

EXPLANATORY MEMORANDUM TO
THE ELECTRICITY AND GAS (ENERGY COMPANY OBLIGATION)
(AMENDMENT) ORDER 2017

2017 No. [XXXX]

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy (“BEIS”) and is laid before Parliament by Command of Her Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 The instrument increases the overall carbon emissions reduction target and the overall home heating cost reduction target to be met by larger electricity and gas suppliers under the Electricity and Gas (Energy Company Obligation) Order 2014 (S.I. 2014/3219) (“the 2014 Order”) and extends the period for meeting those targets by 18 months to 30th September 2018. The targets require the suppliers to install qualifying measures in domestic premises which reduce carbon emissions or the cost of heating the home. The instrument also changes the method for calculating the carbon savings or cost savings from certain measures, changes some of the criteria for the measures that qualify towards meeting the targets and changes some of the rules for the administration of the targets by the Gas and Electricity Markets Authority (“the Administrator”).

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 The instrument will come into force on the day after the day on which it is made. The 31st March 2017 is the latest that the instrument can be brought into force, as otherwise the period set for meeting all of the targets under the 2014 Order would come to an end on 31st March 2017 and a failure by any supplier to fully meet their targets by measures installed before that date would be a breach, which could lead to enforcement action by the Administrator.
- 3.2 The instrument refers to the Publicly Available Specification 2030:2017 which is published by the British Standards Institution. The standards and specifications referred to in the instrument are available for purchase from the British Standards Institution at the postal address and website given in the footnotes to the instrument.

Other matters of interest to the House of Commons

- 3.3 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland.

4. Legislative Context

- 4.1 The instrument is to be made primarily in exercise of the powers conferred by sections 33BC and 33BD of the Gas Act 1986, sections 41A and 41B of the Electricity Act 1989 and sections 103 and 103A of the Utilities Act 2000. The amendment to article 33 of the 2014 Order will be made under section 2(2) of the European Communities Act 1972, and implements the first paragraph of article 7(8) of Directive 2012/27/EU on energy efficiency in respect of this supplier obligation scheme.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is England and Wales and Scotland.
5.2 The territorial application of this instrument is Great Britain.

6. European Convention on Human Rights

- 6.1 The Minister of State for Energy and Intellectual Property has made the following statement regarding Human Rights:

“In my view the provisions of the Electricity and Gas (Energy Company Obligation) (Amendment) Order 2017 are compatible with the Convention rights.”

7. Policy background

What is being done and why

- 7.1 The Energy Company Obligation (ECO) scheme is a statutory obligation placed on the largest energy suppliers that meet or exceed a threshold of supplying more than 2,000GWh of gas or more than 400GWh of electricity to more than 250,000 domestic consumers on an annual basis. The scheme requires them to meet targets to reduce carbon emissions and notional energy bills by installing energy efficiency measures to households in Great Britain.
- 7.2 Supporting the installation of energy efficiency measures in the residential sector in Great Britain will help the Government achieve the following objectives: (i) contribute towards reducing the UK’s harmful greenhouse gas emissions; (ii) help improve energy security by reducing energy demand and therefore reducing the need to import energy; (iii) reduce the cost of heating a home to a reasonable level, in support of the Government’s statutory objective for addressing the situation of persons who live in fuel poverty; (iv) increase productivity (with the potential to boost growth and business competitiveness); (v) help the UK meet its energy efficiency targets and (vi) reduce the costs of meeting the UK’s renewable energy target through promoting more efficient energy use.
- 7.3 Market failures and barriers are known to reduce the take up of cost-effective energy efficiency measures, particularly for fuel poor households. As such, without Government intervention, heating costs and carbon emissions will not fall to the extent that is possible, with a corresponding reduction of impact on the objectives described above. The instrument continues a policy which has been in place since January 2013, and is designed to address the market failures and barriers which are preventing a greater demand for the cost-effective delivery of energy efficiency measures.
- 7.4 The obligation is expressed in terms of energy efficiency outcomes (carbon tonnes saved, notional reductions on home heating costs), not expenditure. It is recognised

that achieving these targets imposes costs on the obligated companies, who can be expected to pass those costs through to domestic consumers. The costs of the ECO scheme will therefore be borne by households, though the energy bills of households which receive ECO measures will be reduced, from what they would otherwise be, on a sustainable basis.

- 7.5 The legislation which governs the existing scheme was put in place in January 2013 and expires in March 2017, with an estimated total spend of £860m per annum in 2017 prices. Approximately two thirds of the estimated existing scheme expenditure has had a primary focus on reducing carbon emissions and one third on reducing notional heating bills for low income households.
- 7.6 In 2015, the Government's Spending Review announced plans for a supplier obligation to run for 5 years from April 2017 at an estimated level of £640m per year in 2017 prices, to tackle the root cause of fuel poverty. The proposed scheme would be the primary vehicle through which Government would meet its manifesto commitment to insulate a million more homes over this Parliament as well as contribute to the Government's statutory fuel-poverty target.
- 7.7 The principal effect of the instrument is to extend the current ECO scheme for the period from April 2017 to September 2018. This is to enable scheme reforms to be introduced while also allowing industry time before further change is intergrated into a new longer term scheme, run from 2018 to 2022. The key changes to the current scheme are noted below.
- 7.8 The ECO scheme will be extended at £640m per annum and re-balanced towards tackling fuel poverty – the element of the scheme that is focused on providing measures to those in fuel poverty and on low incomes will be enlarged from an estimated cost of £310m per annum to £450m per annum. This is intended to improve the targeting of the scheme and make greater progress towards fuel poverty objectives while reducing overall costs.
- 7.9 In light of consultation responses noted in section 8 of this Explanatory Memorandum, the instrument extends the scheme for a period of 18 months rather than 12 months, in order to provide industry with a longer period in which they can adapt their delivery models. An 18-month scheme will also enable the Government to draw lessons from the operation of the transition period and feed them into the design of the new scheme in 2018. Additionally, this will allow the Government to make quicker progress in the short-term towards the manifesto commitment of insulating one million homes, enabling more flexibility when designing the successor scheme.
- 7.10 The part of ECO known as Affordable Warmth, which places the greatest focus on targeting low income and fuel poor households, is increased by £2.76bn notional lifetime bill savings, resulting in an increase from 34% to 70% of the overall estimated spend. The Carbon Emissions Reduction Obligation (CERO) is increased by 7.3 MtCO₂, but will decrease overall as a proportion of the total estimated spend from approximately 34% to 30%. Additionally, the Carbon Saving Community Obligation (CSCO) and its rural sub-obligation are brought to an end, as the other two obligations, CERO and Affordable Warmth, are more cost effective at achieving carbon reductions and tackling fuel poverty respectively.
- 7.11 Eligibility for Affordable Warmth is amended by removing sub-criteria for recipients of some means-tested benefits and by changing the level and number of income thresholds for Working Tax Credits and Universal Credits recipients. This will

simplify the scheme, while improving targeting of fuel poor and low income households.

- 7.12 Eligibility for certain measures under Affordable Warmth is extended to social housing in Energy Performance Certificate (EPC) bands E, F or G in order to allow measures to be provided to social tenants who are most in need and more likely to be fuel poor, while preventing measures under this part of ECO from being directed towards social housing with EPC bands D and above, which show significantly lower levels of fuel poverty.
- 7.13 Local authorities will be able to determine eligible homes under a new 'flexible eligibility' mechanism. Suppliers will be able to use this voluntarily for up to 10% of the Affordable Warmth obligation allocated to them in respect of the 18-month scheme extension. This change will enable the mechanism to be tested during the extension while allowing local authorities to utilise their access to local knowledge in order to better target ECO support to fuel poor or low income households that are vulnerable to the effects of living in a cold home.
- 7.14 New requirements are imposed under Affordable Warmth in order to limit the number of qualifying gas boiler replacements to the equivalent of approximately 25,000 per year (or approximately 37,000 over the 18 months) during the scheme extension. This change will result in better outcomes for fuel poor and low income households overall, as it will ensure that a greater number of the most cost effective and beneficial measures (such as insulation and first time central heating) are delivered under the scheme (at the moment about 90% of Affordable Warmth is met through delivering gas replacement boilers).
- 7.15 A solid wall minimum will be retained and increased from the level proposed in the consultation of approximately 17,000 measures per year to 21,000 (or approximately 32,000 over the 18 month extension), in light of revised, reduced estimates of the costs of these measures under the scheme.
- 7.16 The Publicly Available Specification (PAS 2030) published by the British Standards Institution is a specification for the installation of various energy efficiency measures. In addition to the requirement for measures to be installed in accordance with PAS2030, a new requirement is imposed for all measures referred to in PAS 2030 and completed during the scheme extension to be installed under the responsibility of an installer certified as compliant with PAS 2030. This is to ensure that installation companies are operating to the same minimum standard.
- 7.17 New buildings that are erected on or after the 1st April 2017 and have never been occupied will not be eligible for ECO measures during the scheme extension. Although there has been low levels of delivery to new buildings under the current scheme, this will avoid ECO support being used for measures that are delivered as part of the construction of a new property.
- 7.18 The requirement for CERO measures to be recommended in a Green Deal Advice Report or chartered surveyor's report is removed from the scheme. Although these reports provide some benefits in terms of consumer advice, the Government believes that these are outweighed by the additional cost and administrative burden they add.
- 7.19 Additional flexibility has been provided by introducing a trading mechanism which allows suppliers to trade all or part of an obligation between different supply licences. Changes are also made to the notification process for measures, allowing up to 5% of a supplier's measures to be granted an automatic extension of up to three months after

the original notification deadline and allowing extension applications to be made even where the cause of the missed deadline was administrative oversight. These changes will simplify administration and help reduce scheme costs.

- 7.20 For most measures the current Standard Assessment Procedure methodology for the calculation of carbon or cost savings is replaced by methodologies published by the Administrator. These methodologies ('deemed scores') require fewer inputs and so simplify delivery and reduce scheme costs. An uplift of 30% is applied to the deemed scores in order to mitigate differences that consultation responses noted between the deemed scores and bespoke Standard Assessment Procedure assessments. A 15% in-use factor has also been applied to party cavity wall insulation in order to award a more accurate carbon saving to these measures.

Consolidation

- 7.21 This is the first instrument to amend the 2014 Order. There are no plans for a consolidation at this time.

8. Consultation outcome

- 8.1 The Government consulted on proposed scheme changes for seven weeks from 29th June 2016 to 18th August 2016. This seven week period was considered appropriate as the proposal was to extend the existing scheme with some changes and stakeholder engagement had also taken place in the development of the proposals for consultation. During the consultation period BEIS conducted three stakeholder events in London, Cardiff and Glasgow.
- 8.2 The consultation received 236 formal responses which were broadly supportive of the majority of the proposals, including the need to refocus the scheme towards fuel poverty.
- 8.3 In keeping with the consultation proposals to simplify delivery and refocus the scheme towards better targeting of fuel poor households, the Government has continued with the majority of changes proposed in the consultation.
- 8.4 Responses generally agreed with the proposal to allow local authorities to determine eligible homes for a proportion of the Affordable Warmth obligation, with most support for a 20% or higher cap. However, the Government has set a 10% cap so that this new mechanism can be tested during the scheme extension.
- 8.5 Stakeholder responses displayed mixed views on whether there should be a rural sub-obligation during the scheme extension, due to concerns that without it suppliers might not deliver to rural areas. Similar levels of rural delivery have been occurring outside the CSCO rural sub-obligation as within it, and further policy changes (such as limiting the number of gas boiler replacements) should incentivise further rural delivery. Nevertheless, the Government wishes to safeguard delivery in rural areas so it is introducing a sub-obligation under CERO. 15% of the CERO obligation imposed on suppliers in respect of the scheme extension will have to be met through delivery in rural areas. The existing CSCO and its associated rural sub-obligation is brought to an end.
- 8.6 Responses generally agreed with focusing the scheme more on installations which made the most impact on reducing fuel poverty (more insulation, fewer replacement gas boilers), however views were split on the level of the limit on the replacement of gas boilers and the minimum requirement for solid wall insulation. There were

concerns that the level of replacement boilers proposed was too low and could therefore cause abrupt adjustments to the supply chain if introduced for a one-year period. The Government has taken these concerns into account by extending the scheme to 18 months. Some respondents were also concerned that fuel poor households may not be able to source alternative financial support for gas boiler replacements. However the Government believes that the limit should result in better outcomes for fuel poor households overall as it will ensure that the most beneficial measures are delivered in greater numbers, whereas they are currently crowded out by gas boiler installations. Some respondents argued that the cost assumptions for solid wall insulation modelled in the impact assessment were too low, and the overall target for this measure should be increased. As a result of evidence on this, the Government has increased the solid wall minimum requirement from the consultation proposal to approximately 21,000 measures per year.

- 8.7 A number of respondents were also critical of the overall reduction in the size of the scheme and suggested it should be higher in order to increase ambition in tackling fuel poverty and reducing carbon emissions.
- 8.8 The views of consultees are summarised along with related policy decisions in the Government's consultation response which was published on the www.gov.uk website on 30th January 2017.¹

9. Guidance

- 9.1 An updated version of the non-statutory guidance for obligated electricity suppliers was consulted on in October 2016 by the Administrator Ofgem.
- 9.2 Additional guidance regarding flexible eligibility will be produced by BEIS.
- 9.3 Copies of the final guidance documents will be published and circulated to all energy suppliers and other key stakeholders.

10. Impact

- 10.1 An Impact Assessment has been submitted alongside this Explanatory Memorandum and is published alongside it on the legislation.gov.uk website. It estimates the impact of extending the obligation on larger energy suppliers to September 2018. The expected level of spend by suppliers in order to meet the extended requirements (around £640m per annum) is expected to be lower than under ECO to March 2017 (around £860m per annum), meaning the Regulatory Policy Committee validated the extension to ECO as a net OUT under One in Three Out in its opinion dated 21st December 2016.
- 10.2 The Impact Assessment also estimates the wider impacts of the ECO extension. It estimates the extension will lead to a net benefit to society of £638m (present value), save nearly 9 million tonnes of lifetime carbon savings, see around 500,000 homes insulated, and make a contribution towards reducing the 92% of fuel poor households in England that are estimated to be at Band E or above following the transition scheme.
- 10.3 The impact on the public sector is limited to the cost borne by Government of administering certain aspects of the extension, including paying for the

¹ <https://www.gov.uk/government/consultations/energy-company-obligation-eco-help-to-heat>

Administrator's set up costs and ongoing operations including the production of new guidance as noted in the preceding section.

11. Regulating small business

- 11.1 The instrument does not impose any requirements on electricity or gas suppliers with 250,000 or fewer domestic customer accounts. For suppliers that are part of a group, this threshold is applied at a group level.
- 11.2 To minimise the impact on smaller suppliers who pass through the 250,000 domestic customer thresholds, the share of the targets that is apportioned to them is tapered such that the size of the obligation on smaller companies increases gradually.

12. Monitoring & review

- 12.1 Monitoring of ECO is being undertaken throughout the duration of the scheme.
- 12.2 The Administrator is under a duty (in article 31 of the 2014 Order) to submit a report each month setting out the progress which suppliers have made towards meeting their obligations. Article 31 of the 2014 Order also requires the Administrator to determine whether a supplier has achieved its obligations and submit a final compliance report to the Secretary of State no later than six months after the scheme has ended.
- 12.3 This instrument provides for the scheme to run until 30th September 2018. Consultation with Ofgem, electricity and gas suppliers and other appropriate persons will be required to extend the scheme beyond this date; in addition to requiring a new Order that is approved by Parliament.

13. Contact

- 13.1 Rita Varsani at the Department for Business, Energy and Industrial Strategy, Telephone: 0300 068 6938 or email: rita.varsani@beis.gov.uk who can answer any queries regarding the instrument.