up doing was settling on a structure and a set of prices, which indeed led to a number of these projects walking away.

Q144 John Pugh: Could you give us a list of those, because that would be very helpful?

Stephen Lovegrove: Yes.

Q145 Chris Heaton-Harris: I would like to follow up, because earlier I mentioned that when the Government reduced the feed-in tariffs for the solar industry, the solar industry was very unhappy. They said they were going to walk away and that there would be no further investment in solar in this country, and I think that solar has just gone literally—to use a bad pun—through the roof since. It took a year to settle down on the new price, but then took off. So, in your own Department, there is a model where you can sit back, and you have tested it before.

Why the rush to do this, because I do not buy your answer? Let me start with figure 2 on page 16. If you were to say to me, "We needed the energy quickly, because we have a gap, or a pinch point, coming up, which everybody knows about, in 2015, 2016", I think I could understand that partly, but figure 2 proves that none of these projects, or just a couple of them, are online in time to get rid of that pinch point. So explain to me why the rush was there?

Stephen Lovegrove: There are multiple objectives associated with this programme. One of them was to move to contracts for difference as quickly as possible and away from the ROs, because they represented better value. The quicker we could do that, the better. But also, we needed to be able to stay on track for our 2020 targets for renewable deployment and, further on, our carbon budgets—the second, third and fourth carbon budgets, and ultimately the 2050 target as well. So there was no time to lose on either of those two dimensions.

Q146 Chris Heaton-Harris: So the rush is purely down to our own targets and legislation, not the European target or indeed the climate?

Stephen Lovegrove: No. It is certainly partly down to that. As you know, these are legal targets and we cannot get away from them. But it is also down to the fact that we wanted to get this programme and contract embedded and settled as quickly as possible, because it clearly provides better value for money for consumers.

Q147 Chris Heaton-Harris: To what extent, then, did you take into account security of supply, particularly given this pinch point that we have coming up in the next couple of years, in the selection of the early investment contracts, given that some of the projects being supported are fully dispatchable, while others have intermittent output?

Stephen Lovegrove: We work closely, as you know, with National Grid and Ofgem. National Grid is very much involved in the design of the programme, the prices and what we think will be coming on. The measures that National Grid has announced for the years up to 2020—supplemental balancing reserve and the demand side balancing reserve—have taken into account this deployment curve for these, for the most part, inherently intermittent technologies. We have also taken that into account in the longer-term design of the capacity auction, which we are running in 2014 for 2019.

The security of supply aspects have been fully considered against the background of this programme.

Q148 Chris Heaton-Harris: Your Department has a wholesale price of energy that it expects—what the prices are going to be for the next few decades. But there are other estimates of what they might be out there.

Stephen Lovegrove: There are.

Chris Heaton-Harris: The one that contrasts most starkly with yours is the most recent one by Aurora. Your estimate is that, in 2020, wholesale electricity prices would reach £68 per MWh and £80 in 2030. Aurora claims that it would be £46 per MWh and

£40—going in a completely opposite trajectory to yours. Do you take their work into account and challenge your own assessments?

Stephen Lovegrove: We certainly do. Aurora is a respected market commentator, and we have to take that into account. We use a range of assessments. Our assessments are in line with the International Energy Agency. The range would accommodate Aurora's assessments as well. We are constantly revisiting these assessments.

Perhaps it is worth dwelling, for a moment or two, on the 58% that we may have spent as opposed to the 42% that we may have yet to spend. We actually set that at 50%. Since then, the gas price has changed. As a result of that, it has moved to 58%. The gas price may change back again, and projects may drop away. These are inherently uncertain things.

But if you are asking the question, "Do we constantly review against the full range of gas price assumptions?", the answer is yes, we do. I think we are about to come up with a new set fairly soon, which will to a certain extent reflect the gas price reductions that we have been seeing over the past few months.

Q149 Chris Heaton-Harris: It is important, isn't it, if Aurora's estimates are slightly more correct than yours on where prices end up? We have now committed ourselves to pay a huge chunk of money for a very long time. Essentially, the consumer will not see the full benefit of gas price fluctuations, based on Aurora's estimates, because of this deal.

Stephen Lovegrove: The consumer will not be paying any more wherever the gas price goes, because that is bounded by the levy control framework.

Hugh McNeal: The only other point about forecasting—all of that is true—but the one thing that forecasters have never been good at has been predicting price shocks over the medium term. No one predicted the price shocks in 2006 over the medium term, so a few years ahead. No one predicted what happened between 2010 and 2012 to prices a long way ahead. So it is true, but we cannot travel through time. It is just important to remember what risks we take when we rely too much on any one—

Chair: Hear, hear. I agree with that.

Q150 Chris Heaton-Harris: No one predicted that shale would be around 10 years ago.

Hugh McNeal: Absolutely.

Q151 Chair: Can I ask you a question on that? What is the impact of the decision to cap the carbon price floor on the rest of this?

Simon Virley: The carbon price floor cap will lower wholesale prices, but we are confident that we can continue to hit our targets within the same levy control framework caps, so we have stuck to the £7.6 billion total in terms of the spend on low carbon electricity, so it is being accommodated within that cap.

Q152 Chair: How?

Simon Virley: Because we have always had a slight margin for unforeseen events, within that overall cap.

Q153 Chair: What is the impact of fracking?

Simon Virley: Over this period, we will have to see how the shale gas industry develops. Obviously, DECC is working hard to make sure it can develop in a safe and sustainable way, but we do not expect it to be a major energy source, certainly for the next few years, because there is still a lot of exploration work to do.

Q154 Chair: Will it impact on this time frame?

Simon Virley: Over a longer time frame.

Chair: Over this time frame, it will impact?

Simon Virley: Certainly not in the next few years.

Q155 Chair: Can I ask something, which I hope I have got wrong? On page 8, paragraph 14 of the NAO Report, it sets out how you set the strike price. I hope you can tell me I am wrong on this, but it says: "Strike prices are set for each technology rather than negotiated with individual projects. They are designed to offer an acceptable return to the most expensive viable project (the marginal project) needed." That suggests to me that you set the strike price at the highest possible level, am I right about that?

Hugh McNeal: No, but I understand why you might think that from the way the Report is written. For each technology—and once we have moved to competition this issue moves away—you draw a supply and demand curve and you pick the 50% point. If you go anywhere above the 50% point you cannot get state aid clearance. So there will be projects on the curve that are getting a greater return than they potentially need, but no, it is not at the very top of the curve. That is not how we do it.

Q156 Chair: So it is in the middle?

Hugh McNeal: At 49%[1].

Q157 Chair: Good. Can I ask you about the Major Projects Authority? There are two references to it, on page 19 and page 20. On page 19 the MPA criticised you at one stage and said you had no success criteria and no quantification of benefits. On page 20, at a further stage, again it said there were no unquantified benefits and that there were "risks to value for money because of the lack of price competition." What did you do about those observations?

Stephen Lovegrove: Clearly, when the MPA came and looked at this, they identified some of the risks that you have identified. I think we do completely accept, without any reservation whatever, that it would be better to have competitively set prices than administratively set prices. That is absolutely the direction of travel. We have redoubled our efforts to move to a place where we can have competitively set prices.

Q158 Chair: That is useful on that question and we have been round that this afternoon, but they said there were no success criteria and no quantification of benefits on the first one, and the second time round, unquantified benefits. You have answered the final point.

Hugo Robson: On the first point, that was when we were still developing the plan and they did indeed say, in terms of the success criteria, what would you regard as success? We had not perhaps set that out sufficiently clearly. That was during the time we were doing the whole budgeting process and working through how much budget we might have available. So, indeed, we put in success criteria following that MPA report.

Q159 Chair: And what about the quantification of benefits?

Hugo Robson: The quantification of benefits is part of the business case that we were discussing earlier in terms of—

Q160 Chair: But it's not there. The MPA criticised you. We have been questioning it. There isn't a proper assessment of it, is there?

Stephen Lovegrove: I think there is a proper assessment of it—

Q161 Chair: Why were they critical of it?

[1] Note from witness: It is correct that the point on the supply curves where support has been set was around 50% but not that it was exactly 49% for offshore wind. The figures are only approximate, given the uncertainty in relation to the exact shape of the supply curves (i.e. what project costs are exactly). For offshore wind they are around 50%, changing slightly from year to year.

Stephen Lovegrove: It was done in the business case where we looked at the various objectives that the programme was designed to achieve, and among those were the financial objectives where the business case said they were broadly neutral. The other business case objectives—establishing the industry, keeping us on track for our 2020 targets—those were well evidenced.

Q162 Chair: Why did they make those criticisms then?

Stephen Lovegrove: Because they were making those criticisms at an earlier stage in the process.

Q163 Chair: Not in paragraph 2.12, on page 20—that's the final business case, if I remember rightly.

Stephen Lovegrove: Where it says "unquantified benefits," that refers to the unquantifiable benefits, really, which are in the paragraph above—those three sub-bullets. Effectively demonstrating that the CfDs "were viable"—we have done that. You can't put a number on that; we have demonstrated that they are viable. We have supported "early supply chain development" and "enabling a steady pipeline of projects"—we can't put a number on that, but it's obviously demonstrably the case that Siemens and these other projects will come through. As for "minimising the risk of penalties for failing to meet the UK's 2020 renewable energy…targets," again, we have minimised those risks. They are still real, but we have minimised them. They are not financially quantifiable in quite the way that possibly the MPA would like, but they are nevertheless objectives which we've hit.

Q164 Chair: Can I ask you about the assessment of the projects? I'd like to know what due diligence you carried out, particularly on the applicant statements saying that if you didn't go ahead, there would be a risk of massive delay or cancellation. What due diligence did you carry out on those signed statements within the bids?

Hugo Robson: We reviewed their statements. We reviewed them with external advisers, both financial and technical, and we were, though, relying heavily on a board signed-off statement saying that they were suffering a hiatus of investment.

Q165 Chair: If you were a board member, you would have signed off that statement, wouldn't you? What's interesting is if you were entirely reliant on the board members to say that the project would either have been massively delayed or cancelled. Why does it say on page 23, paragraph 2.18, "Stakeholders we spoke to confirmed that the Department did not undertake any additional due diligence on the submissions and…were surprised the Department did not specify more precisely the evidence they required"? They don't think you did a very good job.

Hugo Robson: It was up to the applicants to put forward the reasons why they were suffering from a hiatus of investment. They had to then sign off at the end of the process to confirm that that was still the case. The basis on which they claimed that they were suffering a hiatus of investment was something that we examined with our advisers.

Q166 Chair: So you disagree with this agreed bit of the Report that says about the stakeholders, who I assume are the people who got these contracts: "Stakeholders we spoke to confirmed that the Department did not undertake any additional due diligence on the submissions and in some cases were surprised the Department did not specify more precisely the evidence they required."

Jill Goldsmith: That was the interviews that we held with a number of companies.

Q167 Chair: Yes, but it is an agreed Report.

Stephen Lovegrove: I am sure that is right; I am certainly not questioning the NAO's view on that. Were these stakeholders who in the main had received contracts or ones which did not receive contracts?

Jill Goldsmith: We spoke to both: people who had received and people who hadn't received. This is a mix of the responses to us.

Hugo Robson: Did we review what was said? Yes. Clearly, we did not go back to everyone with questions. We did go back to some with clarification questions.

Q168 Chair: What is suggested here is that you relied on their honesty and integrity. It is slightly difficult. They are all making quite a lot of money out of this. I have no doubt that they are very honest people and full of integrity, but I think I would have wanted a bit of comfort.

Hugo Robson: The other point to make is that in terms of eligibility criteria we had 57 applications at the start and we ended up with 26 that met the eligibility criteria. I think you can see that a large number of projects did not meet those criteria.

Chair: Yes, but you did not check it.

Q169 Chris Heaton-Harris: I have a question about one of the recommendations. It is one we have talked about briefly throughout the hearing. You have spent 58% and have got 42% left and you are going to introduce competition. I can understand how competition could work for offshore wind, because I think if you had pitched the price at £120 for offshore wind you would have had a gap for a year but then you would have started to get takers.

My concern is when it comes to biomass in this field because I think you have created a barrier to entry. You have picked Drax as the biomass producer, for the right reasons probably. As I said earlier, I have no problem with Drax. They are going to get this high level of support for 15 years. You are now going to ask other companies to find investors to bid for potentially a much lower level of subsidy. I think you have inadvertently created that. I guess time will tell. Have you modelled that? Are you modelling that? Do you understand what I am trying to say?

Simon Virley: I think it would be to the benefit of consumers if we can get the costs down.

Q170 Chris Heaton-Harris: Yes, I know. But equally you have created a barrier to entry. Why would they go in because they can't compete? An investor in—Jackie, what was your one called again?

Jackie Doyle-Price: Tilbury.

Chris Heaton-Harris: Tilbury or Eggborough or wherever is not going to get the same sort of return by a long way, compared with an investor in Drax, because you have guaranteed a set level of subsidy.

Hugh McNeal: At Tilbury there was a fire and then a commercial decision about whether they could still make that viable.

Jackie Doyle-Price: Yes, it did not qualify for this—

Hugh McNeal: The contracts for biomass run only to 2027. That changes the hurdle rate benefit for biomass to some extent. The RO is still open to people as well. If the question is whether we are constantly looking at the relative impact of the different schemes that we are running on particular technology areas, the answer is, yes of course we are. I haven't thought about the issue of barrier to entry in the way that you put it.

Simon Virley: I do not foresee that the fact that Drax have got one contract—and, of course, they are judicially reviewing us on our decision to disqualify them from another of their units—would necessarily deter others from bidding in. We shall see whether others want to come forward to bid in. It would be a good outcome for consumers if the price does come down over time. That is the whole purpose of competition.

Q171 Chris Heaton-Harris: I agree with the second part of what you are saying. I think the first part is that you have created this gold standard of subsidy for Drax and other investors in the biomass market are going to look at that and look at what other people can do, and they will simply not be able to get the same level of subsidy return. It is the point about backing winners, I guess.

Stephen Lovegrove: I guess the point you raise arises from two things: one, that we have a levy control framework. We have to stop somewhere; we have to have a budgeting process. If we don't have a budgeting process then consumers are not protected. Secondly, we have to have a transitional system where prices were administratively set. It is not the case, we have to accept, that everybody is going to benefit equally. It is not the case that everybody is going to be capable of benefiting equally.

Hugh McNeal: We have seen RWE come in. Obviously, RWE Lynemouth are one of the successful contractors.

Q172 Chris Heaton-Harris: Paragraph 20 is about actual costs and returns and you having sight of some of this information. Could you assure the Committee as to how you will deal with that particular recommendation?

Simon Virley: The counterparty body which we are in the process of establishing will monitor whether developers have delivered on what they said they would in the contract. Did they build the wind farm or biomass plant on time and with the capacity they said? To go beyond that—we will give consideration to what is recommended here—would involve a huge, extra bureaucracy in reviewing the finances and the detail rather than the actual costs of each project. That would be a different construct for the counterparty body than the one which is, in essence, about contract management. That is what we are asking the counterparty body to do at the moment, but we will look at your recommendations.

Q173 Chris Heaton-Harris: That is a very polite no.

Hugh McNeal: There are 121 renewable electricity projects being built, as of the end of May, that are greater than 5 MW. You would not necessarily want to have back and forth with all of those; that would be incredibly bureaucratic. If we go down this route, we have to decide how many of these we want to see versus the trade-off of having lots of people—

Q174 Chris Heaton-Harris: But there are only eight projects to administer.

Hugh McNeal: Yes. That is a separate point.

Q175 Chair: Can you explain how the counterparty body will work in the public interest? It is run by industry and I cannot understand how the public interest will be protected.

Simon Virley: It is a Government-owned company so is not run by industry.

Q176 Chair: Who will decide how much extra subsidy goes to the providers if the market price is below the strike price? Who will make those assessments?

Simon Virley: All policy decisions will be made by Ministers.

Q177 Chair: The policy is that if the market price is below strike price, they get extra subsidy, is it not?

Stephen Lovegrove: That is correct, yes.

Q178 Chair: My understanding is—if I have it wrong, great—that the counterparty body will be peopled by representatives from the industry who will make those assessments as to when market price is below your assessed strike price and therefore look at the subsidy. Am I wrong about that?

Stephen Lovegrove: The counterparty body is there to manage those contracts. The main point about the contract is the strike price—the difference between the strike price and the reference price. You are absolutely right. There needs to be a body calculating who needs to be paid what and organising those payments. That will be the counterparty body, alongside Elexon, I think.

Q179 Chair: And that is peopled by industry?

Stephen Lovegrove: It is not peopled by secondees from the industry. It is Government-owned. We have appointed the chair.

Q180 Chair: Who is the chair?

Simon Virley: It is Dr Martin Read, who was the chief executive of Logica for 14 years so is fully versed in settlement processes.

Stephen Lovegrove: We are in the process of appointing a chief executive. We will have an independent board, and the costs of the counterparty body will be met from the levy control framework so are not being met by or remotely running the risk of being captured by the industry.

Q181 Chair: Okay. Just explain to me again, from the consumer's point of view—the market price goes down if we consume less, because we might have a mild winter, better insulation or just decided to cut our energy consumption. The market price goes down and is therefore below the strike price. We end up picking up the tab for it anyway, even though—because of weather or deliberate action—we changed our behaviour as consumers.

Simon Virley: Yes, that is how the contracts for difference work. If the market price goes up above the strike price, the developer pays us back.

Q182 Chair: Even if you consume less, and therefore drive down the market price?

Stephen Lovegrove: No. If you consume less, there will be fewer units of electricity effectively being sold by the generators, and they will therefore get less money. The money the generators get will be a function of—

Q183 Chair: If we consume less, that will impact on market price. It won't only impact on the amount consumed. It will impact on market price, I would have thought.

Stephen Lovegrove: The wholesale price—the reference price—is the price of generating electricity in the marketplace, and we are paying them the difference between that, which fluctuates, and the strike price, which is set.

Q184 Chair: So we are looking at just the wholesale price, not the market price—the price for consumers? If that goes down—

Stephen Lovegrove: If you are talking about the—

Q185 Chair: There must be a demand-supply element in this whole thing.

Stephen Lovegrove: There is. I am just saying that the generator's revenues are going to fluctuate according to the wholesale market price and the amount of electricity that is being used. Therefore, if consumers use less electricity, they will be paying less and the generator will be receiving less.

Q186 Chair: But what I don't understand from what you just said is that, if consumers are using less, for whatever reason, doesn't that impact on price?

Simon Virley: Yes. There are two things going on here.

Chair: Quite.

Simon Virley: It is correct to say that if demand is less than anybody expected and the wholesale price goes down, the payments up to the strike price will be higher. Stephen was illustrating that there will be a knock-on effect, in terms of total quantity of electricity, but they are two separate things.

Chair: We are knocked both ways.

Q187 Chris Heaton-Harris: I have one more question, which is about the 2020 renewable electricity target. The Government set the target that is required by 2020 by the renewable energy directive of 2009. Your website, the Renewable Energy Planning Database, suggests that 35 GW of capacity has been consented and is now operational, or under or awaiting construction, which is sufficient to meet the target, within a 5% margin. You have an extra 18 GW of capacity in the planning system, which would deliver an overshoot of about 50% and would exceed the Treasury's cap on subsidy spending.

Hugh McNeal: I'm afraid I don't recognise the 35 GW figure. I recognise the figure from the Report, which says, based on the delivery plan numbers in December, that we need 43.5 GW capacity. The target is not a capacity target, but a percentage target. It is in terawatt-hours.

Q188 Chris Heaton-Harris: 110, I believe.

Hugh McNeal: Yes. We need at least 30%. At the moment, that translates to a range of about 105 TWh to 109 TWh. The numbers always look good when you look at them top down, so you have to get underneath them. I was trying to give a flavour of that by saying that there are 120 projects being built now and capacity changes. The reason for making that point is that, for example, Tilbury is still included in the current baseline, which was published last year, and Ironbridge is included, although it will be burning out its hours. Sometimes there are projects that are caught within the two sides—constructed and in construction—at the same time.

It may feel that those figures are small, but they are not. When Whitelee, the onshore wind farm, was extending its capacity south of Glasgow, and London Array was built at the same time, that was 400 MW. The other thing is about the historical attrition rates. We talked earlier about how many projects actually get built. There are 1.2 GW in the data for things that had planning consent before 2010, but for project purposes we assume are not going to get built now.

I am not saying we are not doing well for renewable electricity. The latest adjusted figures—for the target, you have to adjust the figures for how windy it has been over five years, and how rainy it has been over 15 years—show we have been doing quite well on electricity in recent years. From my point of view, it is a great unsaid story. None the less, in terms of the target, we had to hit 4.04% for energy in 2011-12, and we hit 4%, with a 0.1% margin of error. We have to hit 5.4% average of this year and last year, and as of last week, we were at 5.2% for last year, so we have got to do a bit better. It's true that the numbers in the pipeline look strong, but when you get underneath the numbers, you see more risks.

Stephen Lovegrove: There is one other thing I will add to that. The 15% target for 2020 and the 4% that Hugh has been talking about are targets for electricity, vehicles and heat. It is fair to say that we are doing better on electricity than we are doing on heat and vehicles, but we have to hit the top target. If there is an underperformance, say, in either heat or vehicles, we will have to try to make it up somewhere else, which will inevitably be electricity.

Q189 Chair: My very final question: have you made a calculation of how many British jobs are going to be created out of the first eight projects?

Hugh McNeal: We have not done macro-calculation but obviously we are monitoring it. For each of these projects, they are going to have conversations with us. This is a cross-Whitehall thing—DECC, BIS and UKTI. We will monitor all the jobs that come here directly and we try, where possible, to see the links to other jobs. That was one of the reasons that I mentioned 3sun earlier. That is a company that supports Siemens installation of wind turbines all the way across Europe. They had the extension of their contract for a couple of years in May. That is linked, to some extent, to the Siemens investment decision and that links back to the Dudgeon turbine decision in January[2].

Stephen Lovegrove: We have a figure of 8,500 jobs being created in the UK as a result of this programme. I do not have the full detail of that but I am very happy to go away, give you the calculations and send you a note as to how we have got there.

Chair: Thank you.

Jill Goldsmith: Can I clarify? There was a conversation earlier about the returns provided to the eight companies and relative returns in the UK compared with elsewhere, and there was a reference to the NERA report in our Report. The NERA report was about hurdle rates, which it suggested were potentially at the higher end in the UK than elsewhere. I think your reply was in relation to strike prices rather than hurdle rates, is that correct? There is a difference between what you were saying, which was about strike prices, and what the NERA report was about, which was the underlying hurdle rates.

Hugh McNeal: Jill, that may well be correct. All I can say is that we look at data that try to compare what we are paying in our country, given all the other issues in different countries, regulatory systems and all the rest, and we look at that in comparison—

Sir Amyas Morse: Could I just say, the answer was a bit misleading and that is why we had to mention it at the end. If we do not say that, we would have to correct your evidence later.

Chair: Good. Thank you very much indeed.

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[2] Note from witness: The figure for jobs supported does not necessarily apply to the UK only and has not been disaggregated on this basis.