EXPLANATORY MEMORANDUM TO

THE ELECTRICITY AND GAS (ENERGY COMPANY OBLIGATION) ORDER 2023

2023 No. 873

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.

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

2. Purpose of the instrument

2.1 The instrument imposes a home-heating cost reduction obligation ("the ECO4A scheme") on licensed gas and electricity suppliers that exceed domestic customer and gas or electricity supply thresholds. The instrument requires obligated energy suppliers to promote the installation of energy efficiency measures in Great Britain. A supplier must achieve its obligation by 31st March 2026.

2.2 The instrument also amends the Electricity and Gas (Energy Company Obligation) Order 2022 ("the 2022 Order"). The 2022 Order imposes another home-heating cost reduction obligation which obligated suppliers must also achieve by 31st March 2026 ("the ECO4 scheme").

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 Parts 1 to 9 of the instrument, which establishes the ECO4A scheme, will come into force on the day after the day the instrument is made. Energy suppliers will need to enter into contracts to deliver the measures needed to meet their obligations under the instrument, however many will not do so at scale without the certainty that is provided by the instrument coming into force. The Department considers it necessary to bring these Parts of the instrument into force on the day after it is made to facilitate the delivery of measures to households as soon as possible, ahead of winter 23/24. Furthermore, suppliers have mandatory annual phase targets, and earlier commencement will increase the amount of time that suppliers have to promote measures completed before 31st March 2024 to meet their first annual target.

3.2 Nothing in Parts 1 to 9 of the instrument requires energy suppliers to do anything in less than 21 days of it coming into force. The first compliance deadline for suppliers is the notification obligation under article 26, which requires obligated suppliers to notify the Gas and Electricity Markets Authority (the "Administrator") of measures they have promoted that are completed in 2023 and for this notification to be made before the end of January 2024. The benefit of Parts 1 to 9 of the instrument coming into force as soon as possible, is that suppliers can start promoting and notifying measures under the scheme earlier than would otherwise be the case, if they wish to do so, and will be informed of the size of their obligations earlier.

3.3 The instrument includes three minor corrections to the 2022 Order and the Department considers it would be disproportionate to apply the free issue procedure. The Department has complied with the requirement stated in section 4.7 of Statutory Instrument Practice to consult with the SI Registrar.

4. Extent and Territorial Application

4.1 The extent of this instrument is England, Wales and Scotland.

4.2 The territorial application of this instrument is Great Britain.

5. European Convention on Human Rights

5.1 The Minister for Energy Efficiency and Green Finance, Lord Callanan, has made the following statement regarding Human Rights:

"In my view the provisions of the Electricity and Gas (Energy Company Obligation) Order 2023 are compatible with the Convention rights."

6. Legislative Context

6.1 The instrument is made in exercise of the powers conferred by sections 33BD of the Gas Act 1986, section 41B of the Electricity Act 1989 and section 103A of the Utilities Act 2000.

6.2 Parts 1 to 9 of the instrument set an overall home-heating cost reduction target for the period from the commencement date to 31st March 2026. Another overall home-heating cost reduction target for the period from 27th July 2022 to 31st March 2026 has already been set by the 2022 Order.

6.3 Part 10 of the instrument amends the ECO4 scheme established by the 2022 Order.

6.4 Many of the powers for the schemes in relation to Scotland have been transferred to the Scottish Ministers by sections 59 and 60 of the Scotland Act 2016. These powers are exercisable by the Secretary of State with the agreement of the Scottish Ministers.

7. Policy background

What is being done and why?

Parts 1 to 9 of the instrument

7.1 The ECO4A scheme was consulted on during 2022 under the name "ECO+" and is being launched to the public as the Great British Insulation Scheme. References in this explanatory memorandum to the Great British Insulation Scheme are to the scheme established by Parts 1 to 9 of the instrument, also referred to as the ECO4A scheme.

7.2 The principal objectives of the Great British Insulation Scheme are to: (i) deliver energy efficiency measures to a greater pool of households now challenged by higher energy bills; (ii) help alleviate fuel poverty and accelerate progress to meet fuel poverty targets; (iii) contribute to carbon reduction targets in the domestic sector; (iv) reduce the costs of meeting the UK's net zero target through promoting more efficient energy use.

7.3 Whereas the ECO4 scheme is aimed at delivering whole house retrofits for low-income and vulnerable households, the Great British Insulation Scheme is aimed at

driving the rapid installation of the most cost-effective mainly single insulation measures, extending support additionally to a much wider group of households in the least efficient, lower Council tax band homes.

7.4 The Great British Insulation Scheme is designed to address the market failures and barriers which are preventing a greater demand for and delivery of cost-effective energy efficiency measures. Without Government intervention, residential fuel poverty will not fall to the extent that is possible, with a corresponding reduction of impact on the objectives described above. The instrument expands a policy which has been in place through various energy company obligation schemes since January 2013.

7.5 Between January 2013, when the first ECO scheme began, and December 2022, the most recent date for which data is available, over 3.5 million energy efficiency and heating measures have been installed in approximately 2.4 million homes through the ECO schemes. This has helped reduce people's energy bills, making homes more energy efficient, reduce carbon emissions and make our energy system more resilient.

7.6 The Growth Plan 2022 announced proposals for the expansion of ECO to run from 2023 to 2026 at a value of £1bn, in 2022 prices.[1] Accordingly, the principal effect of the instrument is to introduce a new home-heating cost reduction obligation for the period up to 31st March 2026. This obligation is expressed in terms of outcomes not expenditure. The obligation is a notional annual bill savings target of £55,998,000 to be achieved by 31st March 2026.

7.7 Those suppliers required to participate in the ECO4 scheme are also required to participate in the Great British Insulation Scheme. The same domestic customer and gas and electricity supply data as is notified by suppliers under the ECO4 scheme is used for the apportionment of the home-heating cost reduction obligation across three phases of the Great British Insulation Scheme. The three phases are phase A (from the commencement date to 31st March 2024), phase B (1st April 2024 to 31st March 2025), and phase C (1st April 2025 to 31st March 2026).

7.8 Unlike the ECO4 scheme, a minimum level of delivery of the obligation will be set for each of the three phases of the Great British Insulation Scheme. The instrument requires each obligated supplier to achieve at least 90% of its home-heating cost reduction obligation and low-income minimum requirement (see the next paragraph) for phases A and B through measures completed before the end of each phase, with the total obligation required to be met by 31st March 2026. This ensures measures are completed throughout the period of the scheme whilst still providing suppliers with some flexibility, taking account of the intrinsic uncertainties in establishing a new scheme and to support cost-effective delivery.

7.9 The instrument also sets a low-income minimum requirement. This will ensure a minimum level of support through the scheme for those on the lowest incomes and most vulnerable ("the low-income group"), whilst allowing the remainder of the support to be targeted at a much larger pool of people now challenged by higher energy bills ("the general group"). There is however no upper limit on the amount of a

[1] https://www.gov.uk/government/topical-events/the-growth-plan

supplier's home-heating cost reduction obligation that can be met through measures delivered to the low-income group.

7.10 The instrument sets standard low-income eligibility criteria (articles 13 to 15 of the instrument) based on receipt of certain benefits or where the property is social housing. The instrument also includes flexible low-income eligibility criteria (articles 16 to 19 of the instrument) through which local authorities or energy suppliers may identify low income or vulnerable households appropriate for support that might be missed through the standard low-income eligibility criteria. At least 20% of a supplier's low-income minimum requirement must be delivered using the standard low-income eligibility criteria. Beyond this specific limitation, the proportion of a supplier's overall obligation that can be delivered through the flexible low-income eligibility criteria is unlimited.

7.11 The home-heating cost reduction target is set at a level that assumes that households in the general group (article 12 of the instrument) will collectively contribute £80 million towards the cost of installing the insulation measures (equivalent to 10% of the £800 million scheme budget earmarked for this group). This reflects that households in this group will generally have higher incomes and be able to contribute. Any contributions will in practice be a matter for agreement between the customer and the installer, reflecting the measure type and property issues.

7.12 To avoid duplication of support, sources of public authority grant funding (such as the Home Upgrade Grant, Social Housing Decarbonisation Fund, and local authority and devolved administration grant funding) cannot be blended with the Great British Insulation Scheme for the same measure. Similarly, a measure cannot count towards both a supplier's ECO4 and Great British Insulation Scheme obligations. It can count towards one only.

7.13 A domestic premises cannot receive more than one insulation measure under the Great British Insulation Scheme. As long as it is installed on the same day as, or after, the insulation measure is completed, owner-occupied premises in the low-income group can also receive heating control measures under the scheme. The heating control measures must be completed within three months of the insulation measure.

7.14 The instrument provides targeted encouragement to support the development of innovative products and installation techniques. Innovation measures delivered to the low-income group will receive 25% or 45% uplifts. Innovation measures receiving an uplift will be capped at 10% of each supplier's total low-income minimum requirement, that is, up to 10% of the 20% low-income minimum requirement. This is to ensure that households in this group can benefit from innovative products and techniques, balanced with supporting as many households overall as possible. Innovation measures delivered to the general group or in excess of the 10% cap will not receive an uplift.

7.15 The instrument also provides targeted encouragement to support the delivery of measures to low-income off-gas rural households in Scotland and Wales. A 20% rural uplift will be applied to delivery to these households. This uplift is designed to reflect the higher costs of rural delivery to these areas whilst accounting for the existence of HUG2 in England. In recognition of off-gas properties tending to have higher energy costs and to promote off-gas grid decarbonisation, the uplift will only apply to rural off-gas grid properties, in a manner consistent with ECO4.

7.16 Unlike the ECO4 scheme, full project scores will not be used in the Great British Insulation Scheme. Measures will receive a score based on the amount of annual bill savings determined for the measure, and including any relevant uplifts.

7.17 The instrument enables delivery of measures before the instrument comes into force, starting from the date of the publication of the Government Response on 30th March 2023, to count towards the home-heating cost reduction obligation.

7.18 Measures completed in 2023 must be notified to the Administrator on or before 31st January 2024. This is to ease the administrative burden on suppliers and the Administrator at the beginning of the scheme. Measures completed after 2023 must be notified on or before the end of the first month following the month in which the measure is completed, unless an extension to that deadline applies.

7.19 All measures must be installed by, or under the responsibility of, a person who is registered with TrustMark (or an equivalent quality assurance and consumer protection scheme). TrustMark includes requirements for the lodgement of information about measures that are installed on its Data Warehouse, compliance with the installation standards of Publicly Available Specification (PAS) 2035, and requirements relating to warranties and guarantees.

7.20 Suppliers will be able to transfer notified measures to other obligated suppliers as an option to ease delivery. The instrument requires the Administrator to reject applications for the transfer of measures between suppliers that are not members of the same group where it considers there is significant risk that the transferring supplier would be unable to achieve its obligation.

7.21 Suppliers will be able to transfer to another obligated supplier all or part of their home-heating cost reduction obligation for an ECO4A phase or low-income minimum requirement for an ECO4A phase.

7.22 There is a high level of interest in the scheme from energy suppliers who deliver the scheme, fuel poverty groups and installers, and members of the public.

Part 10 of the instrument

7.23 The 2021 Sustainable Warmth Strategy[2] announced plans for the expansion of ECO to run from 2022 to 2026 with an increase in value from £640m to £1bn per year (in 2021 prices). A new home-heating cost reduction obligation was introduced by the 2022 Order for the period up to 31st March 2026 ("the ECO4 scheme"). This obligation is expressed in terms of outcomes not expenditure. The obligation is a notional annual bill savings target of £224.3m to be achieved by 31st March 2026.

7.24 Part 10 of this instrument amends the 2022 Order. Most of changes are made to enable heating measures, that are of benefit to ECO4 households in achieving annual cost savings and reducing their overall energy bill, to be installed in a wider range of circumstances.

7.25 The definition of a renewable heating system is amended to allow heating systems fuelled partly by a source of energy or technology mentioned in section 100(4)(a) or

[2] https://www.gov.uk/government/publications/sustainable-warmth-protecting-vulnerable-households-in-england

(c) to (h) of the Energy Act 2008 to be installed (as well as those fuelled wholly or mainly by such sources of energy or technology).

7.26 A new definition is introduced to allow related electricity generation equipment, such as solar pv, to be considered a renewable heating system if the electricity is generated wholly or mainly by renewable means and as long as some of the electrical output so generated is used to produce heat at domestic premises. Changes are also made to widen the circumstances in which related electricity generation equipment may be installed in both on-gas and off-gas homes. Equipment for the generation of electricity by renewable means can only be installed where hydronic heat pumps, electric storage heaters or electric heating systems are already installed or are installed as part of the same ECO4 project.

7.27 To ensure connections to a greater number of existing district heating systems are possible in off-gas homes, changes are made so that connections to district heating systems fuelled by mains gas may be installed where it is not possible to install a hydronic heat pump, wet central heating system fuelled wholly by a hydronic heat pump or a district heating connection fuelled by a hydronic heat pump ("the off-gas heating hierarchy").

7.28 To provide support for homes, particularly off-gas homes, that are unable to receive a heating measure from those currently eligible, the options where electric storage heaters or electric heating systems may be installed are extended to homes with neither an efficient nor an inefficient heating system (i.e., homes with no heating or that use only plug in room heaters or wall mounted electric heaters) and for off-gas homes where it is not possible to install measures from higher up the off-gas heating hierarchy in these homes.

7.29 Provisions are inserted to prevent a measure from receiving support under both ECO4 and the Great British Insulation Scheme. When measures are being notified they will have to indicate to the Administrator which scheme they are being notified under. Suppliers will be able to withdraw notifications, for example, where they wish to renotify the measure under the other scheme.

7.30 Three minor corrections are made:

- To correct the definition of Reduced Data Standard Assessment Procedure, to refer to version 9.94 of the 2012 edition (article 40(a)(iii) of the instrument). A saving provision is made for any cases where the previously cited version was used.
- To amend references to licences under section 7A of the Gas Act 1986, to exclude gas shipper licences (articles 40(a)(ii) and 41 of the instrument). This is not expected to have any substantive impact as no part of the home-heating cost reduction obligation would have been apportioned to gas shippers under the 2022 Order.
- To ensure that certain references to the supplier that promoted a measure are interpreted as referring to the supplier that originally promoted and notified the measure and not as references to any other supplier to whom the measure is subsequently transferred (article 49(b) of the instrument).

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 This is the first instrument to amend the 2022 Order. A consolidation of the 2022 Order is not considered necessary at this time.

10. Consultation outcome

10.1 On 28th November 2022, the Department published a consultation on proposals for what is now known as the Great British Insulation Scheme and on amendments to the ECO4 scheme.[3] The consultation closed on 23rd December 2022. During the public consultation period, the Department conducted two virtual interactive stakeholder events to present the consultation proposals and gather initial feedback from attendees.

10.2 A four-week consultation period was considered appropriate due to the need to support consumers with their energy bills as soon as possible, as well as the design similarities between the Great British Insulation Scheme and the ECO4 scheme; and as regular engagement with stakeholders was conducted ahead of the public consultation period. The Department received 176 specific responses to the consultation, including from energy suppliers, installers, manufacturers, managing agents, trade associations, accreditation providers/oversight bodies, charities, consumer groups and local authorities. A further 18 general responses were also received.

10.3 Overall, respondents were supportive of the proposals and the final policy decisions reflect this. Changes made in response to the consultation, include:

- Eligibility in the general group in Wales has been expanded from Council Tax bands A-C as consulted upon to A-E. This increases the proportion of eligible homes in Wales from 57% to 87%, better aligning with the proportion in England (A-D; 81% of all homes) and Scotland (A-E; 86%).
- The installation standards for cavity wall and loft insulation are maintained as PAS2035 requirements, in line with all other insulation measures under the scheme.
- Obligated suppliers will not have to demonstrate that low-income households cannot meet the ECO4 minimum requirements in order to be eligible for support through the Great British Insulation Scheme.
- Properties that have had support under the Great British Insulation Scheme will not be excluded from receiving support for other measures under the ECO4 scheme.
- Substantial improvement innovation measures delivered to the low-income group will be eligible for a 45% uplift, subject to a cap on the total amount of innovation measures that may receive an innovation measure uplift.

[3] https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026

10.4 Areas where the majority of responses disagreed with proposals include:

- Private rented sector households being ineligible for heating control measures, and for cavity or loft insulation if in the general group. These measures are excluded as landlords have responsibilities to maintain and improve their housing.
- Restricting the rural uplift to off-gas properties in Scotland and Wales only. The Department has restricted it to low-income households in off-gas properties in Scotland and Wales only, in order to account for the existence of the Home Upgrade Grant scheme in England.
- Allowing single insulation measures only under the scheme, as many respondents preferred a multiple measures approach. The Department has maintained a single insulation measure approach so that the Great British Insulation Scheme can support as many households as possible.

10.5 A description of the changes and a summary of the responses to these and other areas are included in the Government's consultation response which is available at https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026.

10.6 As part of the consultation process the Department discussed its proposals with the devolved administrations in Scotland and Wales and subsequently received their formal responses.

11. Guidance

11.1 Non-statutory guidance for obligated suppliers under the Great British Insulation Scheme will be published by the Administrator on its website. The Administrator will also publish updated guidance for the ECO4 scheme.

12. Impact

12.1 The impact on business, charities or voluntary bodies is mainly that obligated energy suppliers will incur costs in meeting their obligations. They are expected to recoup their costs by passing them onto their domestic customers through their energy bills over the three years of the scheme, although the energy bills of those households that receive energy efficiency measures will, as a result, be reduced for the long-term. From April 2023 to March 2024, an allowance for these costs will be covered by the Government through the Energy Price Guarantee to the extent that the default tariff cap (the price cap) set by Ofgem remains above the level of the Energy Price Guarantee. The costs to obligated suppliers are estimated to be around £333m per year on average under the Great British Insulation Scheme to 2026, using 2022 prices and £1bn per year on average under the ECO4 scheme to 2026, using 2021 prices. However, the actual costs incurred by suppliers in meeting their obligations will depend on a range of factors, including: the cost of finding eligible households willing to install energy efficiency measures; the cost of installing energy efficiency measures into these homes; and in some circumstances the level of co-funding suppliers can secure from third-parties.

12.2 There is no, or no significant, impact on the public sector. The Gas and Electricity Markets Authority will be responsible for the administration of the Great British

Insulation Scheme and will continue to be responsible for the administration of the ECO4 scheme.

12.3 A full Impact Assessment of the Great British Insulation Scheme is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website. The final stage Impact Assessment estimated that the Great British Insulation Scheme would have a positive value to society of £831m (NPV, in 2022 prices), with around 376,000 measures estimated to be installed in around 315,000 homes from 30th March 2023 until the end of the scheme in March 2026. The changes to the ECO4 scheme are not expected to have any significant impact on the costs and benefits of the ECO4 scheme.

13. Regulating small business

13.1 Analysis of currently available data suggests that the instrument does not apply to activities that are undertaken by small businesses. The customer number and energy supply thresholds mean that small businesses (those with fewer than 50 full time employees) are unlikely to be included in the obligations imposed by this instrument.

13.2 To minimise the impact of the requirements on small businesses, the instrument uses the supplier allowance in the 2022 Order which, for all suppliers, exempts electricity and gas supply up to 50% of the threshold amount from the calculation of each supplier's share of the overall home-heating cost reduction target. Smaller suppliers will also be able to trade their obligations.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is through a requirement on the Administrator to submit monthly progress reports to the Secretary of State on suppliers' performance against the overall target. The Department also has regular engagement with the Administrator, obligated suppliers, supply chain, local authorities, and others to understand progress on delivery and any delivery issues.

14.2 The instrument does not include a statutory review clause by virtue of section 28(3)(d) of the Small Business, Enterprise and Employment Act 2015, because the deadline for the Administrator to determine whether suppliers have met their obligation under the instrument is 30th November 2026 (and 30th September 2026 for the ECO4 scheme).

15. Contact

15.1 Nick Grout (Great British Insulation Scheme) telephone: 07752 778804 or email: nick.grout2@beis.gov.uk and Andrej Miller (ECO4) telephone: 0300 068 6155 or email: beisecoteam@beis.gov.uk at the Department for Energy Security and Net Zero can be contacted with any queries regarding the instrument.

15.2 Olivia Haslam, Deputy Director for the Warm Homes and Fuel Poverty Team, at the Department for Energy Security and Net Zero can confirm that this Explanatory Memorandum meets the required standard.

15.3 Lord Callanan at the Department for Energy Security and Net Zero can confirm that this Explanatory Memorandum meets the required standard.