EXPLANATORY MEMORANDUM TO

THE ELECTRICITY AND GAS (ENERGY COMPANIES OBLIGATION) ORDER 2012

2012 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.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The Electricity and Gas (Energy Companies Obligation) Order 2012 ("the Order"), implements the Energy Companies Obligation ("ECO") policy which places three distinct obligations on energy suppliers who have more than 250,000 domestic electricity and/or gas customers: a carbon saving obligation, a carbon saving community obligation and a home heating cost reduction obligation. Each type of obligation requires a "supplier" as defined in the Order to install or arrange the installation of qualifying measures in the homes of eligible domestic energy users.

2.2 A supplier must achieve each of its obligations by 31st March 2015. The obligations must be met by installing qualifying measures which reduce carbon emissions or the cost of heating a home.

2.3 The Order implements a policy which is intended to work together with the Green Deal to address barriers and market failures in the energy efficiency market. The Green Deal includes strong frameworks for ensuring service quality, raises awareness of energy efficiency and aims to overcome difficulties in accessing capital for energy efficiency measures by allowing householders to make improvements to their home at no upfront cost. [1] The ECO addresses two key circumstances where Green Deal finance may not remove all upfront costs by providing additional financial assistance to low income households and to households in more difficult and expensive to improve homes. By delivering energy efficiency and heating measures to low income and vulnerable households the ECO will also help to tackle fuel poverty. The Order will be administered and enforced by the Gas and Electricity Markets Authority (Ofgem) which is known in the Order as the "Administrator".

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

3.1 The Order provides that phase 1 of the overall obligation period begins on 1 January 2013. The Government intends to make the Order so that it comes into force on or before that date.

[1] For more information see Section 7.3

4. Legislative Context

4.1 This Order is to be made in exercise of the powers conferred by section 33BC of the Gas Act 1986, section 33BD of the Gas Act 1986, section 41A of the Electricity Act 1989, section 41B of the Electricity Act 1989 and section 103, and 103A of the Utilities Act 2000.

4.2 This draft Order is similar in content to the draft Electricity and Gas (Energy Company Obligation) Order 2012 which was laid in Parliament and approved by a resolution of each House in July 2012, but which has not been made. The Government wishes to make this revised draft Order, instead of that one, to ensure that "in-use factors" are applied when calculating the carbon savings attributable to energy efficiency measures installed under ECO. See paragraph 8.5 for further explanation.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

The Minister 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) Order 2012 are compatible with the Convention rights.

7. Policy background

- What is being done and why

7.1 Reducing carbon emissions from 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) help tackle fuel poverty by reducing the cost of heating a home to a reasonable level; (iv) increase productivity (with the potential to boost growth and business competitiveness) and (v) reduce the costs of meeting the UK's renewable energy target through promoting more efficient energy use.

7.2 At present market failures and barriers are reducing the take up of cost effective energy efficiency measures. As a result, without Government intervention residential carbon emissions will not fall to the extent that is possible with reduced impact on the objectives described above. The Order implements a policy which is designed to address the market failures and barriers which are preventing a greater demand for and delivery of cost-effective energy efficiency measures.

7.3 The Green Deal and the ECO are complementary policy mechanisms which will address market failures and barriers and hence drive demand for cost-effective energy efficiency measures. The Green Deal aims to overcome difficulties accessing capital for energy efficiency improvement measures, mismatched incentive problems, such as individuals only investing in energy efficiency measures for the length of their own expected tenure in a property and aims to provide a trustworthy framework of advice, assurance and accreditation for the energy efficiency supply chain. The ECO is intended to be capable of working in tandem with the Green Deal policy to further enhance the installation of cost effective energy efficiency improvement measures; measures which might not be fully financeable through the Green Deal alone will become so if a supplier agrees to support a measure through the ECO. For example, the full cost of solid wall installation may not be financeable under the Green Deal finance mechanism. However, with a supplier contributing towards the cost of the measure under the ECO, the measure may become viable for a particular domestic energy user. Together both policies are part of a cost-effective strategy for achieving the UK's carbon targets.

7.4 Low income and vulnerable households will also directly benefit from the ECO as the policy requires energy companies to deliver energy efficiency and heating measures to these households, helping to tackle fuel poverty. The Home Heating Cost Reduction Obligation requires energy suppliers to deliver measures to private tenure low income vulnerable households. The Carbon Saving Community Obligation requires energy suppliers to target measures at households living in low income areas and to low income rural households.

- Consolidation

7.5 None.

8. Consultation outcome

8.1 On 23 November 2011 the Department of Energy and Climate Change launched a consultation on proposals for the Green Deal and ECO. The consultation proposals were published on the DECC website alongside a number of supporting documents, including a draft impact assessment and draft statutory instruments (SIs).

8.2 The consultation sought views across England, Wales and Scotland on all aspects of the proposals. The department participated in stakeholder events across Great Britain and hosted workshops and a web chat to further explain and take comments on the details of the proposals. The consultation closed on 18 January 2012 and received over 600 written responses from a variety of organisations and individuals.

8.3 Feedback from the consultation was used to inform a number of changes to the policy. A carbon saving community obligation was introduced, whereby a supplier must achieve carbon saving by promoting qualifying energy efficiency measures to domestic energy users living in rural areas or areas of low income. The carbon saving community obligation will help deliver Government's fuel poverty commitments by providing

8.4 As a result of considering comments received from stakeholders on the need for a smooth transition for the insulation industry between existing schemes and the new ECO, hard-to-treat cavity wall insulation has also been included as an eligible measure within the carbon saving obligation, and district heating systems will also be eligible within all obligations in particular circumstances.

8.5 In addition a further consultation was carried out from 30 August to 14 September on the manner in which carbon scores should be calculated to determine energy suppliers' compliance with the requirements of the Order. The consultation received over 60 responses. Feedback from respondents was used to inform the application of "in-use - factors" in the calculation of carbon saving scores within ECO. These factors are designed to ensure that the carbon savings calculated for energy efficiency measures reflect their actual performance once installed in domestic properties.

8.6 Further details of respondents' views, together with the Government's responses to both consultations, the Green Deal and ECO Impact Assessment and associated publications are available on the Department's website.

9. Guidance

9.1 Non-statutory guidance for obligated parties will be published by the ECO Administrator. This guidance will be consulted on by the Administrator after the Order be made. The Administrator has written a series of open letters to energy suppliers to help them prepare for the introduction of the ECO. .

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

10. Impact

10.1 An Impact Assessment is attached to this memorandum and was published on 11 June 2012 . This Impact Assessment estimates the impacts on society of eligible energy suppliers spending an annual average of £1.3 billion on promoting and installing ECO eligible measures within the context of the Green Deal policy framework. It is estimated that the ECO could lead to around £16.3m (present value) administrative cost to energy suppliers. The pass through of ECO costs could lead to an increase in average annual energy bills during the period to 2017 (compared to business as usual), but bills are expected to be lower in the longer term. The Green Deal and ECO policies are together

estimated to lead to a carbon saving of 0.38MtCO_2 p.a. by March 2015 and 1.8MtCO_2 p.a. by 2020, and have a positive Net Present Value of £8.3billion.

10.2 The impact on the public sector is limited to the cost borne by Government of administering certain aspects of the ECO scheme, including paying for the set up costs and administration.

11. Regulating small business

11.1 Energy suppliers with fewer than 250,000 customers will not be required to participate in the ECO. To minimise the impact on smaller suppliers who pass through the 250,000 customer account threshold the size of an ECO will be tapered such that the size of the obligation on smaller companies increases gradually.

12. Monitoring and review

12.1 Monitoring of the ECO will be undertaken throughout the duration of the scheme. On a monthly basis, starting in March 2015, the Administrator must submit to the Secretary of State a report setting out the progress energy suppliers are making towards meeting their obligations.

13. Contact

Daniel Lord at the Department of Energy and Climate Change, Tel: 0300 068 5327 or email: daniel.lord@decc.gsi.gov.uk can answer any queries regarding the instrument.