EXPLANATORY MEMORANDUM TO

THE WARM HOME DISCOUNT (RECONCILIATION) REGULATIONS 2022

2022 No. 1162

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

2.1 This instrument establishes and provides for the operation of a reconciliation mechanism for the purposes of the schemes made by the Warm Home Discount (England and Wales) Regulations 2022 and the Warm Home Discount (Scotland) Regulations 2022 ("the Scheme Regulations"). The purpose of the reconciliation mechanism is to achieve, so far as reasonably practicable, an equitable distribution among electricity suppliers of the aggregate amount of rebates which they provide under Part 3 of each of the Scheme Regulations. Participating electricity suppliers are required to make or receive payments so that the amounts of rebates provided by them under Part 3 of each of the Scheme Regulations, after such adjustments, are proportionate to their share of domestic electricity and gas customers in Great Britain.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, and Scotland.

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

5. European Convention on Human Rights

5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 This instrument is made under the powers in sections 11 and 31(5) and 31(6) of the Energy Act 2010. The Gas and Electricity Markets Authority ("Ofgem") is the operator of the reconciliation mechanism. Obligations placed on electricity suppliers by this instrument are "relevant requirements" as defined in section 25(8) of the Electricity Act 1989 and are enforceable by Ofgem under its powers in that Act.

6.2 The Warm Home Discount schemes made by the Scheme Regulations are a continuation of the Warm Home Discount Scheme originally established by the Warm

Home Discount Regulations 2011. This instrument contains provisions that apply to scheme years twelve to fifteen, that is from 2022/23 onwards.

6.3 The Parliamentary Under-Secretary of State for the Department for Business, Energy and Industrial Strategy, Lord Callanan, stated that this instrument would be laid in autumn 2022 in advance of the first reconciliation exercises being conducted towards the end of the year (HL Deb 20 June 2022, vol 823, col 10GC).

7. Policy background

What is being done and why?

7.1 Section 9 of the Energy Act 2010 enables the Secretary of State to make schemes for the purpose of reducing fuel poverty. The Warm Home Discount schemes are a key policy in the Government's approach to tackling fuel poverty and reducing the energy costs of low-income and vulnerable households. Electricity suppliers above a certain size are obligated to participate and must provide support to households who are in, or at risk of, fuel poverty, primarily through rebates on their energy bills every year.

7.2 Under Part 3 of each of the Scheme Regulations energy suppliers are required to provide a rebate off the electricity or gas bill to their core group customers. These are customers specified in notices given to the electricity supplier by the Secretary of State and who are:

- Eligible customers in England and Wales and in Scotland in receipt of the guarantee credit element of pension credit; and
- Eligible customers in England and Wales meeting criteria set out in an eligibility statement published by the Secretary of State.

7.3 The Government and energy suppliers identify customers eligible for a core group rebate primarily through data matching. The number of eligible customers for each supplier varies, which means that some suppliers are obligated to provide a disproportionate number of core group rebates compared to other suppliers. This would put suppliers who have a greater proportion of low-income and vulnerable customers at a disadvantage compared to other suppliers.

7.4 The Government therefore introduced a reconciliation mechanism when the Warm Home Discount scheme began in 2011 to balance the differences across suppliers. The intended outcome is that the required spending on core group rebates each scheme year from each supplier is proportionate to their share of the domestic energy market.

7.5 Participating energy suppliers are required to provide their numbers of domestic customers across Great Britain on a set date which Ofgem then uses to determine each supplier's share of the scheme spending. Where a supplier has provided fewer rebates proportionate to their market share, they must make a reconciliation payment to a fund maintained by Ofgem. Where a supplier has provided more rebates proportionate to their market share, they are entitled to receive a payment from this fund.

7.6 Ofgem runs a final reconciliation after the end of each scheme year. The Secretary of State may also direct Ofgem to run an interim reconciliation during the scheme year, to reconcile the spending already incurred. The main benefit of running an interim reconciliation is to reconcile the majority of the liability for rebates soon after it has been attributed to suppliers, thereby leaving only a smaller final reconciliation when the final figures on core group rebates are available. In scheme year 10 (2020/21), the total balancing payments received and paid out during the interim reconciliation

amounted to £15.7 million, while the total balancing payments during the final reconciliation amounted to £1.0 million. With the expansion of the scheme, we expect these figures to be higher for scheme year twelve onwards.

7.7 This instrument contains other provisions for mutualisations, terminations of licenses, "make-right amounts", and distribution of interest. Where a supplier fails to make a reconciliation payment, Ofgem triggers a mutualisation process and redistributes the amount due from the defaulting suppliers shared proportionately across the other suppliers. Where a supplier's license is terminated, Ofgem must recalculate the remaining suppliers' market shares. Where there is an error in the reconciliation or mutualisation payments, Ofgem calculates the "make-right amount" that each supplier is required to pay or is entitled to receive to correct the error.

Explanations

What did any law do before the changes to be made by this instrument?

7.8 The original reconciliation mechanism was created by the Warm Home Discount (Reconciliation) Regulations 2011 and applied to the Warm Home Discount scheme which operated in Great Britain up until scheme year eleven (2021/22). The operator of the reconciliation mechanism required participating suppliers to make or receive payments according to their market share of the core group rebate spending. During this time, customers eligible for a core group rebate were only those in receipt of the guarantee credit element of pension credit.

Why is it being changed?

7.9 This instrument follows on from the Warm Home Discount (Reconciliation) Regulations 2011 with several main changes.

7.10 From scheme year twelve onwards (2022/23), there are two separate Warm Home Discount schemes: one in England and Wales and one in Scotland. As energy suppliers below a certain size may voluntarily participate in the schemes, there may be a different number of suppliers participating in each scheme and a supplier's proportion of the spending under each scheme may therefore be different.

7.11 Furthermore, the Government has expanded the core group under the scheme in England and Wales to include eligible customers who meet criteria set out in an eligibility statement. These are households who are in receipt of a means-tested benefit or Tax Credits and live in a property which has high estimated energy costs relative to other households.

7.12 Finally, the Government has reduced the participation threshold where a supplier with domestic customer accounts meeting or above the threshold are obligated under the schemes. The threshold has been reduced from 150,000 accounts in 2021/22 to 50,000 in 2022/23 and further to 1,000 from 2023/24 onwards. Originally, the market share calculation for each energy supplier was set with reference to their number of domestic customer accounts on 31st December before each scheme year. As smaller suppliers will become obligated under the scheme, there may be a greater risk that smaller suppliers grow or shrink more quickly than larger suppliers. When the suppliers incur their spending on rebates, a growing energy supplier may be liable for a relatively small number of rebates while a shrinking energy supplier may be liable for a relatively large number of rebates.

What will it now do?

7.13 The primary difference between this instrument and the original 2011 instrument is that this instrument contains provisions for administering separate reconciliation exercises in England and Wales and in Scotland with differing market share calculations. This instrument also creates a "set-off" provision to allow Ofgem to set off payments due. For instance, where suppliers are required to make a payment under one scheme but are entitled to receive a payment under the other scheme, Ofgem may adjust the payments that it makes accordingly.

7.14 This instrument also ensures that the reconciliation mechanism applies to the expanded core group in England and Wales.

7.15 To reduce the potential distortion faced by smaller suppliers growing and shrinking when the participation thresholds are reduced to 1,000 domestic customer accounts, this instrument allows Ofgem to require updated customer account numbers from participating suppliers later in the scheme year, when directed by the Secretary of State.

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 None.

10. Consultation outcome

10.1 The Department ran a consultation on the Warm Home Discount scheme in England and Wales between 28 June and 22 August 2021. The Department considered that an eight-week consultation was sufficient for ensuring responses would come from a range of organisations and individuals. The consultation was hosted on gov.uk, with responses via an online portal and email. There were 87 respondents to the consultation, including energy suppliers, charities, consumer affairs organisations, local authorities, housing associations, public authorities, and members of the public.

10.2 The Government proposed continuing the reconciliation mechanism arrangements, incorporating the expanded core group, and continuing in Scotland where appropriate. 73% of respondents agreed with the proposal while only 5% disagreed and the remainder were unsure. Energy suppliers recognised that the reconciliation mechanism has worked well and supported extending it to the expanded core group. Most respondents also noted that applying the reconciliation process to Scotland would be beneficial. However, at the time of the consultation, the Government had not yet consulted on the Warm Home Discount scheme arrangements for Scotland, and therefore respondents highlighted concerns around differences between the schemes, the administrative complexity and costs of having two schemes, and requiring two reconciliation mechanisms. Having considered the responses, the Government confirmed it would proceed with the reconciliation mechanism.[1] The Department then ran a consultation on the Warm Home Discount scheme in Scotland between 9 May and 22 May 2022.

[1] https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022

10.3 The Department considered that a two-week consultation was sufficient as the detailed changes proposed to the scheme in Scotland were fairly minimal. There were 35 responses to this consultation across a range of organisations and individuals. The Government proposed that Ofgem would continue to run the reconciliation process. 90% of respondents agreed, noting Ofgem's experience in running the reconciliation processes in previous scheme years and recognising the benefit in maintaining consistency across Scotland with England and Wales. The Government subsequently confirmed it would proceed with the proposal and explained that suppliers would be required to report separately their spending under each scheme.[2]

11. Guidance

11.1 Ofgem will provide energy suppliers with guidance on compliance with the requirements of the reconciliation mechanism. This guidance will focus on the process and timings for making and receiving reconciliation payments. This guidance will be integrated into Ofgem's wider Warm Home Discount guidance for energy suppliers for each of the England and Wales scheme and Scotland scheme.

12. Impact

12.1 This instrument will have an impact on businesses. Energy suppliers participating in the Warm Home Discount schemes will be required to make payments or will be entitled to receive payments each scheme year according to the difference between their spending on core group rebates and their proportion of the aggregate spending according to their domestic market share. The reconciliation removes any competitive disadvantage from a supplier having a disproportionately large number of customers eligible for a core group rebate.

12.2 It is anticipated that suppliers will incur some administrative costs from complying with the requirements under the reconciliation mechanism, such as reporting customer numbers, reporting core group rebate payments, and making payments. However, these costs are expected to be negligible.

12.3 The impact on the public sector is limited to the administrative costs to Ofgem from operating the reconciliation mechanism. The Government considers these costs minor relative to the size of the scheme and proportionate to the aim of the mechanism.

12.4 A full Impact Assessment has not been prepared for this instrument because of the low level of impact expected on each energy supplier and as the aim is to reduce distortions and competitive disadvantages. The Government submitted a full Impact Assessment for the Warm Home Discount (England and Wales) Regulations 2022 and published a supporting analytical annex, including an assessment of the impacts of the scheme, alongside the Government Response to the consultation on the Warm Home Discount scheme in Scotland.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), the approach taken is to exempt the very smallest electricity suppliers. The Government has set a size threshold under which energy suppliers are not required to participate in the scheme. This threshold has been set at 50,000 domestic customer

[2] https://www.gov.uk/government/consultations/warm-home-discount-scotland

accounts in 2022/23 and 1,000 domestic customer accounts from 2023/24 onwards in the Warm Home Discount (England and Wales) Regulations 2022 and the Warm Home Discount (Scotland) Regulations 2022. The reduction in the threshold balances ensuring as many customers as possible can access the scheme as well as reducing barriers to switching between energy suppliers with ensuring that the smallest suppliers and newer entrants into the energy market do not face disproportionately large costs from participating in the scheme.

13.3 Smaller suppliers may volunteer to participate in a scheme in a scheme year, subject to approval by Ofgem.

14. Monitoring & review

14.1 The instrument does not include a statutory review clause. The schemes made by the Scheme Regulations have effect until 31st March 2026. The Secretary of State is under a duty to conduct a review of a scheme or particular parts of a scheme under regulation 30 of the Warm Home Discount (England and Wales) Regulations 2022 and regulation 33 of the Warm Home Discount (Scotland) Regulations 2022 if the circumstances set out in those regulations are met.

15. Contact

15.1 Jack Ramsden at the Department for Business Energy and Industrial Strategy Telephone: 07901 885617 or email: jack.ramsden@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Olivia Haslam, Deputy Director for Warm Homes, at the Department for Business Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Lord Callanan at the Department for Business Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.