The Electricity and Gas (Energy Company Obligation) (Amendment) Order 2022

Lead department	Department for Business, Energy and Industrial Strategy
Summary of proposal	The Energy Company Obligation (ECO) places an obligation on larger energy suppliers to achieve both carbon and bill savings by promoting and installing energy efficiency measures into homes. The current ECO scheme (ECO3) expires at the end of March 2022 and the proposal is for a follow-on scheme (ECO4) to run from April 2022 to March 2026.
Submission type	Impact assessment (IA) – 21 February 2022
Legislation type	Secondary legislation
Implementation date	1 April 2022
Policy stage	Final
RPC reference	RPC-BEIS-5086(2)
Opinion type	Formal
Date of issue	16 March 2022

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	The IA's assessment of direct impacts on business and impacts on small and micro-businesses is sufficient. The EANDCB figure has been calculated in line with RPC guidance. The Department has provided a good overall cost benefit analysis and a strong monitoring and evaluation plan.

Business impact target assessment

	Department assessment	**RPC validated**
Classification	Qualifying regulatory provision (IN)	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£872.0 million	£872.0 million
Business impact target (BIT) score	£3,490.0 million	£3,488.0 million
Business net present value	-£3.8 billion	
Overall net present value	£810.0 million	

[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. The RPC rating is fit for purpose or not fit for purpose.

RPC summary

Category	Quality[2]	RPC comments
EANDCB	**Green**	The EANDCB figure is calculated consistently with previous ECO schemes and in line with better regulation framework and RPC guidance. The method used accords with RPC comments on the consultation stage IA.
Small and micro business assessment (SaMBA)	**Green**	With the customer account and energy supply thresholds unchanged, no small or micro businesses are expected to be drawn into the scope of ECO. The IA would benefit from further discussion of the impact of halving supplier allowances and the impact on the smallest obligated suppliers.
Rationale and options	**Satisfactory**	The Department provides a sufficient rationale for intervention, drawing upon both market failure and equity considerations. The IA would benefit from further comparison with the regulatory options discarded following consultation, and discussion of non-regulatory options.
Cost-benefit analysis	**Good**	The IA makes good use of data and experience from previous ECO schemes and helpfully sets out improvements to the evidence base since consultation. The IA would benefit from addressing further the data limitations in relation to Scotland and Wales. The IA includes a useful and well-presented sensitivity analysis.
Wider impacts	**Satisfactory**	The IA includes useful analysis of distributional impacts and impacts on competition. The IA would benefit from further discussion of impacts on innovation and supply-chain risks.
Monitoring and evaluation plan	**Good**	The IA includes a comprehensive section on monitoring and evaluation plans, with further details added since consultation.

[2] The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. Please find the definitions of the RPC quality ratings here.

Summary of proposal

The Energy Company Obligation (ECO) scheme was launched in 2013 and requires energy suppliers to deliver a target of notional annual bill savings by installing energy efficiency and heating measures to selected, or targeted, homes. The policy is intended to drive uptake of energy efficiency measures among low income and vulnerable households in, or at risk of, fuel poverty. The current ECO scheme (ECO3) expires at the end of March 2022 and the proposal is for a follow-on scheme (ECO4) to run from April 2022 to March 2026. As with the current (ECO3) scheme, ECO4 will continue to focus on low income, vulnerable and fuel-poor households but with a narrower focus on supporting the least energy efficient homes.

At the consultation stage, the Government considered different options, in particular around which Energy Performance Certificate (EPC) bands support should be limited. The final proposal is that support will be provided to EPC D, E, F and G owner-occupied homes, with minimum requirements imposed necessitating that EPC F and G homes reach EPC D, and EPC D and E homes reach EPC C. Social housing and privately-rented E-G rated properties will be eligible for certain energy efficiency measures. There are specific targets in relation to delivering notional annual bill savings for private tenure homes and the installation of solid wall insulation measures. The proposal removes eligibility for those on non-means tested benefits (to target those on lowest incomes and most likely to be in fuel poverty) and increases to 50 per cent the proportion of the scheme that suppliers can deliver with local authorities ('flexible eligibility').

The 'eligible pool' for the proposal is estimated at 3.7 million properties (table 1, page 10 of the IA). As with previous ECO IAs, the policy is appraised over 46 years, reflecting the economic lifetime of the longest-lasting energy efficiency measures that are expected to be installed. The proposal is estimated to cost around £4.4 billion in present value terms. Around £3.3 billion is incurred by business, with the largest cost (£2.4 billion) being the cost of installing energy efficiency measures. The largest remaining cost (£1.0 billion) is reinstallation costs once the original measures reach the end of their useful lifetime, which is payable by households. Benefits are estimated at £5.2 billion, with the large majority accounted for by carbon reductions (£2.5 billion) and energy savings (£1.9 billion). Overall, the proposal is, therefore, estimated to have a net present value of £0.8 billion. The costs to business translate to an EANDCB of £872 million, calculated over the four-year life of the scheme.

EANDCB

The Department's EANDCB figure is calculated consistently with previous ECO schemes and in line with RPC guidance. The Department now expects economic rent[3] to accrue to the supply chain rather than to households. However, the IA correctly includes the cost to energy suppliers, and excludes the benefit to installers,

[3] This is the excess profit installers make when selling notional bill savings to energy suppliers. The IA provides a good explanation of the concept of economic rent at paragraphs 63-70.

associated with this from the EANDCB (paragraph 103).[4] The EANDCB figure is also now correctly calculated over the four-year lifetime of the scheme, the period over which all of the direct costs to business are incurred. It is significantly higher than some estimates in the consultation stage IA, which were as low as £80 million where the figure was calculated over 46-years and economic rent to supply-chain companies was included.

Business impact target (BIT) score

In accordance with the better regulation framework, treatment of measures in force for less than five years, the BIT score is the EANDCB multiplied by the lifetime of the measure, in this case four years.

The EANDCB figure is a significant increase on ECO3. The latter was reported in the BIT report for 2018-19 at £608.3 million (2016 prices; 2017 present value base year).[5] The difference reflects the significant increase in supplier spend envelope between the two schemes. The difference in the EANDCBs for ECO3 and ECO4 (adjusted to a common price and present value base year) represents the additional annual regulatory burden on business of ECO since the start of the current parliament.

Missing impact(s)

The IA notes that its modelling is not able to cover homes permitted under 'in-fill', for example where a block of flats or street includes mixed tenure occupants (paragraph 112, 2nd bullet). The IA notes that the impacts are not expected to be large but it would benefit from further discussion of the significance of this.

Un-monetised impact(s)

The IA states that there will be some small costs to BEIS and the administrator (*Ofgem*) which have not been monetised. The IA would benefit from explaining what these are, and further discussion of their likely scale.

Counterfactual/baseline

The IA sets out a detailed, yet clear, discussion of the counterfactual, where the current ECO scheme ending in March 2022 and, therefore, obligated energy suppliers no longer being required to deliver heating and insulation measures to homes. The IA now, helpfully, includes further discussion of energy efficiency requirements in other government heating and building policies, explaining why any overlap is expected to be small.

See also comments under 'cost-benefit analysis' below.

[4] The benefit to installers is treated as 'resources used to comply with regulation' (paragraph 99) and is excluded from the EANDCB, in line with the RPC guidance at link: https://www.gov.uk/government/publications/rpc-case-histories-other-bit-methodology-issues-march-2019

[5] https://www.gov.uk/government/publications/better-regulation-annual-report-2018-to-2019 (p16).

SaMBA

The Department's SaMBA is sufficient. With the customer account and energy supply thresholds unchanged, the Department's analysis suggests that no small or micro businesses are expected to be drawn into the scope of ECO. The IA notes that the proposed halving of supplier allowances will increase the share of obligations for smaller obligated suppliers. The IA now addresses this more fully (paragraphs 119-120 and table 11) but would benefit from discussing this area further. The IA does discuss mitigation but would benefit from explaining and providing more details of the "*alternative delivery approach…allowing* [smaller suppliers] *to deliver measures to help fuel poor households in a simpler way*" (paragraph 117).

The IA would benefit from including further cross-reference to a separate proposal (and associated IA) to remove ECO thresholds from 2024. The IA would also benefit from some consideration of the impact of recent market concentration on the growth of suppliers over the ECO obligation threshold and implications of this before any legislation is introduced to remove the threshold.

The Department notes that some small and micro businesses in the supply chain may benefit indirectly from increased supplier demand for their services.

Rationale and options

As with previous ECO IAs, the Department sets out sufficiently a rationale for intervention, drawing upon both market failure and equity considerations. As this is the latest in a number of ECO schemes, the description of the rationale for intervention is proportionate. Although the ECO scheme has been running for many years, the IA would still benefit from some further explanation for why any alternative options to regulation would not meet the requirement of the policy objectives (paragraph 27).

The IA would benefit from discussing further possible interactions with other government policies in this broad area, in particular promotion of heat pump installations (for example in the section on boilers – paragraphs 44-45).

The consultation stage IA included a number of regulatory options, and the final stage IA discusses briefly the rationale for the Government's final position. The IA would benefit from greater comparison of the proposal against the options discarded since consultation, ideally with indicative NPV figures.

Cost-benefit analysis

Evidence and data

The IA would benefit from providing an overview of what has been delivered under the ECO schemes since they began in 2013, lessons learned and an overall assessment of how successful they have been in achieving the policy objectives.

The IA includes a very useful table (table 2, page 14) setting out key improvements to the evidence base since consultation. The IA appears to make good use of data and experience from previous ECO schemes, such as on supplier administration costs. The IA sets out assumptions, and how they have been tested, in paragraphs 103-113 and at annex A. The IA would benefit from referencing more explicitly data sources used for assumptions, in particular how far they draw upon experience with previous ECO schemes and consultation engagement with stakeholders.

The IA usefully includes sensitivity tests where there is particular uncertainty, such as in relation to costs of search to identify eligible households and properties (figures 2 and 3, pages 28-29, in particular). The IA describes some areas where the Department has not been able to model risks, such as the mix of measures and possible changes to the Standard Assessment Procedure (paragraph 112, 4th-5th bullets). The IA now includes more discussion on these areas but would benefit from discussing, where possible, further the potential likely scale of impacts of these risks.

The estimated NPV has changed markedly since consultation, from a small net cost to £820 million. The IA notes that this change has been driven primarily by an increase in carbon values used to monetise carbon savings, reflecting updated HMT Green Book figures. The IA would benefit from discussing further the significance of this in its sensitivity analysis.

The IA would benefit significantly from discussing evidence of the effectiveness of 'ECO Flex' under previous ECO schemes as a means of delivering to low-income households, given the significant increase in measures that will be delivered through this mechanism under ECO4.

Methodology

Suppliers' possible actions under the proposed ECO4 order are modelled using the National Household Model (NHM). The model is based on the English Housing Survey (EHS), an annual survey of 13,000 face-to-face interviews and 6,000 physical surveys of households in England. The NHM is usefully explained in some detail at annex A to the IA. The IA makes extensive reference to ECO3 but would benefit from explaining overall how the modelling for ECO4 relates to that used for previous ECO schemes, such as the Affordable Warmth Model for ECO3 (which was also based on EHS data).

The IA notes data limitations in relation to Scotland and Wales and that the modelling relies on data from the English Housing Survey. This has two main constraints on the analysis: first, the need to 'scale up' from England to Great Britain (using the ratio of the number of households in England to Great Britain - 1.167) and, secondly, on regional breakdowns (notably in relation to impact on fuel poverty - paragraph 91). Given that this is the fourth ECO scheme, the IA would benefit significantly from exploring whether there are data from the earlier schemes in relation to Scotland and Wales to support the assumptions made. The analysis should consider, in particular, whether there are supply issues for remote rural communities/islands in Scotland, especially if demand goes up for installation of

energy efficiency measures. The RPC would expect to see these areas addressed in IAs on any further ECO schemes.

The IA indicates that the South East will account for the highest proportion of homes treated in England under ECO4, whereas the North West was the main beneficiary under ECO3 (paragraph 138 and table 24). The IA would benefit from explaining why this is the case and how this is consistent with ECO's objective of targeting fuel poverty where most needed and the Government's broader 'levelling up' agenda.

Appraisal period

The IA would benefit from sensitivity modelling of the 46-year appraisal period. This would recognise the likely lower life length of other measures, particularly in relation to heating systems and loft insulation (which might last around only 15 to 20 years). It may also be the case that some of the properties themselves will have an economic life of less than 46 years.

Assumptions

The IA explains that costs incurred by energy suppliers are expected to be passed onto domestic customers: the average cost of ECO4 on an annual household dual fuel bill is estimated at around £37 per year. The IA now includes reference to how *Ofgem* incorporates this into its default tariff cap (paragraph 94). The IA would benefit from discussing how this pass-through could make energy suppliers less intent on minimising the costs of implementing the measures and how this would be kept under review.

The IA states that the assumption that households would meet reinstallation costs is uncertain and that households may not choose to reinstall measures after their useful life (paragraph 74). The IA would benefit from justifying further the inclusion of the impacts of reinstallation in the analysis (given that it is not a requirement of the proposal) and discussing the realism of the assumption that households will meet reinstallation costs, addressing affordability issues for lower-income households. The IA would benefit significantly from providing sensitivity analysis on the impact on costs and benefits if households do not reinstall energy efficiency measures.

Wider impacts

The IA discusses a number of non-monetised, wider impacts. This is generally at a high-level and could be usefully expanded in some areas. The IA notes 'increase in innovation' as a non-monetised impact (paragraph 97, 7th bullet) and, although the IA contains further references to innovation, it would benefit from a greater discussion of potential innovation impacts, including potentially drawing out more useful insights from the figures presented. The IA has helpfully added some discussion of competition impacts (paragraph 97, 8th bullet). This assessment depends significantly on customer switching and would benefit from including information on actual levels of switching. The competition assessment would also benefit from addressing further the potential market distortions between obligated and non-obligated suppliers, especially the smallest obligated suppliers who will see

costs rise and who may be the closest competitors of non-obligated suppliers. On trade impacts, the IA could discuss potentially lower energy imports and associated impacts on business.

The IA would benefit from considering costs to local authorities of delivery under ECO4 Flex and the potential for uneven delivery, depending on resources available to each local authority.

The IA helpfully includes analysis on low-income groups, including producing 'equity-weighted NPVs'. Given the expected 'pass-though' of costs to consumers, the IA would benefit from discussing further the impacts of this on consumers and lower-income groups, particularly given that this would be on top of substantial energy price increases taking place in April 2022. The IA would also benefit from discussing further the incentives for suppliers to meet their obligations in the most cost-effective way if they can target which customers receive support, and the impact on lower-income households unable to contribute or those in more difficult-to-access (for suppliers) rural locations (with potentially higher incidences of fuel poverty).

The IA discusses briefly supply-chain risks (paragraph 112, final bullet) but would benefit from discussing this area further, such as availability of skilled labour or importing of products, which might affect the delivery or cost of the proposal.

Monitoring and evaluation plan

The IA includes a very good and detailed section on monitoring and evaluation plans (paragraphs 139-162). This has been expanded since consultation, with further details added on the monitoring framework and evaluation approach, including planned timings and methods. This would benefit from discussing how objective 4 on improving physical and mental health will be measured. Monitoring will be undertaken by the scheme administrator (*Ofgem*) and there will be an evaluation conducted by external researchers. The IA describes how its plans are informed by learning from evaluation of previous ECO schemes.

As noted above, the IA would benefit from providing an overview of what has been delivered under the ECO schemes since they began in 2013.

Regulatory Policy Committee

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