

# **Government response to the consultation on raising the threshold at which energy suppliers are required to participate in DECC environmental and social programmes**

# General Information

## Purpose of this Document

This document sets out the Government response to the consultation seeking views on:

- A proposal to raise the customer threshold for supplier involvement in the Carbon Emissions Reduction Target (CERT), Community Energy Saving Programme (CESP) and Feed in Tariffs (FITs).
- A proposal that the raised threshold should also apply to Warm Home Discount, which was the subject of a parallel consultation.

**Consultation was issued:** 21 December 2010

**Closed on:** 24 January 2011.

**Consultation reference:** URN 10D/1022 – Raising customer account threshold.

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# Introduction

In December 2010 the Government consulted on raising the customer threshold at which electricity and gas supply companies are required to participate in DECC's social and environmental programmes. The objective of this proposal is to encourage more competition in retail energy markets by reducing burdens on small energy suppliers: the compliance costs of these schemes can act as a barrier to entry into the market.

Three of DECC's current programmes – Carbons Emissions Reduction Target (CERT), Community Energy Saving Programme (CESP) and Feed In Tariffs (FITs) - place obligations on suppliers with more than 50,000 customers. This threshold recognises that in comparison with bigger suppliers, smaller suppliers are likely to suffer disproportionately larger costs per customer. This is due to the fixed costs of complying with obligations, for example costs of setting up systems and then administering them. In addition, the Government has consulted on introducing the Warm Home Discount Scheme (WHD), which will require suppliers to give direct financial support with energy bills to their most vulnerable customers. Annex 1 gives a brief overview of each of these schemes.

The Government consulted on whether the current threshold of 50,000 customers for obligations under DECC's current environmental schemes should be increased to 100,000 customer accounts and whether this threshold should also apply to WHD. The rationale for the proposed increase is that the number and extent of social and environmental obligations have grown in recent years and there is evidence that a number of small suppliers are approaching the threshold level of customers for mandatory participation in these programmes. It was not envisaged that the threshold would be breached when the schemes were first introduced. Our analysis shows that suppliers with 50,000 customers incur significantly greater 'per customer' costs of compliance with obligations than a large supplier with 5 million or more customers.

In the consultation we asked for feedback on the following questions:

- Do you agree that the threshold should be increased to 100,000 if not, what level do you think it should be set at and why?
- What factors should DECC take into account in determining the threshold?
- Do you agree there should be a single threshold for all supplier programmes?
- What options for the design of future DECC programmes should the Government consider in order to reduce the burdens they place on small and large suppliers?

The Government received 16 responses to the consultation and in the following pages we set out our final proposals for raising the customer threshold in the short term and consider some issues raised during the consultation in relation the future design of DECC programmes. A list of respondents can be found at Annex 2.

# Government Response

## Carbon Emissions Reduction Target, Community Energy Saving Programme and Warm Home Discount

1. The majority of respondents agreed that the current threshold for mandatory participation in CERT, CESP and WHD should be increased, with a number suggesting that it should be raised beyond the 100,000 proposed in the consultation document to 250,000 customers. Two respondents argued that the threshold should be increased to 1,000,000 customers.
2. The majority of respondents agreed with the Government that the costs to smaller suppliers associated with complying with environmental and social programmes represent a higher proportion of their overall costs than for large suppliers. Respondents also agreed that these disproportionately high costs reduce competition as they can be a factor in deterring new businesses from entering the market and that they reduce incentives on smaller market participants to grow.
3. The Government's proposal to raise the threshold to 100,000 customers was founded on projections based on the growth rates that we had previously seen for new market entrants. These projections showed it was unlikely that any small suppliers currently operating in the market would increase their customer numbers to 100,000 by 2013. However, during the consultation respondents presented evidence that has led us to revise that assumption and we now believe that in order to exempt small suppliers from these environmental and social programmes and the Warm Home Discount Scheme it is necessary to raise the threshold to 250,000 customers.
4. The Government has already stated in its response to the WHD consultation that it intended to set the threshold for mandatory participation at 250,000 customers. This threshold was set in the scheme regulations which came into force on 1<sup>st</sup> April 2011. The threshold level was chosen because we would expect the per customer cost of complying with WHD to be significantly higher for small suppliers than for the 'Big Six', who have already been involved in pilots to identify eligible customers. Marketing the scheme and identifying eligible customers would be disproportionately costly for small suppliers.
5. The Government also intends to raise the threshold to 250,000 customers for mandatory participation in CERT and CESP for the remaining period of these two programmes. All three schemes – CESP, CERT and WHD – involve significant fixed costs for which suppliers are not compensated and which therefore have a disproportionate impact on small suppliers. Increasing the thresholds will bring significant benefits for small suppliers and therefore help boost competition, without imposing material new costs on suppliers as a whole.

6. Raising the threshold to 1,000,000 customers, as two respondents suggested, could result in noticeably increased burdens for participating suppliers if a number of suppliers grew towards 1,000,000 customers. However, we do not expect that raising the threshold to 250,000 customers will make any substantive difference to the effectiveness of DECC's programmes or to materially increase the burden on participating suppliers.

## Feed in Tariffs

7. The Government proposed in its consultation that the same threshold should be applied for mandatory participation in all schemes to ensure consistency across obligations. However, it emerged during the consultation that FITs are less of a concern to small suppliers and indeed some small suppliers have voluntarily opted into the scheme. Suppliers making FITs payments may claim administration costs as part of "qualifying FITs costs" determined annually by the Secretary of State and this takes account of the likely difference in costs for mandatory participation and voluntary participants' administration costs, to reflect their higher per customer administration costs.
8. We have decided that the threshold at which a supplier is obliged to make FITs payments should remain at 50,000 customers pending the review of FITs announced on 7 February to be implemented in 2012. Consideration of the threshold at which suppliers are obliged to make FITs payments will form part of this review. We will, however, ensure that in setting the qualifying FITs costs for 2012-13 we will compensate appropriately any small suppliers that exceed 50,000 customers in 2011.

## Effect of raising the thresholds on consumers

9. Some respondents expressed concern that customers could lose out if they are with a supplier that does not participate in WHD. Customers wishing to take advantage of WHD are free to switch to a participating supplier. And small suppliers will be able to opt in to providing the Core Group benefits within the WHD to avoid losing customers if it makes commercial sense (more information on WHD can be found on page 10 in Annex 1).
10. Concerns around equity were also raised in relation to CERT and CESP, as customers of small suppliers can still benefit from these schemes, because obligated suppliers are free to promote measures to any householder, irrespective of their gas or electricity supplier. Some respondents argued that raising the threshold would mean that customers of obligated suppliers would be subsidising customers of small suppliers to a greater extent. Our analysis shows that in practice this is unlikely to be economically significant across the schemes if the threshold is raised to 250,000 customers.

## Thresholds relating to gas and electricity licence obligations

11. Some respondents pointed out that there are certain licence obligations that do not apply to suppliers with 50,000 customers or fewer, for example the requirement to offer a choice of payment method and the requirement not to discriminate unduly between different consumer groups in pricing. They argued that it would be important to retain the current threshold for these obligations, particularly where they provide important customer protection. The Government does not see a case for revising thresholds that provide protection for consumers. However, this is a matter for Ofgem.

## Compliance with EU Third Energy Package

12. A couple of respondents were concerned that raising the customer threshold for mandatory participation in DECC schemes may not be compatible with the EU Third Energy Package. They pointed to a requirement that member states do not discriminate between undertakings. The Government has carefully considered these concerns and is satisfied that its approach to raising the threshold complies with the requirements in the Third Package and notes that the approach will ensure that one of its key objectives, to secure a competitive market, is met in this particular context.

## Designing future programmes

13. We received some very helpful suggestions and observations in relation to designing DECC's future programmes. Some respondents were concerned that our proposals to raise the threshold for mandatory participation in the Government's environmental and social schemes would set a precedent, and that once the agreed threshold were reached it would be increased again.
14. It is not the Government's intention to continue to increase the threshold. We agree with respondents that a 'cliff edge' threshold can act as a barrier to growth, whatever number of customers it is set at, as breaching the threshold incurs the cost of compliance across the whole of the supplier's customer base. It is our intention to design future programmes to minimise disproportionate burdens on small suppliers and to minimise burdens on all suppliers, rather than continue to revise thresholds.
15. A number of respondents favoured some sort of buy-out scheme for future programmes. Some respondents argued that allocating programmes to a central player and then recovering costs on a pro-rata basis would be a more equitable way of minimising burdens on small suppliers. Other suggestions included:
  - A gradual phasing in or sliding scale, which exposes smaller suppliers to the cost of programmes on a gradual basis as they increase their market share.

- Tapering contributions or payments, so that the supplier makes a contribution for every additional customer once a threshold is reached, rather than incurring costs for whole customer base.
  - A per customer levy on small suppliers for each obligation, the proceeds of which could be used to for purposes related to the obligation. There would still need to be a threshold above which the option of a levy would not be available.
16. Several respondents suggested a fundamental review of the current thresholds. The Government does not agree that a fundamental review is the best way forward. Instead the Government will consider the suggestions received during consultation and seek to design any future schemes, including the new Energy Company Obligation, to ensure they do not significantly disadvantage small suppliers compared to larger ones.



## Annex 1 – Overview of the CERT, CESP and FITs obligations and proposed Warm Home Discount Obligations

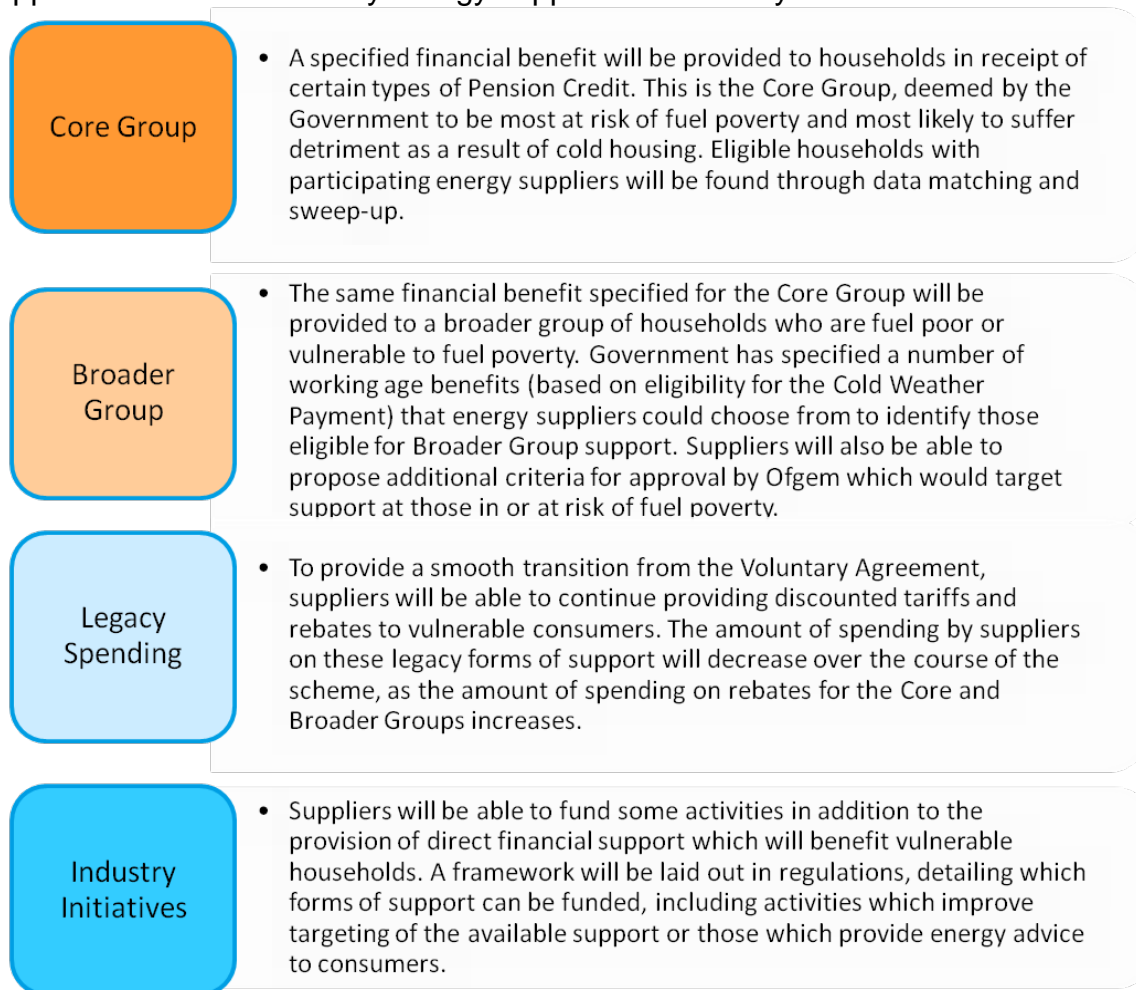
1. The **Carbon Emissions Reduction Target (CERT)** is an obligation placed on suppliers with more than 50,000 domestic customers. Participating suppliers are allocated a proportion of the total target based on their market share of the domestic energy market. They are required to meet these targets through the promotion of energy efficiency measures to households, for example by establishing schemes to encourage (usually with subsidy) the installation of loft or cavity wall insulation. These schemes can be delivered through third parties but suppliers must monitor the schemes and report to Ofgem. Ofgem approves the schemes and monitors compliance. Ofgem has the power to impose a financial penalty of up to 10% of company turnover if a supplier fails to achieve its target. CERT has recently been extended through to the end of 2012. DECC estimates that the approximate cost is £41 per household per year<sup>1</sup>.
2. The **Community Energy Saving Programme (CESP)** applies to suppliers with more than 50,000 domestic customers and also to generators producing over 10 TWh/year on average. These businesses are required to deliver energy saving measures to domestic consumers in specified low income areas. Ofgem sets them targets based on their market share, approves proposals, monitors compliance and enforces CESP. As with CERT, businesses can contract out delivery of the activity to meet their obligations, or transfer or trade the obligation to other obligated parties. DECC estimates that the average annual cost to all obligated parties is £120m.
3. Suppliers with more than 50,000 domestic customers must pay **Feed in Tariffs (FITs)** to small domestic generators and other suppliers can opt-in on a yearly basis. Participating suppliers must verify the eligibility of generators, the accuracy of the information they provide and submit details to Ofgem for entry on the central FIT register. They must also manage the relationship with generators, calculate and make the payments due to them, and help to prevent and mitigate abuse of the scheme. All licensed suppliers, not just those who are mandatory or voluntary participants, are required to make payments to support the costs of the scheme and a levelisation process distributes this burden between them according to market share. Suppliers paying FITs may claim administration costs from the levelisation process through “qualifying FITs costs”, which are determined annually by the Secretary of State. This takes account of the likely difference in costs for mandatory and voluntary participants’ administration costs (voluntary participants are able to claim an additional £30-35 per customer to reflect their higher per customer administration costs). DECC estimates that the total annual cost that all suppliers will pass on to consumers to pay FITs (to 2020) will average £610m.

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<sup>1</sup> Impact assessment accompanying the consultation on the role of consumer electronics and appliances in CERT – Table 2

4. The **Warm Home Discount** will require suppliers primarily to give direct financial support with energy costs to more of their most low income and vulnerable customers. Participating energy suppliers will be required to contribute to the scheme in proportion to their share of the domestic energy market based on the number of domestic gas and electricity accounts that each energy supplier serves. Suppliers will be required to provide support worth £250 million in 2011/12 rising to £310 million by 2014/15.

5. Support will be distributed by energy suppliers in four ways as set out below:



6. Government has made clear that it intends to use data matching and sweep up processes<sup>2</sup> to identify customers of participating energy suppliers should receive a Core Group rebate. It will not be possible to know in advance how the costs of providing rebates to any eligible Core Group customers will be spread across energy suppliers as suppliers would not know in advance how many eligible households they had among their customer base.

<sup>2</sup> Further information on data matching and sweep up is available in the Government’s response to the Warm Home Discount Consultation available via <http://www.decc.gov.uk/en/content/cms/consultations/warmhome/warmhome.aspx>

7. This means that a particular energy supplier (or suppliers) may face a disproportionate share of the costs of supporting this group if they are required to support more than their market-share's worth of households in the Core Group. The Government believes that it will be necessary, therefore, to have a *reconciliation mechanism* alongside the scheme to ensure that the costs of supporting households in the Core Group are shared fairly across energy suppliers. Regulations to facilitate data matching and a reconciliation process will be laid before Parliament for approval later this year.
  
8. Government has also made clear in its response to the Warm Home Discount consultation that energy suppliers below the threshold for mandatory participation would be able to give benefits to the Core Group on a voluntary basis if they wished to and, in line with our proposals on targeting, therefore be able to take part in the data match process to identify consumers eligible for the Core Group. They would also therefore be able to participate in the reconciliation process. The Warm Home Discount consultation response can be found via: <http://www.decc.gov.uk/en/content/cms/consultations/warmhome/warmhome.aspx>

## Annex 2 – List of organisations that responded to the consultation

British Gas

Consumer Focus

Co-operative Energy

Cornwall Energy

Ecotricity

EDF Energy

Energy Action Scotland

E.On

ERA

First Utility

Good Energy

Ovo Energy

Respect Energy

RWE npower

Scottish Power

Scottish & Southern Energy



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