E3G

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GREEN LEVIES

HOW TO REMOVE POLICY COSTS FROM BILLS FAIRLY AND EFFECTIVELY

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The new Prime Minister's most urgent task is to deal with the unprecedented rise in energy bills scheduled for October. Long-term energy security solutions like energy efficiency, new renewables, and the electrification of heating and industrial processes will be essential. But lowering bills quickly is the most critical concern.

Liz Truss is reportedly considering a large support package to effectively freeze prices. Whatever mechanism is chosen, this package will include the energy bill rebate announced in spring and is likely to involve suspending "green levies" – a pledge made several times during the recent Conservative party leadership election.[1]

Environmental and social policy levies – costs for government energy policies that are recovered through consumer bills rather than the exchequer – come to £160 per year. 97% of these costs come from four policies: the Renewables Obligation (RO), Feed-in Tariffs (FiT), the Warm Home Discount (WHD), and the Energy Company Obligation (ECO).[2] Although policy levies make up a very small proportion of overall bills – under 5% - there would be some value to bringing some of their costs into government spending. This briefing outlines how the government can remove levies from bills without damaging important fuel poverty programmes or investor confidence by:

- **Switching Renewable Obligation Certificates to Fixed Price Certificates by the end of 2023 and taking the costs into the exchequer to cut policy costs in half.**
- **Covering Feed-in Tariff payments by paying suppliers directly and passing the savings on to consumers.**

[1] Bloomberg UK, **Truss Drafts £130 Billion Plan to Freeze UK Energy Bills**, 6 September 2022.

[2] Ofgem, **Default tariff cap level: 1 April 2022 to 30 September 2022**, February 2022.

- **Issuing a temporary rebate using the Energy Bills Support Scheme mechanism to cover the cost of the WHD and ECO this winter, and of the RO until 2023.**
- **Suspending plans in the Energy Security Bill for new levies on bills.**

Taken together these measures would save households around £156 per year to 2024, and around £99 in subsequent years.

Removing RO costs from bills would cut policy costs in half

The Renewables Obligation was launched in 2002 to support large-scale renewable energy projects in the UK. It put an obligation on energy suppliers to source an increasing proportion of their electricity from renewables. Ofgem issue Renewables Obligation Certificates (ROCs) to eligible renewable generators, and electricity suppliers are required to use these to demonstrate obligation compliance.

In 2017, the RO was replaced with Contracts for Difference (CfDs), which auction a strike price for renewable generation. Generators pay back to government when the wholesale price is above the strike price. The current market situation and competitive CfD auctions mean their cost on bills has fallen to virtually nothing. From October CfDs will be paying back to consumers and are likely to lower bills by around £15.[3]

The RO is by far the largest levy cost, at £80.[4] As the scheme is now closed, with new renewable generation the cheapest available on the market, it makes sense to bring the costs into the exchequer. To do this, government would first need to stabilise the price of ROCs, which is currently set by the trading market between suppliers and generators. Fortunately, this stabilisation is already government policy. In 2013, the government set out a plan to switch the RO to a Fixed Price Certificate (FPC) scheme in 2027, to address ROC price volatility.[5] Moving to FPCs would give revenue stability to RO generators and cost certainty to the government, enabling the Treasury to bring RO costs in-house.

To take the Renewables Obligation off bills – halving the impact of policy costs in one go – the new Prime Minister should bring forward the planned transition date to FPCs to the end of 2023, four years earlier than planned, and then take the costs into government sending. This would give time to consult with the market and reach a negotiated FPC price and put it in place through secondary legislation. Government

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[3] Energy and Climate Intelligence Unit, **Paying Back**, March 2022.

[4] Ofgem, **Default tariff cap level: 1 April 2022 to 30 September 2022**, February 2022.

[5] DECC, **Energy Act: Renewables Obligation Transitional Arrangements**, 2013, and BEIS, August 2021, **Renewables Obligation: addressing electricity supplier payment default under the RO scheme.**

could cover the cost of the RO in the meantime through the Energy Bill Support Scheme mechanism. This would carry a cost to the exchequer of around £2.3bn per year.

Passing payments through suppliers is the simplest way to remove FiT costs

The Feed-in Tariff scheme aimed to encourage the uptake of renewable and low-carbon electricity generation, which required electricity suppliers to make payments for electricity generated and exported to the grid by FiT accredited installations. It costs households around £19 per year.[6] The scheme closed to new applicants in 2019.

FiTs are in effect individual contracts with tens of thousands of generators. This means that changes to the contractual terms, while possible, would likely have high administrative costs and could be subject to legal challenge.

A simpler way to remove FiT costs would be to make payments directly to energy suppliers and have them pass through the savings to consumers. This could be done with primary powers to change the Ofgem energy price cap, to guarantee that consumers see the benefit. The Energy Security Bill could be amended for this purpose.

Alternatively, the government could use the Energy Bills Support Scheme mechanism, which was introduced in April to apply a direct £400 grant to consumer bills from October 2022, and increase its value to cover FiTs at a cost of around £550m.

The Warm Home Discount and ECO are more important now than ever – but a temporary rebate could help households this winter

Although they are sometimes referred to collectively as "green levies", two important levies target fuel poverty rather than renewables. The WHD requires energy suppliers to support low-income households and those vulnerable to cold-related illnesses or living in fuel poverty. 2.26 million fuel poor pensioners and people in fuel poor households in receipt of some means-tested benefits received £140 rebates in 2020-21.[7]

ECO helps tackle some of the underlying causes of fuel poverty by delivering new boilers, heating controls and energy-saving insulation measures to fuel-poor households. It is expected to help 112,500 households this year. ECO has delivered low-income customers £17.5bn in lifetime savings since 2013 and saves households an average of £290 per year.[8] Under 2022 prices, these savings will be even higher.

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[6] Ofgem, **Default tariff cap level: 1 April 2022 to 30 September 2022**, February 2022.

[7] Ofgem, **Warm Home Discount Annual Report: Scheme Year 10**, January 2022.

[8] BEIS, **Household Energy Efficiency Statistical Release**, 25 November 2021, and E3G, **The Energy Company Obligation**, January 2022. Lifetime savings are forecast across the life of the installed efficiency measures.

The levy funding system for ECO and the WHD is a source of stability for suppliers which allows for easier administration and contracting with delivery partners putting energy saving measures in homes. It is also more progressive than other levies, as the benefits go directly to low-income households. For this reason, fuel poverty organisations have called for government to prioritise the other legacy policy levies, which are more regressive, to be moved to general taxation.[9] However, given the high costs faced by all households this year, the new Prime Minister could use the Energy Bills Support Scheme mechanism to issue a rebate for these costs. This would come to around £1.65bn.

No new revenue support levies should be introduced to bills

In general, recovering costs through fixed charges on energy bills is a regressive way to pay for policy. Taking the costs into government spending and funding them through general taxation is more progressive because tax payments scale by income.

This briefing note has set out some of the complexities involved with removing existing levies from bills. While the Renewable Obligation and Feed-in Tariffs respectively accomplished lots of worthwhile objectives, they have also left a legacy that is creating headaches for households and government alike. The new Prime Minister should not leave similar problems for their successors.

The Energy Security Bill currently before Parliament proposes new levies to support early-stage hydrogen and carbon capture, usage, and storage (CCUS) projects.[10] While both technologies may have an important role to play in the UK's net zero target, the cost of supporting these new and relatively unproven investments should not fall on households without any progressive cost sharing. The case for levies is particularly weak for these technologies, because unlike renewable electricity generation, there is no proven consumer use-case for either technology – their uses will be primarily industrial.

The new Prime Minister should therefore demonstrate a clear break with the past approach to levy funding by amending the Energy Security Bill to fund revenue support for hydrogen and CCUS without loading new costs onto customers.

Legacy policy costs are not the whole story

Taking the steps outlined above to save households £156 per year on their bills this year and next, and £99 every year after that, would be a worthwhile step. But with soaring

[9] National Energy Action, **Fuel Poverty Monitor 2020-21**, November 2021.

[10] UK Parliament, **Energy Bill [HL] Government Bill**, July 2022.

international gas prices set to push annual bills to £3549 in October, assuming no intervention, more significant long-term reform will also be needed.[11]

The recently announced Review of Electricity Market Arrangements is an important first step. The new Prime Minister should commit to ensuring consumers feel the full benefits of renewable generation by decoupling the cost of electricity from the cost of gas, accelerating the deployment of new renewable generation, and stepping up public and private investment in energy efficiency.[12]

About E3G

E3G is an independent European climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

More information is available at **www.e3g.org**

[11] Ofgem, **Default tariff cap level: 1 October 2022 – December 2022**, 26 August 2022.

[12] E3G, **The Home Energy Security Strategy: A Permanent Solution for Lower Bills**, June 2022.