

EXPLANATORY MEMORANDUM TO

THE ELECTRICITY AND GAS (CARBON EMISSIONS REDUCTION) (AMENDMENT) ORDER

2010 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 This explanatory memorandum has been prepared for the Electricity and Gas (Carbon Emissions Reduction) (Amendment) Order 2010 which amends the existing Electricity and Gas (Carbon Emissions Reduction) Order 2008 (SI 2008/188) (“the CERT Order”) as amended by the Electricity and Gas (Carbon Emissions Reduction) (Amendment) Order 2009 (SI 2009/1904).

2.2 The CERT Order sets energy suppliers who have more than 50,000 domestic customers an overarching household carbon saving target (defined in the Order as a “carbon emissions reduction target”). Suppliers must promote measures to a domestic energy user which will assist to reduce that household’s carbon footprint through increased energy efficiency, reduced energy consumption or microgeneration.

2.3 The amending Order enacts, in light of consultation responses, various amendments to the existing framework through which suppliers must meet a household carbon emissions reduction target. In summary, it:

- (i) increases the overall carbon emissions reduction target to 293 million lifetime tonnes of carbon dioxide (MtCO₂) (from 185 MtCO₂);
- (ii) sets a new overall insulation target as part of the extension;
- (iii) creates a super priority group of vulnerable households and sets a new overall super priority group target;
- (iv) extends the target period so that suppliers must achieve their increased obligation by 31st December 2012 (superseding 31st March 2011);
- (v) makes some changes to the way the Authority must determine the carbon emissions reduction for solid wall insulation measures to incentivise this technology; and
- (vi) makes some consequential amendments that are necessary as a result of the changes being made.

2.4 These changes reflect the policy intention to set suppliers a new, challenging overall carbon emissions reduction target as part of the drive to a low carbon economy, to focus the scheme on driving insulation measures (which deliver long lived energy and carbon emission reductions in the non-traded sector and are a key contribution to carbon budgets) and to secure low income households a more equitable opportunity to benefit from energy saving measures.

2.5 Specifically, the amendments will act to set suppliers a new higher overall household carbon saving target, raising it from 185 to 293 million lifetime tonnes of CO₂ (article 4). The obligation period will be extended from March 2011 to December 2012 (article 5). This is to align the end of the Carbon Emissions Reduction Target with the end of the first carbon budget period, set as a result of the Climate Change Act 2008, provide ongoing certainty on a household energy

framework to encourage early energy saving investment and to allow time for a more radical longer term household carbon saving mechanism to be developed and implemented.

2.6. The increase in the overall target will drive uptake of household energy efficiency measures and in turn help the UK tackle climate change, help it meet its legal obligation to cut greenhouse gas emissions by 2050, increase the security of energy supply and contribute to the alleviation of fuel poverty. The CERT Order requires energy suppliers to achieve 40% of the overall carbon saving target with activity delivered to a “Priority Group” of low income households (those eligible for certain welfare benefits/credits and/or aged 70 and over and thus regarded as vulnerable households). This amending Order sets energy suppliers two new additional targets to be achieved by the end of the scheme:

i) That suppliers meet 15% of the increase in target (16.2 MtCO₂) in a Super Priority Group of lower income pensioner and family households who are regarded as those least likely to currently benefit but are considered the most vulnerable to fuel poverty and the detrimental health impacts of a poorly heated house (article 3, 4).

ii) That suppliers meet 68% of the increase in target (73.4 MtCO₂) through professionally installed insulation measures. The insulation obligation can be met through qualifying insulation measures promoted in any part of the scheme (article 4, 9).

2.7. These amendments are believed to maximise the long term carbon and energy saving benefits of the programme (to both UK and individual households) against the potential short term costs of the scheme which may fall to consumers in their energy bills. Taking into account costs, the CERT extension has a positive Net Present Value to society of £8.65 billion.

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

3.1 The framework set out in the Electricity and Gas (Carbon Emissions Reduction) Order 2008, as amended, is being amended to reflect the policies described above in preference to creating a new obligation running from March 2011 to December 2012. This reduces the administrative burden of the scheme as suppliers would otherwise be forced to close and report on all schemes and re-contract for their investments. This approach allows suppliers to plan a smooth investment strategy to the end of the overall period, reducing their potential costs (which might otherwise be passed onto consumers).

3.2 The Government proposes to bring the amendments into force as a matter of urgency. Although the existing CERT obligation is in place to March 2011, suppliers are very advanced towards meeting this target. Suppliers will only invest towards their share of the new targets once they are in force and governed by legislative certainty. On current delivery trajectories, insulation and other energy efficiency activity will stall by September 2010 unless the increased targets have been brought into effect. Without the obligation period in the CERT Order being extended there will be a shortfall in offers for consumers to improve the energy performance of their homes this winter. This will particularly impact vulnerable households for whom an increase in energy efficiency is key to avoiding or alleviating fuel poverty. This will also have a significant impact on the supply chain as it adjusts to a “break” in demand (i.e. job losses) and our ability to regain this momentum in delivering towards climate change budgets.

3.3 The Government is looking to set two new obligations on energy suppliers over the CERT extension period:

i) an **insulation minimum**. This is designed to guarantee that a percentage of the increase in the overall target is delivered through professionally installed insulation measures. In policy terms, this provides Government greater certainty on the numbers of households who will benefit, the quality of workmanship and both the non traded carbon savings and economic benefits being maximised and realised.

ii) a **Super Priority Group**. This will guarantee that a minimum number of the most vulnerable households receive measures that allow them to benefit from improved thermal comfort/lower fuel bills. This second vulnerable group has been necessary to introduce as evidence showed that those households in the wider Priority Group more able to part pay for measures (i.e. aged 70 and over not on benefits) secured most offers under CERT to date. The introduction of the Super Priority Group will help to ensure that CERT is more equitable. Consideration was given to removing non benefit recipients as part of the Priority Group, but these households, in spending more time at home and being more susceptible to ill health, are still considered more vulnerable than able to pay households.

4. Legislative Context

4.1 The Draft Order is intended to be laid before Parliament for approval by a resolution of each House of Parliament. The draft Order will be laid before Parliament under Section 41A(12) of the Electricity Act 1989, section 33BC(12) of the Gas Act 1986, and section 103(5) of the Utilities Act 2000.

4.2 This supplier obligation, known as the Carbon Emissions Reduction Target, applies in England, Scotland and Wales. CERT commenced on 1st April 2008 and concludes on 31st March 2011. It is the third three-year cycle of the household energy supplier obligation, formally known as the Energy Efficiency Commitment. This amendment proposes to extend the scheme by twenty one months, from 31st March 2011 to 31st December 2012.

5. Territorial Extent and Application

This instrument applies to Great Britain.

6. European Convention on Human Rights

The Minister of Energy and Climate Change has made the following statement regarding Human Rights:

In my view the provisions of the Electricity and Gas (Carbon Emissions Reduction) (Amendment) Order 2010 are compatible with the Convention rights.

7. Policy background

7.1. The primary aim of the CERT Order is to make a contribution to the UK's legally binding target under the Kyoto protocol (to cut greenhouse gas emissions by 12.5% below 1990 levels by 2008-2012) and the Climate Change Act 2008 requirement (to cut emissions of green house gas emissions by 80% below 1990 levels by 2050). It does this by setting energy suppliers a carbon emissions reduction target. Suppliers meet this target by promoting the uptake of low carbon energy solutions (whether energy efficiency measures or micro-generation sources of energy) to household energy consumers, thereby assisting them to reduce the carbon footprint of their homes. In taking up these measures, households will enjoy reduced fuel costs and/or enjoy greater levels of thermal comfort. There are numerous policy barriers to consumers taking up these measures

directly, which this policy aims to overcome, including information barriers, apathy and up-front costs.

7.2. The amendments being made by this Order are expected to deliver a significant contribution towards achieving the UK's goals and targets. The current CERT obligation which must be met by all qualifying suppliers is 185 MtCO₂ by March 2011. The amendment Order increases the overall target by 108 MtCO₂ savings to 293 Million lifetime tonnes of CO₂ by December 2012. It is estimated to require about £2.3 billion investment by energy suppliers in meeting their targets. For reasons of equity, the obligation requires a proportion of savings be delivered to groups considered less likely to otherwise benefit from energy efficiency measures.

7.3. Stimulating growth in green technologies and social innovation is critical to the drive to a low carbon economy and CERT has a role in market transformation and in encouraging activity by suppliers to promote innovative measures or approaches. As an incentive to the promotion of those measures, CERT attributes an additional 50% in carbon savings. In order to limit any potential loss of carbon savings the uplift is attributable within a 10% ring fenced percentage of their total target.

7.4 Other specific amendments include:

- Suppliers will only be able to promote microgeneration measures which are eligible under other Microgeneration support mechanisms - Feed In Tariffs (introduced in April 2010) and the Renewable Heat Incentive (proposed to begin April 2011) for promotion to Super Priority Group households. By restricting microgeneration support to households considered unlikely to benefit from microgeneration in the early stages of these other support mechanisms, we will help avoid unnecessary double incentives and at the same time support vulnerable households access to measures which can provide a significant increase in thermal efficiency. All microgeneration uplifts will be withdrawn from April 2011, but not before, as suppliers will have already invested to March 2011 on the basis of a carbon saving score which included these uplifts. (article 12)
- CERT supports innovation in energy saving products and appliances by providing a 50% increase in carbon score to qualifying products. The *market transformation* baseline is currently the Electricity and Gas (Energy Efficiency Obligations) Order 2001. This means that a measure which saves carbon but was not promoted under the 2001 Order can be promoted as a market transformation action under the CERT Order. However, we will increase the baseline to measures which have not been promoted under the Electricity and Gas (Energy Efficiency Obligation) Order 2004. This will mean that suppliers need to come forward with new products or similar products which are no less than 20% more efficient than products promoted under the previous scheme to March 2008, rather than in the first scheme to March 2005, helping drive innovation in product efficiency. This is necessary to avoid rewarding suppliers with bonus carbon scores for measures which have gained a foothold in the market since 2005, and which have been successful in securing consumer uptake and so are cost effective even without this uplift. (article 3 – the definition of a market transformation action, paragraph (v) and (vi)).
- Suppliers will be awarded a carbon score for solid wall insulation based on the main heating fuel of the property it is installed in (see schedule 3 of the 2008 Order for the appropriate fuel carbon coefficients). These will apply for solid wall insulation on a property by property basis rather than the standard gas/electricity score used for other measures. Appropriate properties will be eligible for both the property specific score for solid wall insulation and the existing uplifts for solid wall insulation. These are the market transformation uplift (where suppliers can achieve a 50% increase in carbon saving score) or the Priority Group flexibility option uplift (where suppliers can achieve a 95% uplift for internal and 175% uplift for external solid wall insulation). Current rates of solid wall insulation are low, and are thought to be negligible off the gas grid. This amendment to the way solid wall insulation is scored will provide

additional incentives for promoting solid wall insulation in off gas grid properties. It is expected to lead to more geographical equity and to stimulate the market for a technology which needs to be rolled out at scale to meet carbon budgets.

- The Regulator Ofgem have been provided more directive reporting powers to ensure that the scheme continues to be effectively administered. Specifically, there is now an overlap of measures being delivered under CERT and the Community Energy Saving Programme (the Electricity and Gas Community Energy Savings Programme Order 2009, S.I. 2009/1905). We need to know where measures eligible under both schemes have been delivered to establish under which mechanism they received support, so as to avoid any potential double counting of carbon savings. This strengthened oversight is critical to ensuring we stay on course for scheme targets and carbon budgets.

8. Consultation outcome

8.1 A three month consultation on extending CERT closed on 14th March generating 102 responses from groups including energy suppliers, local authorities, the energy efficiency industry, consumer groups, Ofgem (the scheme administrator) and Scottish and Welsh offices. The policy decisions reflected in the amending Order take account of comments received through the consultation process. They also take account of the latest information on the costs of delivering carbon saving measures and other parameters that are likely to influence capacity constraints and suppliers' costs in meeting their CERT obligations, including levels of consumer demand. A detailed summary of responses and a Government response is published on the DECC website¹. There was broad support from stakeholders in consultation responses for the central proposals which the amendment Order seeks to implement. They are:

Extension and ambition

8.2 96% of respondents addressing the issue agreed that the existing CERT obligation should be extended as opposed to a new and distinct obligation being imposed. We received strong support for the proposed level of ambition and for the principle of the two key objectives - to increase the volume of insulation delivered and to secure a fairer scheme. 93% of respondents addressing the issue agreed that the CERT obligation should be increased pro rata on the current target, with the general consensus being that this represented a challenging yet achievable target given the potential costs falling to consumers. Keeping the costs of the scheme passed to consumers at a reasonable level was a key concern of respondents, whilst varying degrees of challenge were called for as part of the headline objectives.

Driving Insulation

8.3 91% of respondents addressing the question supported the proposal to introduce an insulation minimum. Of those not agreeing to a minimum, most disagreed with the principle of an insulation minimum stating that the imposition of a ban on CFL eligibility would be sufficient to drive insulation levels. 86% of respondents supported an insulation minimum being achieved through professionally installed measures only. 72% of respondents stated that the insulation minimum should be higher than the level proposed. 74% of stakeholders indicated support for the withdrawal of CFLs as qualifying measures. 55% of respondents recommended retaining some support for micro generation measures under the CERT extension, particularly for vulnerable households given that the upfront costs of microgeneration remain prohibitive.

Securing an equitable distribution of benefits

8.4 84% of respondents addressing the principle of a Super Priority Group supported its introduction, with almost all agreeing that additional measures were needed to ensure equitable delivery of benefits. There was strong agreement (86% of respondents) that *eligibility* to the

¹ <http://decc.gov.uk/>

Super Priority Group be limited to older poorer households (identified via Pension Credit), families with children (identified via Child Tax credit where income is lower than £16,190). There was also support for extending qualification to include low income sick or disabled groups, as well as for targeting people in hard to treat properties, from all consultee groups. 90% of respondents addressing SPG *design* issues agreed that there should be a limited list of heating and insulation measures which Super Priority Group households should be entitled to benefit from at least one of. There were, however, a broad variation of respondent views on which measures should be eligible and how far the list should extend. Views on the level of the sub-target varied between 5% (energy suppliers) and 20+% (fuel poverty stakeholders and consumer groups), with most indicating that the level could only be set on the basis of decisions on eligibility.

9. Guidance

9.1 We will be looking to continue to engage with stakeholders such as energy suppliers, Ofgem, the energy efficiency industry, local authorities, charities and environmental organisations as we implement the amendments. Ofgem will be consulting on updating their detailed operational supplier guidance alongside these amendments. We issued a press release alongside the Government response publication, contacting all stakeholders who responded to the CERT extension consultation. We will be engaging these organisations on the operational detail through meetings and events as necessary.

10. Impact

10.1 The amendment Order directly feeds into the existing order and so a one order text will result when it comes into force. The associated impact assessment attached to this memorandum considers the total costs and benefits of the CERT extension period and assesses sensitivities around the introduction of the specific amendments being introduced.

10.2 The impact on business is expected to be positive in that the energy efficiency industry – manufacturers, retailers and installers will benefit from the revenue and employment benefits stimulated by an increase to the carbon saving obligation and energy supplier investment needed to meet this. The costs of the scheme can, and are expected to be, passed on in part to household electricity and gas consumers. Suppliers have an incentive to keep the costs of their obligations under CERT as low as possible in order to minimise the amount of any cost pass through to consumers. This reflects the competitive supplier market and the drive to acquire and retain customers.

10.3 Charities and voluntary bodies could also benefit from an increased contribution to their local energy efficiency schemes.

10.4 Independent analysis commissioned by DECC into the previous supplier obligation phase states that the obligation has led to no discernable evidence that the impact of the scheme has in any way had a deleterious effect on smaller companies. It argues that the obligation has typically resulted in the smaller players in the insulation and lighting business organising themselves to be effectively a “bigger player” thus overcoming the perceived problems for energy suppliers of dealing with small businesses. The innovation of directly supporting the manufacturer in the creation of energy efficient products should mean that the retailers of appliance and consumer electronics will not be disadvantaged by their size other than through normal commercial arrangements.

10.5 The impact on the public sector is positive. Local authorities and registered social landlords have worked successfully with suppliers to insulate social housing in the supplier obligation programmes.

11. Regulating small business

11.1 The legislation does not apply to small business. The CERT obligation does not apply to new and small energy suppliers with fewer than 50,000 domestic customers. This means that new entrants will not have to set up CERT programmes while at an early stage. The draft Order contains other provisions that avoid the risk of creating barriers to new entrant companies: where a supplier prefers not to set up its own CERT programmes, then it may transfer all or part of its target to another supplier, purchase accredited performance from another supplier or contract out the operation of its programme.

12. Monitoring & review

12.1 Ofgem is required to report annually (July) to the Secretary of State on suppliers' progress towards their carbon saving targets. Ofgem voluntarily publish the suppliers collective progress, and the number of main measures installed, on a quarterly basis. The impact of the CERT period in so far as it has achieved its carbon and energy saving ambitions, together with the range and number of energy efficiency measures installed, will be reported by Ofgem at the end the programme in early 2013.

12.2 The Government will commission an independent review of the broader social and environmental costs and benefits at the end of the scheme, consistent with the independent reviews of the previous two three-year phases. Government will also look to assess the real world impact of the scheme through an analysis of consumption data, helping determine the impact of energy efficiency measures, fuel prices and weather impacts respectively.

13. Contact

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