EXPLANATORY MEMORANDUM TO

THE CLEAN HEAT MARKET MECHANISM REGULATIONS 2024

2024 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Energy Security and Net Zero and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Dr Miatta Fahnbulleh, Minister for Energy Consumers at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

2.2 Tara Deshpande, Deputy Director for Electrification, Products, Buildings and Delivery, at the Department for Energy Security and Net Zero can confirm that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Harry Bradwell at the Department for Energy Security and Net Zero. Telephone: 0207 215 8419 or email: harry.bradwell@energysecurity.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This Statutory Instrument establishes a low-carbon heat scheme known as the Clean Heat Market Mechanism (CHMM). The CHMM will operate from 1st April 2025 and involves the imposition of low-carbon heat targets on the manufacturers of fossil fuel boilers whose sales meet certain thresholds. Targets are set by reference to a proportion of such boiler sales and must be met by the surrender of certificates representing installations of low-carbon heat pumps.

4.2 The CHMM aims to provide the heating appliance industry with a clear, stable policy framework and the incentive to invest with confidence in scaling up the consumer market for heat pumps, thereby accelerating deployment and driving down energy demand from buildings. This scheme will work alongside a range of other policies, such as grant funding for heat pump installations, to establish an overall policy framework capable of supporting a transformation of the heating market.

Where does the legislation extend to, and apply?

4.3 The extent of this instrument (that is, the jurisdictions which the instrument forms part of the law of) is England and Wales, Scotland and Northern Ireland.

4.4 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

5.1 The CHMM established by these regulations will be a scheme to encourage the supply and installation of low-carbon heat pumps.

5.2 Meeting the UK's net zero target requires decarbonising the vast majority of heat in buildings. This requires a transition from the large majority of buildings being heated by appliances which burn fossil fuels to the use of low-carbon heating technologies. Since nearly half of UK annual natural gas consumption is used for heating buildings, accelerating this transition will also reduce dependency on global fossil fuel markets.

5.3 The CHMM will, from 1st April 2025, place an obligation on the manufacturers of heating appliances which have sales above specified thresholds to meet targets for the proportion of electric heat pumps they sell each year, relative to fossil fuel boilers.[1] These targets will provide firms with the certainty to invest in building the heat pump market and growing the supply chain and promoting and expanding the uptake of these technologies by consumers. Manufacturers who are close to the sales thresholds have registration and notification obligations. Targets are set for "scheme years", which is the period from 1st April to 31st March, and by reference to fossil fuel boiler sales during the same period. The CHMM will run for four years initially.

5.4 A heat pump manufacturer will be able to earn a certificate for the installation during a scheme year of a qualifying domestic-scale hydronic heat pump notified via an appropriate certification scheme which is approved by the Secretary of State. In order to provide flexibility in how the obligation can be met, these certificates will be tradable. Scheme participants – that is, manufacturers of fossil fuel boilers sold for installation in existing UK buildings above the minimum volume thresholds stipulated in the regulations – will be able to meet their low-carbon heat target, in part or in whole, through acquiring certificates from other heat pump manufacturers. Providing further optionality in how the obligation may be met, certain installations of hybrid heat pump systems that involve both a heat pump and a fossil fuel boiler element will also qualify, receiving 0.5 heat pump certificates.

5.5 Flexibility will also come from the fact that scheme participants will be able to carry forward a limited proportion of their target from one scheme year to make up in the subsequent year, and from all scheme participants and certificate holders (that is, heat pump suppliers which do not have targets because they are not the manufacturers of fossil fuel boilers) being allowed to carry forward some level of unsold or unused certificates to the following scheme year.

5.6 If a scheme participant should fail to acquire and surrender to the scheme administrator from their account the correct number of heat pump certificates on the due date, it will be required to make a payment of £500 per missing certificate.

5.7 The scheme administrator (the Environment Agency) will be responsible for the overall delivery of the scheme, ensuring compliance with the scheme and carrying out appropriate enforcement action in instances of non-compliance, potentially in

[1] Manufacturers of fossil fuel boilers and heat pumps are identified in the regulations as the "supplier", which is defined in regulation 2(1) as the undertaking which manufactured the heating appliance, or had it manufactured, and which owns or has the right to use the brand name, trade mark or other distinctive mark under which the appliance is marketed in the UK. In almost all cases, a single undertaking would be identified by this definition. However, there may be a very small number of instances where two or more manufacturers could meet that definition, for example where a heating appliance is marketed under joint branding. In such cases, provision is made in regulation 2(4) to (7) to identify the appropriate undertaking as the supplier of the heating appliance.

partnership with other enforcement agencies. The compliance and enforcement regime has been designed to incentivise compliance and early settlement and adheres to the principles of fairness and proportionality.

6. Legislative and Legal Context

How has the law changed?

6.1 Section 143 of the Energy Act 2023 enables the Secretary of State to make regulations establishing a low-carbon heat scheme such as the CHMM to encourage the supply or installation in the United Kingdom of low-carbon heating appliances, through the imposition of low-carbon heat targets. This is the first use of this power.

6.2 Section 145 of the Energy Act 2023 enables a low-carbon heat target to be set in a variety of ways. Annual targets under the CHMM will be set for any undertaking, or group of undertakings, which carries on the specified activity of being the supplier (as defined in regulation 2(1)) of a certain number of fossil fuel boilers for installation in existing properties in the United Kingdom. Section 145(1)(b) enables the setting of targets by reference to the proportion of that activity that must relate to "relevant heating appliances", within the meaning of section 143(3), which for the purposes of the CHMM are electric heat pumps. Targets are met by surrendering certificates which represent installations of heat pumps. Heat pump installations must meet certain conditions, including being certified by a scheme approved by the Secretary of State under the regulations. Section 145(2) (power to specify conditions about the carrying out of activities to which a scheme relates) and section 145(4) (power to confer discretion on the Secretary of State in connection with the setting of targets) are relied on for these conditions.

7. Consultation

Summary of consultation outcome and methodology

7.1 There were two public consultations on the draft policy proposals and a third consultation, which was an 'addendum' to the 2023 Government Response and focused on a proposal to postpone the scheme's implementation date from April 2024 to April 2025. The first consultation was conducted between 19th October 2021 and 12th January 2022[2], the second was conducted between 30th March and 8th June 2023[3] and the third was conducted between 14th March 2024 and 9th May 2024[4]. The first consultation sought views on the overall shape, usefulness and focus of a potential market-based mechanism for low-carbon heat. The second consultation set out a range of key proposals relating to specific design parameters for the CHMM, including in respect of scheme participants, scope, targets, payments-in-lieu, credit-trading, data and scheme administration. The third 'addendum' consultation sought views on delaying the scheme's implementation date to April 2025.

7.2 The first consultation received a total of 67 individual responses, the second received a total of 73 individual responses and the third consultation received 42 individual responses. The consultations attracted responses from a wide range of organisations, representative and trade bodies, industry professionals, academics and individual members of the public. The government response to the first consultation was

[2] https://www.gov.uk/government/consultations/market-based-mechanism-for-low-carbon-heat
[3] https://www.gov.uk/government/consultations/clean-heat-market-mechanism
[4] https://www.gov.uk/government/consultations/clean-heat-market-mechanism-adjustment-to-scheme-introduction-date/clean-heat-market-mechanism-proposal-to-change-the-scheme-start-date-to-1-april-2025

published on 11th May 2022. The government response to the second consultation was published on 30th November 2023. Finally, the government response to the third consultation was published on 21st November 2024. (The response publications can be found at the same web-links as the consultation documents – see footnotes 2, 3 & 4).

7.3 Whilst a majority of respondents were generally supportive of the proposals and the policy intentions behind them, as set out in the first two consultations, among those who disagreed, including businesses expecting to be scheme participants with an obligation, a common theme in responses to consultation questions was a concern that more time was needed for the market to adjust, with either lower heat pump deployment targeted, greater flexibility allowed over time, lower potential cost implications for parties missing targets, and/or a delay in the scheme's launch altogether.

7.4 In response to this feedback, the flexibility allowance for target carry-forward has been increased in the final design beyond the 2023 consultation proposals, a proposed multiplier associated with such carry-forward was removed from the final policy design, and the level of the payment-in-lieu required for missing heat pump certificates against targets has been reduced to £500.

7.5 In response to the third consultation, half the respondents stated they would have preferred the scheme to launch in April 2024, with some of these respondents accepting April 2025 was now the most likely option for the scheme launch. Both respondents who were supportive and unsupportive of delaying the scheme to April 2025 provided feedback about elements of the scheme design. This feedback was similar to those raised in the first two consultations.

7.6 The CHMM proposals were consulted on across the United Kingdom and the Devolved Administrations have been engaged throughout the development of the scheme. All three Devolved Administrations have been broadly supportive of the scheme, both its intent and application. In accordance with section 151(4) of the Energy Act 2023, the Secretary of State gave notice to the Devolved Administrations of the intent to introduce scheme regulations of this kind and provided them with 28 days to make representations for consideration.

8. Applicable Guidance

8.1 The Environment Agency, the scheme administrator, will be responsible for running the day-to-day operations for the scheme, including performing functions such as handling enquiries, registration checks, issuing notices and monitoring compliance with the scheme rules. The Environment Agency will publish guidance on the administration of the scheme on their website ahead of launch to provide clarity to heating appliance manufacturers on how to comply with the scheme, and on their role as administrator.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

Impact on businesses, charities and voluntary bodies

9.2 The impact on business, charities or voluntary bodies is predominantly focused on manufacturers of fossil fuel heating appliances sold in the UK. The wider supply

chain will also be impacted by the obligation, as third parties might be involved in delivering the installations to meet the targets.

9.3 Fossil fuel heating appliance manufacturing is a relatively concentrated market sector, with four companies responsible for close to 90% of annual gas boiler sales (ca. 1.8m per year, though lower in 2023 at ca 1.5m), and five companies responsible for a further ~7% of sales. The four largest companies, and a number of the second-tier companies, are all multi-technology corporations producing and selling a range of appliances, including heat pumps, in several countries. In the oil boiler sector, four companies share around 93% of annual sales (over 59,000 per year), and another two companies a further 3%[5].

9.4 In delivering their obligation, businesses will incur familiarisation and administrative costs which will vary by business. There will also be administrative costs associated with compliance with the scheme, for instance from reporting and the provision of evidence and participation in verification audit processes. The costs to these businesses of meeting the obligation are difficult to assess with confidence, as is the extent to which such costs may be offset by higher revenue associated with such sales. The possibility to trade certificates means that the costs faced by different scheme participants could vary significantly, depending on whether they decide to account for their low-carbon heat target, in part or in whole, through acquiring certificates from other heat pump manufacturers. Some of the costs that scheme participants will face are transfers between businesses; others will be offset by direct benefits to business.

9.5 The legislation does not impact small or micro businesses directly.

9.6 To minimise the impact of the requirements on small or micro businesses (employing up to 50 people), companies that meet the criteria of the small companies regime under the Companies Act 2006 are excluded from the scope of the obligations in the regulations. In addition, *de minimis* threshold exclusions from the policy scope: manufacturers of fossil fuel appliances with less than 20,000 relevant gas boiler sales or less than 1,000 relevant oil boiler sales, currently equivalent to a little over a 1% market share in each case, are not in scope of the obligation to meet heat pump targets with respect to those appliances. This further limits the costs to smaller firms that may not meet the criteria of the small companies regime and/or those with only limited activities in the UK. Beyond companies in scope of the regulations, existing, diversifying or new micro and small businesses engaged in the installation of low-carbon heating are likely to benefit indirectly from the policy's increase in business in this area.

9.7 There is no, or no significant, impact on the public sector.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The Department will conduct monitoring and undertake an evaluation of the CHMM to assess the extent to which the objectives and expected impacts of the scheme are realised, as well as to collect evidence that will support wider learning in relation to low-carbon heat and other relevant policy areas (such as energy efficiency, net zero consumer behaviour changes, etc.). The ongoing monitoring will also support the management of the scheme, including tracking of deployment, credit trading and compliance.

[5] BSRIA (2024), 'Domestic Boilers Market Analysis 2023'

10.2 A statutory review clause is included in the instrument. The monitoring and evaluation conducted during the scheme will support this post-implementation review and the outcome of the review will inform a decision whether or not to extend the CHMM beyond its current four years.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Minister for Energy Consumers has made the following statement regarding Human Rights:

"In my view the provisions of the Clean Heat Market Mechanism Regulations 2024 are compatible with the Convention rights.".

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").