UK energy company obligations

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Background

What is an energy company obligation?

- Government sets a outcome and obliges the big six suppliers to deliver that outcome
- The outcome must be related to reducing domestic carbon emissions (or with new powers in the Bill the cost of heating) and can be complex, including rules for what can be delivered and which households are eligible
- An administrator then ensures the rules are followed – however once the outcome is set, government has no day to day control of the delivery - changes require legislation
- Energy suppliers fund their obligations through energy price rises with poorest hit hardest by higher energy costs

Why use the suppliers to deliver?

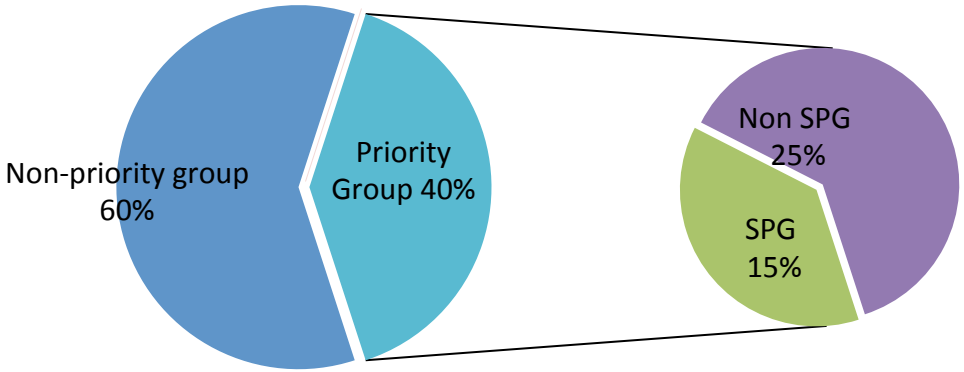
- Energy suppliers have a direct customer relationship with every household
- Liberalised market and economies of scale are thought to keep costs down

Existing schemes: CERT & CESP

- Schemes runs from April 2008 to December 2012.
- Estimated over £5 billion will be invested by suppliers in current scheme
- Suppliers may absorb some of these costs, but assumed that at least some costs passed onto energy bills (therefore it is key to keep costs down)
- Delivery approach is very flexible

CERT - Objectives

- A GB wide obligation on gas and electricity suppliers to meet household carbon emission reduction targets;
- Commenced 1st April 2008 and ends 31st March 2011;
- Target of 293 $MtCO_2$ by 2012 - critical to achieving our climate change targets;
- Professional Insulation Minimum (68%)
- CFLs ineligible from April 2011
- Solid wall insulation incentivised
- At least 40% of the carbon saving obligation has to be achieved in a priority group of low income and elderly vulnerable households (15% Super priority Group);
- Suppliers achieve targets by promoting, typically through subsidised offers, low carbon and energy efficiency measures.



How CERT works: supplier delivery

Suppliers design schemes to meet their targets → Marketing and Subsidies for measures



Suppliers have multiple delivery routes → Contracts with installers, Retailers, Local Authorities etc



Verification

Installation Auditing (5%) → Potential fine 10% of Global turnover

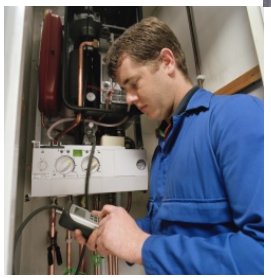
Success on the ground

Measures	EEC1: April 2002 – March 2005	EEC2: April 2005- March 2008	CERT: April 2008 – March 2011		Rounded Total
			First Year	Second Year First Quarter	
Cavity wall insulation	791,524	1,760,829	545,594	172,052	**3.3 million**
Loft insulation (top up)	528,496	1,297,257	689,353	224,460	**3.5 million**
Loft insulation (virgin)	226,245	490,770			
DIY loft insulation (per 40m2)	399,483	799,573	533,227		**1.7million**
Solid wall insulation	23,730	41,319	8,626	5,578	**80 thousand**
Numbers of Households Insulated	5 Million (based on 1.3 measures per house).		1 Million		**6 million**
CFLs	35.7 million	101.8m	152.7 m	17.2 m	**307million**
Fuel Switching	41,000	78,000	15,733	4,412	**140 thousand**
Heat Pumps	-	-	545	142	**687**

Community Energy Savings Programme (CESP)

- Carbon obligation on energy companies (2.9MtCO_2)
- Estimate £350m worth of energy efficiency measures in 100 schemes with focus on low income areas
- CESP evaluation integral to pilot and future learning:
  - Involving owner occupiers & rented sector
  - Financing
  - Regeneration opportunities





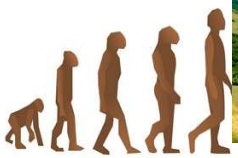
The future Energy Company Obligation (ECO)

The landscape has changed:

- **CERT and CESP end in December 2012, and Warm Front ends in March 2013**
- **The opportunities for the cheapest and most immediately cost-effective energy saving measures are diminishing**
- **The Green Deal allows householders to capitalise the savings on energy bills to pay for upfront cost of energy efficiency measures. However there are some situations where the Green Deal is less likely to work. Therefore, we still need an ECO.**
- **The future ECO will:**
  - Be designed to work with the Green Deal
  - Support a very restricted list of technologies supported

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The ECO





Has evolved to fit new 2012 landscape



An outcome we set, energy companies deliver



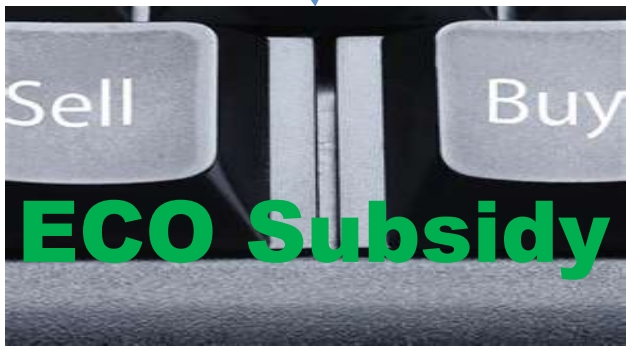


Has two distinct objectives:
Carbon & Affordable Warmth
&…
will fill the gaps where the Golden Rule doesn't work

Designed to integrate with and have same standards as Green Deal framework

Quality Accreditation Standards

A competitive market for ECO subsidy





Energy Company Obligations: Delivery costs

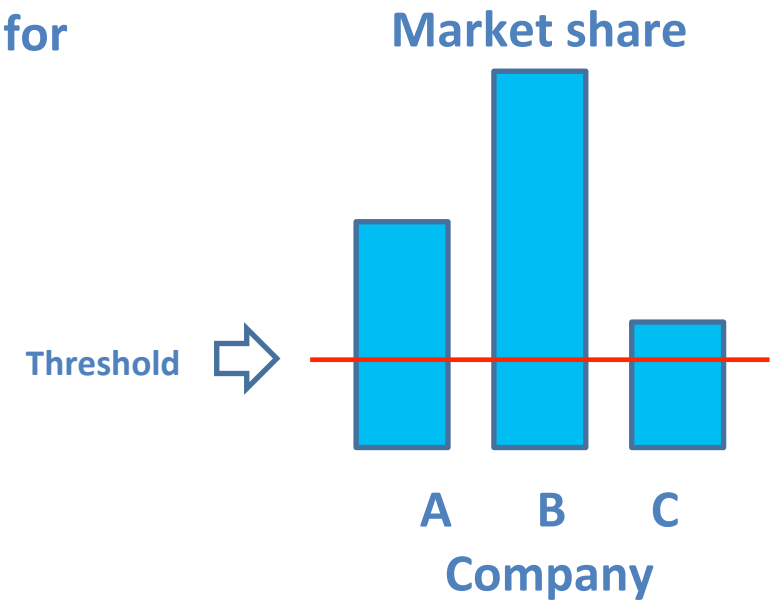
- Energy companies are in competition for customers/market share. As such they compete to deliver their obligations as cost effectively as possible.

- Obligations must be based on market share to avoid distorting the market – if all companies were equally effective at delivering then costs passed through would be the same for all consumers, irrespective of supplier.

- Smaller suppliers are likely to suffer disproportionately larger costs both in setting up the necessary systems required and in their ongoing administration of their obligation.

Thresholds

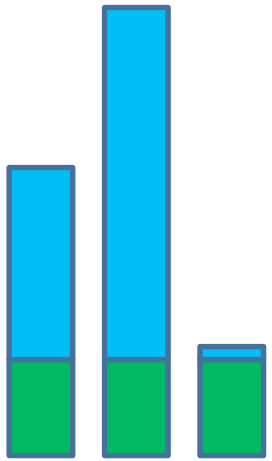
- Given the fixed cost issue, it seems sensible to consider a threshold for inclusion
- Irrespective of where we draw the line, a 'cliff edge' threshold might act as a barrier to growth, as breaching the threshold incurs the cost of compliance across the whole of the supplier's customer base.



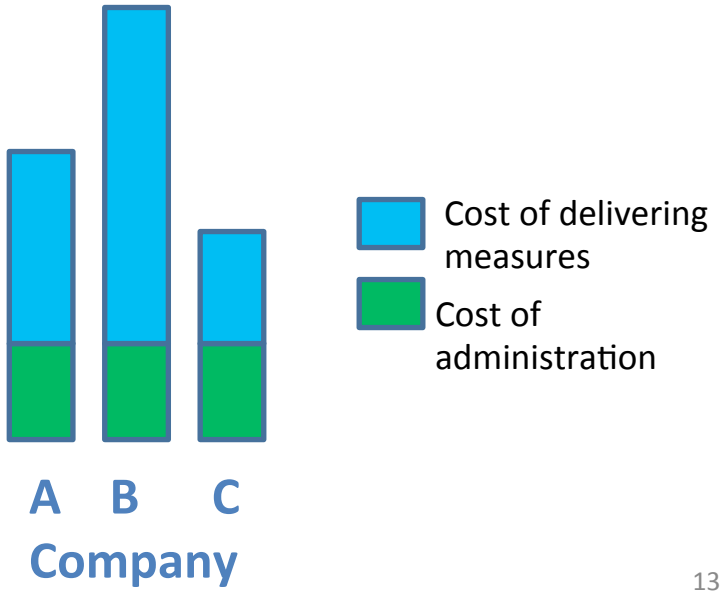
Tapering

- To ameliorate the cliff edge effect the threshold could be tapered so that the supplier makes a contribution for every additional customer once a threshold is reached, rather than incurring costs for whole customer base.
- The higher the threshold the greater the potential need for tapering

Total cost of obligation (tapered)



Total cost of obligation (cliff edge)



Where should the threshold be?

When deciding where to set a threshold there are two key questions to be considered:

- Of the costs an obligation imposes on energy companies, what proportion is fixed?
- What is the size and composition of the energy supply market?

Setting the threshold: Fixed Costs

Energy companies tend to guard their costs closely, however it can be fairly assumed that **the bigger and more complex an obligation the larger the fixed costs** are likely to be. For example:

- An obligation to deliver cavity wall insulation to 10,000 houses in each of 10 specific regions is likely to involve higher (admin & logistical) fixed costs than just: any 100,000 houses.
- Further (search & verification) costs would be added if delivery had to be directed to households on low incomes.

The greater the fixed costs the stronger the case for a higher threshold as it will place a bigger burden on companies, giving the larger ones an unfair advantage, and potentially incentivising smaller companies to stay under the threshold.

Setting the threshold: energy supply market

What is the size of the market?

- A threshold of 100,000 may be too high to include a significant number of energy companies supplying less populous member states. Whereas this threshold may be too low in countries with large populations.
- Therefore to maximise the proportion of the market that is covered - the smaller the market the lower the threshold.

How competitive is the market and how pressing is the need to encourage new market entrants?

- New entrants tend to force existing market players to respond through lower prices and/or better products and services.
- Therefore consideration needs to be given to the utility of new entrants and whether the market is open and competitive with lots of players, or if it is dominated by a small number of companies and has lots of existing barriers to entry. The latter situation perhaps calls for a higher threshold.

The Energy Company Obligation (ECO)

UK situation:

- The threshold for previous energy company obligations has been 50,000 customers (no tapering). Small energy companies are close to this threshold and if they grow, will face a burden.

- We want to encourage new market entrants and promote competition. We are therefore considering the case for a 250,000 customer threshold.

- A larger threshold makes the case for tapering stronger. However larger thresholds mean less of the market is captured by the obligation.

THE UK ECO
Sectors targeted & Social Equity

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The ECO: Sectors

Sectors Targeted

- Domestic Housing

Why?

- Lots of Carbon to be saved – Some of the oldest housing stock in Europe
- 40% of existing stock is pre-1944, with mostly solid walls, which are hard to treat buildings
- 70% of the housing stock in 2050 already exists today
- UK Government has policies to cover other sectors e.g:
    - Carbon Reduction Commitment
    - Climate Change Agreements
- We want to benefit from the existing relationships energy companies have with their customers

Social Equity

How is social equity ensured?

Sub targets within Energy Company Obligations.

- **CERT**
  - Priority and Super Priority Groups
- **ECO**
  - Affordable Warmth obligation to deliver heating systems and basic insulation to low income and vulnerable
  - Distributional Safeguard to ensure equitable distribution of carbon saving measures
  - Referral mechanism?
- **Other Government policies to assist people on low incomes**