EXPLANATORY MEMORANDUM TO

THE ELECTRICITY AND GAS (ENERGY COMPANIES OBLIGATION) (AMENDMENT) (NO. 2) ORDER 2014

2014 No. [XXXX]

1. This explanatory memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This Order amends the Electricity and Gas (Energy Companies Obligation) Order 2012 (S.I. 2012/3018), as amended by S.I. 2014/1131 (the "ECO Order"), which requires large gas or electricity suppliers to achieve carbon and home heating cost reduction targets by promoting the installation of energy efficiency measures at domestic properties. These targets are the carbon emissions reduction obligation ("CERO"), the carbon saving community obligation ("CSCO") and the home heating cost reduction obligation ("HHCRO").

2.2 This Order will in particular, (i) reduce the overall carbon emissions reduction target for the period 1st January 2013 to 31st March 2015 from 20.9 MtCO2 to 14 MtCO2, (ii) provide that achieving the carbon emissions reduction obligation by 31st March 2015 is not an enforceable regulatory requirement, (iii) provide that certain new types of measure are eligible for the carbon emissions reduction obligation if installed on or after 1 April 2014, (iv) expand the scope of eligible "areas of low income" for the carbon saving community obligation, and make provision for an alternative way for suppliers to meet the "rural sub-target" part of the carbon saving community obligation ; (iv) provide for certain carbon qualifying actions to make a contribution towards a supplier's carbon emissions reduction obligation of 1.75 times the carbon saving originally attributed to the qualifying action, (v) provide that a group of suppliers may apply to the Administrator to credit towards an applicant supplier's obligations under the ECO Order actions which were installed and approved under the predecessor scheme 'CERT', (vi) provide that suppliers can apply to transfer qualifying actions and excess actions from one ECO obligation to another more than once; and (vii) provide that the Administrator must notify suppliers whether they have met their obligations by 30th September 2015, and that the Administrator must report to the Secretary of State whether suppliers have met their obligations by 30th September 2015.

3. Matters of special interest to the Joint Committee on Statutory Instruments or the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 This Order is made in exercise of the powers conferred by section 33BC and 33BD of the Gas Act 1986(1), section 41 and 41B of the Electricity Act 1989(2) and section 103 of the Utilities Act 2000(3). It amends the Electricity and Gas (Energy Companies Obligation) Order 2012 (S.I. 2012/3018), as amended by S.I. 2014/1131 (the "ECO Order").

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

The Secretary of State for Energy and Climate Change has made the following statement regarding Human Rights:

In my view the provisions of The Electricity and Gas (Energy Companies Obligation) (Amendment) (No. 2) Order 2014 are compatible with the Convention rights.

7. Policy background

7.1 The Energy Company Obligation (ECO) period commenced on 1 January 2013, with an end date of 31 March 2014. ECO places an obligation on large energy suppliers to deliver energy efficiency improvements in households in order to meet their defined targets.

7.2 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. While the energy efficiency improvements delivered will reduce the energy bills of recipient households on a

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([1]) 1986 c.44. Section 33BC was inserted (as section 33BB) by section 10(1) of, and Schedule 3, paragraph 36 to, the Gas Act 1995 (c.45). Section 33BB was substituted for (and renumbered as) section 33BC by section 99 of the Utilities Act 2000 (c.27). This section was also amended by sections 15 and 17 of, and paragraphs 1 and 2 of the Schedule to, the Climate Change and Sustainable Energy Act 2006 (c.19) and section 79 of, and paragraph 1 of Schedule 8 to, the Climate Change Act 2008 (c.27). Section 66 of the Energy Act 2011 (c.16) also amends this section. Section 33BD was inserted by section 68 of the Energy Act 2011.

([2]) 1989 c.29. Section 41A was substituted for section 41 by section 70 of the Utilities Act 2000 (c.27) and amended by sections 16 and 17 of, and paragraphs 4 and 5 of the Schedule to, the Climate Change and Sustainable Energy Act 2006 (c.19) and section 79 of, and paragraphs 2 to 5 of Schedule 8 to, the Climate Change Act 2008 (c.27). Section 67 of the Energy Act 2011 (c.16) also amends this section. Section 41B was inserted by section 69 of the Energy Act 2011.

([3]) 2000 c.27. This section was amended by section 17 of, and paragraph 7 to, the Climate Change and Sustainable Energy Act 2006 (c.19) and section 79 of, and paragraph 6 of Schedule 8 to, the Climate Change Act 2008 (c.27). This section has also been amended by section 72 of, and paragraph 7 and 8 to the Schedule, the Energy Act 2011 (c.16).

sustainable basis, the costs of the ECO policy will therefore be borne by households. DECC in its original Impact Assessment for the scheme estimated these costs as being around £1.3bn per year on average.

7.3 Over the course of operation of ECO, the Government has been monitoring, to the extent possible, the actual costs of the scheme. While there is some concrete evidence (from statistical returns submitted by obligated companies, and from prices on the brokerage platform – an online market on which companies can trade ECO-compliant activity) to support the view that costs were around £1.3-1.4bn pa, the Government also heard conflicting views from some of the obligated companies, to the effect that the obligation could end up costing considerably more than originally estimated, with resulting pressures on consumer bills.

7.4 In the circumstances, the Government concluded that it was right to review the scheme to ensure that it remained as cost-effective as possible. A set of proposals was announced in December 2013 with the overall intention of reducing the costs of the scheme, particularly of the CERO element, but without compromising on the level of ambition of those elements directed at the alleviation of fuel poverty. These proposals (along with a number of other suggestions designed generally to improve or simplify the operation of the scheme) were then set out in more detail, in a public consultation document published on 5 March 2014.

7.5 As noted below, the Government's conclusions have now been set out in the consultation response published on 22 July 2014. The Order that is the subject of this Explanatory Memorandum gives effect to those elements of the consultation outcome which are relevant to the current period of ECO (up to 31 March 2015); a new Order is expected to be laid before Parliament in Autumn, creating a new obligation period (from 1 April 2015 to 31 March 2017).

7.6 In the light of the Government's initial proposals in December 2013, obligated energy companies made announcements to the effect that they would (if these proposals were implemented) expect their energy bills to consumers to be £30-35 lower than would otherwise be the case. The Government believes that the final decisions now taken in the outcome of consultation should allow for energy bill reductions in line with, if not greater than, the levels anticipated in December 2013.

7.8 Article 3 amends the definition of "area of low income" by referring to a new document for a description of the areas that fall within this definition for carbon saving community qualifying actions carried out on or after 1 April 2014. As a result of this change, a larger number of areas will fall within the definition "area of low income". This article also updates, with effect from the date this Order comes into force, the definition of "Publicly Available Specification" to refer to a new version of this standard.

7.9 Article 4 reduces the overall carbon emissions target from 20.9 MtCO2 to 14 MtCO2 for the current ECO obligation period, ending March 31 2015. Evidence gathered from the commencement of the ECO Order in January 2013 indicates that the low level of

progress towards suppliers' individual CERO targets was due to distinct cost pressures under the current CERO obligation. Since this element of the ECO scheme does not specifically focus on promoting energy efficiency measures to those in fuel poverty, the most optimal approach to reducing the cost of the ECO scheme to domestic energy consumers is to reduce the carbon emission reduction target by 33 per cent.

7.10 Article 5 inserts a new article 8A into the ECO Order, which requires the Administrator to determine a supplier's reduced phase 3 carbon emissions reduction obligation. This reduced phase 3 carbon emissions reduction obligation will reflect the reduction to the overall carbon emissions target made by article 4 of this Order.

7.11 Article 6 makes amendments to article 12 of the ECO Order to provide that, if installed on or after 1 April 2014, certain new types of measure are eligible for the carbon emissions reduction obligation. Previously these measures were only eligible if installed alongside hard to treat cavity wall insulation or solid wall insulation. The new measures are cavity wall insulation (rather than only hard to treat cavity wall insulation, as previously), flat roof insulation, loft insulation, rafter insulation, room-in-roof insulation, and a connection to a district heating system. Extending eligibility to these measures will increase the potential for carbon savings at a lower cost per tonne, allowing optimal carbon reductions to be achieved at a reduced cost to domestic energy consumers. Article 6 sets out the conditions that must be met when these measures are installed, and conditions that must be met where other insulation measures (referred to as "secondary measures") are installed alongside these measures.

7.12 Article 7 amends the requirement, in article 13 of the ECO Order, that 15% of a supplier's carbon saving community obligation is met by promoting carbon saving community qualifying actions to members of the affordable warmth group living in a rural area. It provides that this 15% sub-target can also be achieved by promoting carbon saving community qualifying actions installed on or after 1 April 2014 in a deprived rural area. Simplifying the rural eligibility criteria to ensure a greater number of households will be eligible to receive support, should increase the delivery of the rural sub-target which, to date, has been low.

7.13 Article 8 amends article 14 of the ECO Order to clarify, in light of the amendment to the definition of "area of low income" in article 2 of the ECO Order, how the determination as to whether the 25% limit on adjoining installations in article 14(2) is met is to be made where a measure was installed before 1 April 2014. Article 8 also removes article 14(3), which provided that adjoining installations were not qualifying actions until the determination on the 25% limit has been made.

7.14 Article 9 amends article 16 of the ECO Order, to provide for the notification, after this Order comes into force, of qualifying actions installed in the period 1 April 2014 to the end of the month in which this Order comes into force.

7.15 Article 10 inserts new articles 19A to 19D into the ECO Order. These new articles provide for certain carbon qualifying actions to make a contribution towards a supplier's

carbon emissions reduction obligation of 1.75 times the carbon saving attributed to the qualifying action under article 19 of the ECO Order. This article only provides for this uplift to be applied where a supplier (or, if a group company, its group) achieves more than 35% of its carbon emissions reduction obligation for phases 1 and 2 by 31st March 2014 by the installation of solid wall insulation or hard to treat cavity wall insulation. These amendments will ensure that the overall impact of introducing new, cheaper, measures installed from 1 April 2014 onwards is equitable across obligated suppliers since each has a differing rate of delivery progress.

7.16 Article 11 amends article 20 of the ECO Order to extend the deadline for applications for transfer of qualifying actions between suppliers to 30th April 2015.

7.17 Articles 12 to 14 insert a new article 21ZA into the ECO Order, and make consequential amendments to articles 21 and 21A of the ECO Order. Article 21ZA provides that a group of suppliers may apply to the Administrator to credit towards an applicant supplier's obligations under the ECO Order actions which were installed and approved under the Electricity and Gas (Carbon Emissions Reduction) Order 2008 (S.I. 2008/188) ("CERT actions"). It provides that a CERT action can be carried forward to an applicant supplier's ECO obligations if it is surplus to the relevant supplier group's obligations under CERT, and the other requirements of article 21ZA are met. Permitting 'carry forward' of this activity has the benefit of reducing the overall unit cost of ECO delivery.

7.18 Article 14 amends article 22 of the ECO Order to provide that suppliers can apply to transfer qualifying actions or excess actions from one ECO obligation to another more than once. It also provides that the Administrator must notify suppliers whether they have met their obligations by 30th September 2015 (rather than 1st July 2015, as previously), and that the Administrator must report to the Secretary of State whether suppliers have met their obligations by 30th September 2015 (rather than 31st January 2016, as previously).

7.19 Article 15 amends article 24 of the ECO Order to provide that achieving the carbon emissions reduction obligation is not a relevant requirement. This will enable a more consistent delivery profile across this ECO period (from 2013 to 2015) and our proposed second ECO period (which will run from 2015 to 2017).

- Consolidation

7.20 No consolidation is proposed at present.

8. Consultation outcome

8.1 On 5 March 2014, the Department of Energy and Climate Change launched an eight week consultation on changes to the Energy Company Obligation (ECO). The consultation proposals were published on the DECC website.

8.2 The consultation sought views across England, Wales and Scotland on all aspects of the proposals. During the consultation period, DECC conducted seven stakeholder events around the country to present the consultation proposals and gather initial feedback from attendees The consultation closed on 16 April 2014 and the Department received 266 responses from key stakeholders, including obligated energy suppliers.

8.3 It must be noted that, in strictly numerical terms, the majority of respondents opposed the proposals to significantly reduce the level of ambition of the CERO element of ECO. This may reflect the fact that many respondents were from the industries involved in supplying the carbon-saving measures in question, or represented the interests of households who might be recipients of these measures (for example, local authorities). The Government has also needed to bear in mind the perspective of household energy bill payers, who ultimately bear the costs of the obligation, but who are less likely to respond to a formal consultation of this sort.

8.4 Feedback from consultation was used to inform a number of changes to the proposed policy, for example, in contesting the rationale and costs of making changes to the assessment processes by which ECO carbon measures can be recommended. In other instances consultees supported the proposals and in doing so provided views and evidence which helped the Government flesh out its initial proposals and reach concrete final decisions, for example on the precise arrangements for the introduction of district heating schemes as eligible primary measures, or on detailed mechanisms to support increased delivery of ECO to off-gas households.

9. Guidance

9.1 After this Order is made, an updated version of the non-statutory guidance for obligated suppliers will be consulted on, and then published, by the Energy Company Obligation Administrator, Ofgem.

9.2 Copies of the published guidance will be circulated to all energy suppliers and other key stakeholders. The guidance will be available free of charge from the website of the Administrator.

10. Impact

10.1 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website. The Impact Assessment covers all changes to ECO set out in the Government consultation response, both those which are implemented by the current Order, and those which will be implemented by a separate Order establishing a future ECO scheme, since the changes form a package. Many aspects which are important to energy companies and others in understanding the cost impacts - for example, rules relating to the “carry forward” of activity between the 2015 and the 2017 targets – cannot be isolated and set against one or other period of the obligation.

10.2 The Impact Assessment estimates the changes to ECO as having an overall positive impact on society of around £1bn (NPV), with around 1.9 million households likely to be supported with measures by the end of the scheme in 2017. It estimates the costs to the obligated suppliers of delivering their ECO targets to be around £800m per year on average over the remaining years of the scheme to 2017, but notes that there remain uncertainties over cost estimates, cost profiles, and actual pass through to consumers.

10.3 There is no significant impact on the public sector. The administrator, Ofgem (a public body), will be required to produce new guidance.

11. Regulating small business

11.1 The legislation does not apply to small business. Energy suppliers with fewer than 250,000 customers are not required to participate in the Energy Company Obligation, which also includes a "taper" mechanism to minimise the initial impact on smaller companies who pass across the threshold and become obligated for the first time.

12. Monitoring & review

12.1 Monitoring of ECO is being undertaken throughout the duration of the scheme. The Administrator submits monthly reports to the Secretary of State setting out the progress energy suppliers are making towards meeting their obligations.

13. Contact

Charles Phillips at the Department of Energy and Climate Change can answer any queries regarding the instrument, Tel: 0300 068 5190 or email: charles.phillips@decc.gsi.gov.uk.