

EXPLANATORY MEMORANDUM TO
THE ELECTRICITY AND GAS (CARBON EMISSIONS AND COMMUNITY ENERGY SAVING) (AMENDMENT) ORDER 2011

2011 No. [XXXX]

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1.1. 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 and Community Energy Saving) (Amendment) Order 2011 which amends the Electricity and Gas (Carbon Emissions Reduction) Order 2008 (SI 2008/188)¹ and the Electricity and Gas (Community Energy Saving Programme) Order 2009 (S.I. 2009/1905). These schemes are known as CERT and CESP respectively.

2.2 Through the existing Orders:

i) Through CERT, Government sets electricity and gas suppliers who have 50,000 or more domestic customers an overarching household carbon saving obligation (293 Million lifetime tonnes CO₂) to meet by December 2012, together with sub-targets for reasons of promoting equity and insulation. Suppliers must promote measures to a domestic energy user which can be proven to reduce that household's carbon footprint through increased energy efficiency, reduced energy consumption or in some circumstances micro-generation.

ii) Through CESP, Government places a similar (but smaller) obligation on electricity and gas suppliers to achieve a carbon emissions reduction obligation. The CESP Order also places an obligation on electricity generators who have generated 10 TWh/yr or more of electricity in previous years (generation periods) to achieve a carbon emissions reduction obligation. The key difference is that, whereas CERT is about delivering carbon savings at least cost, CESP is designed to drive a whole house, area intensive approach to increasing the energy efficiency of the housing stock, building on local partnerships. It is focused on low income households, targeted through the lowest 10% of the Indices of Multiple Deprivation. It has the

¹ as amended by the Electricity and Gas (Carbon Emissions Reduction) (Amendment) Order 2009 (S.I. 2009/1904) and the Electricity and Gas (Carbon Emissions Reduction) (Amendment) Order 2010 (S.I. 2010/1958).

additional objective of significantly reducing the fuel bills of households reached. The obligation began in October 2009 and will continue until December 2012.

iii) Both the CERT Order and the CESP Order is administered and enforced by the Office for Gas and Electricity Markets.

2.3 This amending Order looks to introduce, in light of consultation responses, the same minor amendments across both Orders. Specifically, it would act to increase the threshold at which suppliers are required to participate in the CERT and CESP schemes. An electricity or gas supplier has been under an obligation to meet a carbon reduction targets under these schemes if it has 50,000 or more customers on the relevant date. This amendment would require that from 1st April 2012, an electricity or a gas supplier will only have such an obligation if it has 250,000 or more domestic electricity or gas customers on 31st December 2011, superseding the 50,000 figure now in the legislation. The Order also makes some consequential amendments to both the CERT Order and the CESP Order which are necessary as a result of this change.

2.4 The aim is to reduce a potential barrier to growth for small energy suppliers. Market entry and the threat of market entry are important in energy markets, as in other markets, to promote competition. Moreover, competitive markets are in the interests of consumers, since competition incentivises firms to innovate in order to reduce prices and improve the products and services they offer. It is also hoped that a higher threshold will reduce burdens on small suppliers, in line with Government's broader burden reduction agenda.

2.5. An additional minor additional amendment pursued here is an extension of the deadline obligated CERT suppliers have to trade (subject to Ofgem approval) completed qualifying CERT actions between themselves from the date currently set in legislation of March 2012 to December 2012 (the end of the scheme). This will allow suppliers to retain flexibility for longer in terms of the options they have to meet their binding obligations. This aligns CERT with CESP.

2.5 These amendments are set to have a positive impact on costs to business and so energy market competitiveness. In turn this can help keep energy bills as low as possible.

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

3.1. The amendment to the Order needs to come into force before 31st December to have the desired effect. The delay between the announcement of Government's intention to pursue this Order change (in June) and the effect is

because Government was considering wider possible changes to the CERT scheme. These considerations are ongoing and are timed out of being pursued at the same time as the amendments presented here, which have strict time constraints.

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. Section 41A(12) of the Electricity Act 1989 and section 33BC(12) of the Gas Act 1986, as amended by section 103(5) of the Utilities Act 2000 contain powers for the Secretary of State, by Order, to impose an obligation on electricity and gas suppliers to achieve carbon emissions reduction targets.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

6.1 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 and Community Energy Saving) (Amendment) Order 2011 are compatible with the Convention rights.

7. Policy background

- *What is being done and why*

7.1 The proposals here increase the threshold, at which gas and electricity supplier become subject to carbon reduction obligations under CERT and CESP, from 50,000 customers to 250,000 customers. This change is driven by recognition of the fact that the costs of complying with CERT and CESP are likely to have a disproportionate impact on small suppliers compared to large suppliers; thereby, potentially restricting the growth of smaller suppliers and market entry. Increasing the threshold is therefore intended to increase the competitive pressures in the retail energy market to achieve the consumer benefits associated with more robust competition. This is a pressing matter as some small suppliers have already crossed the threshold, whilst other small suppliers are growing rapidly.

7.2 CERT contains provisions that avoid the risk of creating barriers to new entrant companies: where any 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, subject to approval from Ofgem, who manage the scheme. The proposal here on transfers would extend the transfer deadline for

all CERT obligated suppliers, thereby facilitating further flexibility in how suppliers deliver their obligations under CERT.

7.3 The primary aim of CERT and CESP 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). The schemes do this by setting energy suppliers carbon emissions reduction targets. Suppliers meet these targets by promoting the uptake of energy saving solutions 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.

7.4 There are various policy barriers to consumers taking up these measures directly, including information barriers, apathy and up-front costs which these schemes are designed to overcome. Through CERT, some 7.5 million households are expected to benefit from subsidised or free loft and cavity wall insulation. CERT is expected to deliver a £22 billion net benefit to society over the life of the measures. Through CESP, 90,000 homes are expected to benefit from whole house energy saving solutions, helping them save an average £300 from their annual fuel bills, with an average net benefit to society of £122 million over the life of the measures.

7.5 The associated impact assessment (IA) provides an assessment of the rationale for and objectives of the amendment to the threshold. An IA covering the total expected costs and benefits of the CERT programme to March 2011 was published in June 2008 and an additional IA for the extension of the programme to December 2012 was published in June 2010². An IA for the CESP scheme was published in May 2008³.

- ***Consolidation***

7.6 The amendment Order directly feeds into the existing orders and so a one order text will result when it comes into force.

8. Consultation outcome

8.1 DECC undertook a consultation between December 2010 and January 2011 seeking views on a proposal to raise the customer threshold for supplier involvement in the Carbon Emissions Reduction Target, the Community Energy Saving Programme and Feed in Tariffs, from 50,000 (100,000 was initially proposed). The rationale for the proposed increase is that the number and size of social and environmental obligations have grown in recent years at the same time there is evidence that a number of small suppliers are approaching the threshold level for mandatory participation. It was not envisaged that the threshold would be breached when the schemes were first

² http://www.decc.gov.uk/en/content/cms/consultations/cert_ext/cert_ext.aspx

³ http://www.decc.gov.uk/assets/decc/consultations/cesp/1_20090710121840_e_@_@_cespia.pdf

introduced. Our analysis shows that suppliers with 50,000 customers incur significantly greater 'per customer' costs of compliance with obligations than a large supplier.

8.2. A detailed summary of responses and a Government response is published on the DECC website.⁴ The majority of respondents agreed that the current threshold for mandatory participation in CERT and CESP should be increased, with a number suggesting that it should be 250,000 customers or higher. In light of consultation responses, it became clear that some small suppliers would (and we now believe have) increase beyond the 50,000 customer threshold within the term of the schemes. This being the case, it was concluded that it was vital Government act to improve energy efficiency without placing disproportionate costs on small suppliers. Moreover, the 50,000 threshold was considered to no longer meet Government's objectives of protecting small business from a disproportionate impact and promoting a competitive energy market. Given the broad support from stakeholders for the proposal to increase the threshold, this amending Order looks to enforce this.

9. Guidance

9.1 We will contact all stakeholders who responded to the consultation and, working with Ofgem, engage these organisations on the operational detail through meetings and events as necessary.

10. Impact

10.1 As set out above, the impact on business is expected to be positive. There is no further impact on other bodies from these changes. CERT and CESP can still help those charities, voluntary groups, and LAs who partner with energy suppliers, in accessing grant funding to support the energy efficiency improvement of households. CERT and CESP also continue to be potentially available to all qualifying domestic customers irrespective of who the energy supplier is. An impact assessment is attached to this memorandum.

11. Regulating small business

11.1 The proposals here helps smaller business' by increasing the threshold at which they would be obligated so that new entrants will not have to set up CERT programmes.

12. Monitoring & review

12.1 Ofgem is required to report annually to the Secretary of State on suppliers' progress towards their carbon saving targets. Ofgem voluntarily publish the suppliers collective progress more routinely. An interim evaluation of both schemes was published on 28 October and is available on the DECC website. Ongoing evaluation work will result in a final report on both schemes in 2013.

⁴ <http://www.decc.gov.uk/en/content/cms/consultations/threshold/threshold.aspx>

13. Contact

13.1 Nicholas Taylor, Head of CERT and CESP at the Department of Energy and Climate Change (Tel: 0300 068 5154; email: nicholas.taylor@decc.gsi.gov.uk) can answer queries regarding the instrument.