

Energy Companies Obligation Brokerage Mechanism

Consultation Document



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The consultation and Impact Assessment can be found on DECC's website:
<http://www.decc.gov.uk/consultations/Default.aspx?status=26&area=0>

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General information

Purpose of this consultation

This consultation exercise is designed to inform the Government's approach to regulating the Energy Company Obligation (ECO) brokerage service.

Issued: 12 December 2012

Respond by: 15 April 2013

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Consultation reference: URN 12D/427

Territorial extent:

This consultation is for England, Wales and Scotland.

How to respond:

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome. Please send your response, preferably in electronic format, by the 15th April to:

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Additional copies:

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Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise all responses and place this summary on our website at www.decc.gov.uk/en/content/cms/consultations/. This summary will include a list of names or organisations that responded but not people's personal names, addresses or other contact details.

Quality assurance:

This consultation has been carried out in accordance with the Government's Code of Practice on consultation, which can be found here:

<http://www.bis.gov.uk/files/file47158.pdf>

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

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Executive Summary

This consultation exercise is designed to inform the Government's position on regulating the Energy Companies Obligation (ECO) brokerage service.

In the November 2011 consultation on the Green Deal and Energy Companies Obligation, the Government proposed the introduction of a market-based mechanism to support an open and competitive market for the delivery of ECO. There was a clear majority of views expressed in favour of the proposal. The Government will therefore put a brokerage mechanism in place on a voluntary basis while it carries out this consultation asking for views, and any supporting evidence, on the need to regulate energy companies to use the brokerage service.

The brokerage service will operate as a fortnightly auction which will allow delivery agents to sell 'lots' of commitments to deliver units of ECO Carbon Saving Obligation, Affordable Warmth and Carbon Saving Communities. ECO obligated energy suppliers will compete to purchase ECO units. We are looking for views and evidence to supplement our understanding of what volumes of ECO should ideally be traded on the platform and whether ECO obligated energy suppliers should be regulated to use it.

This consultation therefore asks 3 main questions:

- **What proportion of their Energy Company Obligation would energy companies ideally trade through brokerage, to ensure that the benefits of brokerage are realised?**
- **If there are non-regulatory incentives to encourage energy companies to use brokerage?**
- **Whether energy companies should be regulated to use brokerage to deliver a portion of their Energy Company Obligation?**

List of consultation questions

Consultation Questions	
1.	<p>What proportion of ECO Carbon Saving Obligation should be traded on brokerage?</p> <p>Low Medium High</p>
1b.	<p>What percentage do you suggest? Why? Please provide evidence to support your answer</p>
2.	<p>What proportion of ECO Carbon Saving Communities Obligation should be traded on brokerage?</p> <p>Low Medium High</p>
2b.	<p>What percentage do you suggest? Why? please provide evidence to support your answer</p>
3.	<p>What proportion of ECO Affordable Warmth should be traded on brokerage?</p> <p>Low Medium High</p>
3b.	<p>What percentage do you suggest? Why? please provide evidence to support your answer</p>
4.	<p>Do you have any suggestions for voluntary mechanisms for encouraging energy companies to use brokerage to deliver their Energy Company Obligation?</p>
5.	<p>Should we regulate energy companies to channel their Energy Company Obligation through brokerage?</p>

Introduction

The Green Deal and the Energy Company Obligation – Working Together

1. Empowering consumers, by giving them access to energy efficiency home improvements is at the heart of the new 'Green Deal' and Energy Company Obligation (ECO). These programmes will help reduce carbon emissions from the domestic and non-domestic building stock, which is essential if the UK is to meet its statutory domestic carbon budgets. Improving household energy efficiency is also a key strand of our strategy to help address the needs of low income and vulnerable customers from 2012 and to make further progress on our statutory obligation to tackle fuel poverty.
2. The Green Deal will substantially reduce the need to pay upfront for energy efficiency measures. The Green Deal lets customers pay for some or all energy efficiency improvements made to a property, over time through their electricity bill. Repayments will be no more than what a typical household should save in energy costs¹. (quick guides to the Green Deal can be found at http://www.decc.gov.uk/en/content/cms/tackling/green_deal/gd_quickguides/gd_quickguides.aspx)
3. The Energy Company Obligation (ECO) will replace the existing Carbon Emissions Reduction Target (CERT) and the Community Energy Saving Programme (CESP), which will both expire in December 2012. Like the CERT and CESP schemes, ECO will improve the energy efficiency of people's homes and will form part of the Government's programme to tackle fuel poverty.
4. ECO will work alongside the Green Deal to provide additional support for packages of energy efficiency measures, including solid wall insulation or hard to treat cavity wall insulation – measures which are socially cost effective, but unlikely to be fully financeable by Green Deal finance. ECO will also provide insulation and heating measures to low-income and vulnerable households and insulation measures to low income communities.
5. The estimated split in ECO expenditure by energy companies in order to deliver their carbon saving and notional heating cost reduction targets is around 75:25 – with the total expected expenditure from energy suppliers to deliver on their targets at an average of around £1.3bn per annum.
6. To ensure that these objectives are met Government has set three targets all to be achieved by March 2015: the Carbon Saving Obligation to reduce CO₂ emissions by 20.9 Mt lifetime CO₂, the Carbon Saving Community Obligation 6.8Mt lifetime CO₂ and the Affordable Warmth Obligation to a reduce notional lifetime heating costs for low income and vulnerable consumers by £4.2bn.

¹ Capital from businesses, recouped through energy bills, will provide the initial investment provided the measures meet the Golden Rule: estimated savings on energy bills should always equal or exceed the cost of the work. This revolutionary approach to funding will create a new market which could draw in overall greater funding for energy efficiency than in the past.

7. The Carbon Saving obligation (around £760 million per year) will be available for energy efficiency measures in harder to treat homes, i.e. packages of measures that include solid wall or hard to treat cavity insulation.
8. The Carbon Saving Communities obligation (around £190 million per year) will be targeted at areas of low income, defined using the bottom 15% of Lower Super Output Areas from the Indices of Multiple Deprivation in England, Wales and Scotland. Suppliers will be required to deliver 15% of their overall Carbon Saving Communities obligation to rural, low income households in settlements with a population size under 10,000.
9. The Affordable Warmth obligation (around £350 million per year) will be targeted at the poorest and most vulnerable consumers, and who are likely to be in fuel poverty. Only those in private tenure and in receipt of a qualifying benefit will be eligible for support under Affordable Warmth.
10. The introduction of Carbon Saving Communities was announced following consultation, bringing the total amount of ECO guaranteed to low income households and communities to around £540 million per year. If social housing benefits as expected from the ECO Carbon Saving Obligation then around 50% of the total ECO obligation will go to those in low income households and living in low income areas.
11. ECO has been designed to deliver energy efficiency measures across a range of tenure types, rural and urban areas, and income groups. In delivering past obligations, including the CESP and CERT schemes, energy companies have tended to focus on certain types of area which are easier to work in. Stakeholders have highlighted that rural areas and core urban areas can pose particular delivery and cost challenges for them. However, ECO is different. For example the focus of ECO Carbon Saving Obligation on solid wall insulation/ hard to treat cavities, and ECO Affordable Warmth on private tenure homes, may encourage ECO activity in cities, where housing stock is often older, and where economies of scale for otherwise expensive measures like solid wall insulation could be significant.
12. Similarly, the Carbon Saving Communities Obligation has a rural sub-target, to specifically ensure delivery of measures in rural areas. The ECO scoring system should also make the treatment of off-gas grid properties, which are frequently found in rural - but also in inner city - areas, more attractive. The use of the brokerage mechanism may also help ensure that opportunities in these areas can more readily be “brought to the ECO market”. DECC therefore expects that ECO could be delivered in areas which may not previously have received energy company obligation support, and DECC will also be actively monitoring ECO on a regular basis see if this is the case.
13. The introduction of the Green Deal and the ECO will stimulate a new market for energy efficiency. It is an opportunity to foster a competitive, innovative and efficient market in the UK. The Government will therefore encourage and facilitate, through the ECO Brokerage, the growth of an ECO and Green Deal market that is transparent and open.

The ECO Brokerage

14. Under previous schemes, including the Community Energy Saving Programme (CESP) and the Carbon Efficiency Reduction Target (CERT), little information about the cost of delivering measures was made public.² The Government therefore recognises the risk that potential new and/or innovative companies may not have a sufficiently clear price signal to inform and develop their ECO offering.
15. The Government wishes to facilitate opportunities for a wide range of delivery agents to compete to deliver ECO. Whilst, in general, it will be in energy companies' interest to source their ECO points from the lowest cost providers, the Government wants to minimise the risk that some delivery agents with competitive offerings struggle to access ECO funding through obligated suppliers. In particular, the administrative burden of establishing and maintaining relationships with energy companies could prove inhibiting for smaller and/or newer market players.
16. To address these challenges, in November 2011, when consulting on the Green Deal and Energy Company Obligation, we proposed the introduction of a voluntary, market-based brokerage mechanism as a means of facilitating competition in the new energy efficiency market. Brokerage would, by providing a platform on which ECO points could be traded for ECO support, encourage competition on both sides of the market and ensure access among delivery agents to ECO is equitable, transparent, efficient and cost effective.
17. The proposal met with significant support, with ~90% of views, including Energy Companies, expressed in favour of the introduction of a brokerage to improve market functioning. The value of acting early to address the risks outlined above was highlighted in the responses of future Green Deal Providers. They identified a potential imbalance in the Green Deal market if energy companies were to form their own vertically integrated green deal businesses. These businesses would have direct access to their own ECO expenditure, and would be able to move early in the Green Deal, establishing early market lead potentially at the expense of other entrants.
18. Suggestions for the percentage of ECO that should be channelled through brokerage varied. Some respondents (mainly energy companies) proposing a level of 10-20%, but a majority of respondents suggested that it should be 50% or more. Many said up to 100%, reasoning that if brokerage provided the most cost effective way for a supplier to meet their obligation, there would be no reason why all of it should not be through brokerage.
19. The Government published its response to the ECO and Green Deal consultation in June 2012. We proposed to launch brokerage on a voluntary basis by the end of the year to meet early ECO delivery demand. Through voluntary brokerage, the Government will address the risk that the ECO market lacks transparency early in the period of the obligation.

² DECC (2011) Research Report, Evaluation of the deliver and uptake of the Carbon Emissions Reduction target
<http://www.decc.gov.uk/assets/decc/11/funding-support/3339-evaluation-of-the-delivery-and-uptake-of-the-carbo.pdf>

Brokerage objectives

20. Brokerage has clear objectives, all of which contribute to encouraging a competitive and transparent ECO market. It has also been designed in a way that will deliver benefits to the wider energy efficiency market and the Green Deal scheme.

Ensure price transparency

21. An open brokerage platform which publishes the sale price of lots will deliver real-time price information for participants in the Green Deal and ECO. A robust price signal should enable companies to better make projections of future revenue streams; a key enabler for new entrants and useful for existing market players. Where potential new entrants can deliver ECO compliance at or below the prevailing price, by identifying new potential for low cost measures and/or by innovating and lowering the cost of existing measures, brokerage would provide a signal on which to base their decision to enter the ECO market.

22. Price transparency will also give Government and the Green Deal Regulation and Oversight Body valuable insight in to the marginal cost of delivered measures and inform the monitoring current ECO targets and the setting of future ECO targets.

Improve market access, encourage competition, encourage cost efficiency

23. Brokerage will remove the need for the establishment of relationships with energy companies, which could prove burdensome, particularly for smaller providers. All delivery agents will be able to access ECO by offering competitively priced lots on brokerage to energy companies instead of or in addition to forming bilateral partnerships with energy companies. Brokerage will also operate anonymously, so pre existing relationships with energy companies will not influence the auction process. This could increase the routes to market for delivering energy efficiency measures and allow new, innovative providers to enter the market.

24. A dynamic market, with a variety of providers - all equally capable of accessing ECO and competing on price - would have advantages for current players, new entrants and customers. Established suppliers of energy efficiency can operate with confidence that they are delivering a competitively priced service. Energy companies can also have the same confidence in the prices they are paying on and off brokerage through bilateral agreements. New entrants can develop innovative offerings and enter the market with increased certainty that they have a route to offering competitive ECO bids to energy companies. Most importantly, should a brokerage platform result in increased competition, this could drive down the marginal cost of ECO measures that Energy Companies are expected to pass on to consumers via energy bills.

Strengthen ECO and the Green Deal supply chain

25. The Energy Company Obligation and the Green Deal will support the development of a new market for energy efficiency. Notably, the ECO Carbon Saving Obligation will stimulate demand for solid wall insulation and hard to treat cavity wall insulation technologies; measures which have not been rolled out on a large scale under previous obligations. As these technologies are relatively new, there is significant scope for innovation throughout the ECO period. Providers may be able to develop more effective products and services to reduce costs and improve the carbon savings of measures.

26. However, during previous schemes, as an Office of Fair Trading study of the home insulation market found, a lack of consumer knowledge of products and services and low interest in

gaining it when being offered free or discounted measures under CERT and CESP has had negative impacts by lowering the incentives for innovation in the supply chain. There is a risk, that as with CERT and CESP, in the subsidy driven market created by ECO, a lack of research and development incentive will lead to reduced levels of innovation.

27. ECO brokerage may mitigate this risk of product stagnation by ensuring a clear and transparent price signal, which would encourage new entrants into the market and potentially increase competition between providers. The link to Green Deal Finance should also reduce the risk of low innovation as the Golden Rule will reward cheaper, more effective products. Furthermore, this proliferation of providers could also deliver a supply chain that is better able to respond to increasing demand for measures as delivery of across ECO types ramps up over the obligation period.

Funding streams for ECO and Green Deal working in harmony

28. Key to delivering a positive customer journey throughout the Green Deal process is ensuring that Green Deal and ECO funding streams work in harmony together. Most households will need a package of measures including solid wall or hard to treat cavity wall insulation to transform their home's energy efficiency profile and, keeping these improvements within the Golden Rule, will require support from the ECO CSO. Making this ECO funding readily accessible to the accredited providers of Green Deal technology and products will allow the combination of funding to occur smoothly. This would make it possible for a single GDP to deliver the entirety of the package that includes Green Deal and ECO funding in one round of improvements, without needing to have a bilateral relationship with the energy company.

29. Given these objectives for brokerage and the forthcoming start of ECO, we are now seeking further views on 3 issues:

- What proportion of their ECO would energy companies ideally trade through brokerage, to ensure that the benefits of brokerage are realised?
- Are there are voluntary incentives to encourage energy companies to use brokerage?
- Whether energy companies should be regulated to use brokerage?

The Brokerage Model

30. Following the positive responses that the suggestion of ECO brokerage received in last November's consultation, we have designed a voluntary ECO brokerage platform. To facilitate the design process we established an ECO Steering Group. Members included representatives from energy companies, potential Green Deal Providers, Local Authorities and Registered Providers of Social Housing. We also commissioned Deloitte to investigate potential models for brokerage, likely market behaviours, and to recommend a model for brokerage based on the conclusions of their research. DECC accepted Deloitte's recommendation for a brokerage model - a periodic auction. Based on feedback from the ECO Steering Group, the brokerage auctions will, at its launch, operate on a fortnightly basis.

31. The Government would like to thank the members of the ECO Steering Group for their valuable input and advice, which has been instrumental in developing a brokerage model.

The Brokerage Auction Process

32. **Before the auction:** In line with a specified deadline, sellers will register their lots with the broker before the auction specifying the following lot information:

- Type of ECO (i.e. Carbon, Affordable Warmth or Carbon Saving Communities)
- Lot Size
- Reserve Price
- Delivery Time Frame

The broker ensures that all sellers have provided the required information and in the correct format, and then compiles and publishes these lots to all registered bidders anonymously and without the reserve price before the auction.

33. **Day of the auction:** Energy companies bid on the published lots on the day of the auction. The platform will offer real-time bidding. At 5pm, the auction closes and the broker reconciles lots. The highest bidder on any lot wins that lot.

34. **After the auction:** The broker informs successful bidders and sellers that they have entered into a bilateral contract for delivery of the lot which has been sold and at what price. The broker then publishes the anonymous results of the auction, the details of successful and unsuccessful lots. Details and the purchase price at which lots sold will be clearly visible to all current and potential market participants. The reserve price of unsold lots will not be published.

Trading parameters

35. **Standard contracts:** All participants will have to be signatories to two standard contracts. Contract 1 will set out the rules of trading. Contract 2 will be a standard bilateral contract between the buyer and the seller that will be enacted after each successful trade. It will include details on payment, and the terms for non/ under/ over delivery on carbon/ bill savings, and verification and reporting in line with Ofgem Requirements³. The broker is not party to the standard bilateral contract and will have no role in the delivery or enforcement of this contract. However the broker will collect and store data from energy companies, on the completion/delivery of the contracts.

36. **Brokerage will be anonymous:** The details of buyers and sellers will not be made public during or after the auction. This will ensure that access to ECO funding on brokerage is genuinely equitable and will reduce the risk of the deliberate channelling of ECO subsidy through energy companies own vertically-integrated delivery arms, or to preferred partners.

37. **Sellers:** The primary objective of brokerage has always been to stimulate the Green Deal market and it is with that in mind that in the very first instance, when trading volumes are likely to be low, we have decided to restrict trading to Green Deal Providers. However, as the brokerage platform develops we will look at options for expanding participation to other groups e.g. social landlords and local authorities

³ Ofgem are the regulator of the ECO, and have published draft guidance on the operation and verification of the ECO, in addition to the details published in the ECO Order.

38. **Commodities:** All 3 types of ECO will be traded on brokerage; ECO Carbon Saving Obligation, ECO Affordable Warmth, ECO Carbon Saving Communities Obligation.
39. **Lot Size:** Lots will be submitted in standardised formats. Standard lot sizes should reduce the risk of gaming as it will be harder for bidders to identify lots which will help maintain anonymity of sellers. In setting the lot size parameters, we have ensured that no genre of provider is disadvantaged. Over time, the standardised lot sizes may be amended by the broker, in consultation with DECC and brokerage participants.
40. **Delivery timeframes:** The ECO traded on brokerage will be purchased as a future commitment to deliver ECO⁴, with the delivery timeframes standardised to a set number of months (3 months, 6 months, or 12 months). Standardisation of delivery timeframes should also help maintain anonymity and make it more straight forward for energy companies to compare lots offered.
41. **Reserve prices:** While the market is finding a price point, no reserve price will be published with the lot information. However, when DECC, in consultation with brokerage participants, is satisfied that a market price has been established, a reserve price may be included in the lot profile.
42. A purely illustrative lot may therefore look something like:

Lot Code	Lot Type	Lot Size	Reserve Price	Delivery Time Frame	Current Highest Bid
12.11.12.104	AW	£100,000 Bill savings	£0.15 /£bill saving	3 months	£0.19/£bill saving

Rating sellers on ECO Brokerage

43. DECC is considering whether a seller rating should be incorporated into the brokerage service. Such a rating system could bring several benefits to the platform. It could reward positive delivery records among sellers as higher ratings could mean that their lots may sell for a premium. Energy companies could also have greater confidence in the lots they were buying and may be more discriminating in the prices they pay.
44. However, implementing a rating system must be done fairly and impartially. It would require:
45. Sufficient data reported by energy companies on the final percentage of delivery against contracts bought through brokerage. As delivery time frames on brokerage are up to twelve months from the date sold it could take a year to develop a full delivery history for sellers;
46. This data, the percentage of the contract delivered, to be collected and interpreted impartially in a way that does not favour a particular size of contract or participant;

⁴ This is to meet the legal regulations of ECO that require the promotion of qualifying measures by Energy Suppliers; i.e. they must be able to prove that the measure was installed as a result of the obligation. Delivered measures cannot be traded.

47. A means of reviewing ratings available to participants as a rating could either impede or enhance the price a seller commands on brokerage;
48. To ensure that the rating system did not facilitate the identification of sellers by bidders on the platform.
49. We are therefore carefully considering how we can take this forward and will liaise with brokerage participants on any decision and approach to implementing seller ratings. In the meantime the Broker will collect and hold securely the relevant impartial data from energy companies regarding the actual delivery of all contracts sold on brokerage, from the first auction.

Minimising Brokerage Delivery Risk

50. The brokerage platform will be anonymous, meaning that energy companies will be committing to a contract with an unknown organisation for delivery of their ECO. Ordinarily, energy companies would choose who they contracted with and satisfy themselves that the organisation is able to deliver the contract to a satisfactory standard. Anonymous contracting could therefore increase the risk that an obligated energy company were unable to meet their overall ECO obligation; particularly if brokerage forms a large portion of the company's ECO delivery.
51. Experience in other markets, and under CERT and CESP has demonstrated the issues around heightened delivery risk, even where due diligence has been undertaken. Specifically energy companies are concerned about 3 scenarios:
- Under-delivery: Sellers may not take due care when estimating their capacity to deliver. Additionally, sellers could deliberately take advantage of upward movements in the market price, deliberately defaulting on contracts re-sell ECO compliance at the higher market price;
 - Non-compliant measures: Sellers deliver measures that are defective or not eligible under ECO and are discovered to be so either before payment or during verification by Ofgem;
 - Seller insolvency: Energy companies will not be able to undertake specific financial due diligence on individual sellers to ensure their risk of insolvency during delivery of the contract is low.
52. The Government has recognised the legitimacy of these concerns and has therefore worked closely with energy companies and potential sellers onto the platform to minimise these risks through design of the standard bilateral contract. Central to the contract are the payment structures and protections ensuring that companies only pay for compliant measures delivered at the end of the delivery time frame promised in the lot. If a provider delivers less than 90% of the ECO as sold on brokerage, then the seller in question meet any additional cost of re-purchasing the un-delivered ECO at the current market price.
53. The Government also considers, in light of the delivery risk issues above, that access to sell lots on brokerage should be restricted to those where the risks of delivery and insolvency are reduced, and/ or managed. In deciding how to limit access, Government will also consider

the benefits of extending brokerage participation for platform liquidity and potential benefits to the new Green Deal market alongside wider energy efficiency delivery. It should be noted that all Green Deal Providers, non-Green Deal Provider delivery agents, and Local Authorities and Housing Associations/Registered Providers of Social Housing can all still access ECO directly via a direct bilateral partnership with ECO obligated energy companies, although we recognise the challenges involved in this for some providers.

54. In considering their response to the consultation questions on whether the use of brokerage by energy companies should be regulated respondents may wish to consider the potential impact of limiting access to brokerage only to organisations which are authorised to act as a Green Deal Provider under the Green Deal authorisation scheme⁵.

⁵ Applications for authorisation to act as a Green Deal Provider are considered by the Secretary of State on the basis of whether the applicant is fit to act as a Green Deal Provider, and this includes an assessment of how the applicant intends to operate in offering Green Deal Plans to customers. Organisations which are granted authorisation are required to comply with the requirements of the authorisation scheme, which are set out in the Green Deal Framework (Disclosure, Acknowledgment, Redress, etc.) Regulations 2012, including requirements to enter into and comply with the Green Deal Arrangements Agreement (a contract with energy suppliers), to participate in the Green Deal Ombudsman Scheme, to comply with the Green Deal Code of Practice, and to comply with monitoring and reporting requirements.

Volumes of ECO to be traded on brokerage

55. Government is seeking views and evidence to inform its understanding of how much ECO should ideally be traded on brokerage. It is vital to the success of the mechanism that sufficient volumes of ECO are channelled through brokerage; low liquidity could prevent the establishment of a functioning platform and negate the benefits of brokerage. However, we also recognise that there are potential benefits to delivering portions of ECO without going through a brokerage.
56. There are three types of ECO (Carbon Saving Obligation, Carbon Saving Communities and Affordable Warmth) which could be traded as commodities on brokerage. Due to the difference in the obligations and the way the targets must be delivered, when considering what volume of the ECO should be traded through brokerage, we have looked at each element of ECO separately. Further detail on the obligations is available in the Government's response to the Green Deal and ECO consultation⁶.

ECO Carbon Saving Obligation

57. The Energy Company Obligation Carbon Saving Obligation (CSO) is designed to complement the domestic Green Deal in a number of areas. For some of the most effective carbon saving measures, Green Deal finance alone is not expected to cover the upfront cost. ECO will combine with Green Deal finance to make these measures affordable under the Green Deal. Under the CSO suppliers are required to deliver 20.9Mt lifetime CO₂ savings by March 2015 and are expected to invest around £760 million annually to achieve this target.
58. ECO CSO is focussed on the delivery of solid wall insulation (SWI) and hard to treat cavity (HTT) wall insulation. Other insulation measures under the carbon saving obligation will only be classified as eligible if they are promoted and installed as part of a package that includes either SWI or HTT. These other measures must also be installed 6 months before or after the main measure. Compared to measures commonly installed under CERT and CESP, solid wall insulation and hard to treat cavity wall insulation are less well developed as energy efficiency technologies. ECO CSO will help stimulate the opportunities for innovation in this new area in the energy efficiency market. There is likely to be significant room for innovation across the supply chain for these products and Government wants to ensure that this new market is open, transparent and competitive. Brokerage could mitigate the risk of early market domination in the ECO market by energy companies. It could therefore reduce the risk of any potential barriers to entry for Green Deal providers. A competitive Green Deal provider market could in turn facilitate an innovative energy efficiency supply chain. .
59. Central to ensuring that ECO CSO can complement the Green Deal will be allowing funding streams for both to work in harmony. Customers who receive a package of measures that requires a combination of ECO and Green Deal funding will want to receive these measures in a single round of improvements. While access to ECO would be straightforward for the Green Deal delivery arms of energy companies or companies with established partnerships

⁶ <http://www.decc.gov.uk/assets/decc/11/consultation/green-deal/5521-the-green-deal-and-energy-company-obligation-cons.pdf>

with energy companies, if other providers / installers cannot access ECO it may limit the measures they can install. Brokerage is designed to allow open access to ECO and ensure that this is possible for all Green Deal Providers that can deliver cost-effectively.

60. There are sources of funding beyond the Green Deal that will allow householders to benefit from ECO (this is true for all three elements of ECO). Local Authorities and Registered Providers of Social Housing may, for example, be willing to provide or source supplementary funding for installation of energy efficiency measures alongside ECO or households may part-fund measures themselves, from their own savings. For example there may be economies of scale installing ECO measures as part of a planned upgrade of housing stock by undertaking multiple housing improvement works simultaneously (such as costs of scaffolding, materials, labour etc). This could be, for energy companies, a very cost effective way of meeting their CO2 emissions reduction target. Delivering energy efficiency measures in this way was a key route for energy companies to deliver CERT and CESP and these partnerships could be an important delivery route under ECO. Similarly, the devolved administrations will have in place programmes (such as Scotland's National Retrofit Programme and Wales' arbed scheme) where their resources for energy efficiency measures and enabling works will be targeted at fuel poor areas aiming to lever in significant ECO funding to deliver fuel poverty and carbon emission targets.

ECO Carbon Saving Communities

61. The Carbon Saving Communities obligation within ECO is designed to target insulation measures in the 15% most deprived low-income communities defined using the Indices of Multiple Deprivation in England, Scotland and Wales. ECO CSCO will apply a degree of flexibility (set out in regulation) to allow for the installation of measures in properties in adjacent non-qualifying areas. This is in response to lessons learned through the delivery of CESP.
62. Defining low income communities by geographic boundaries is not always effective at capturing rural poverty. To ensure that rural households are not disadvantaged, and to guarantee a minimum level of support, suppliers will be required to deliver 15% of their overall Carbon Saving Communities obligation to rural, low income households in settlements with a population size under 10,000.
63. A wider range of measures will be eligible under the Carbon Saving Communities obligation, including cavity wall, loft and solid wall insulation. We expect that loft and cavity wall insulation will be the most frequently delivered measures. Suppliers' target under the Carbon Saving Communities obligation is to deliver lifetime CO2 savings of 6.9Mt by March 2015, at an estimated cost to the obligated energy companies of around £190 million per year.
64. Carbon Saving Communities projects are likely to be quite large in scale because they are area based, and may therefore have longer delivery timeframes and uncertainties attached. This may, particularly in the early phases of brokerage, make them less attractive lots. However, the burden sharing around the scoping out of projects that brokerage can allow, may make brokerage a more attractive route for delivering ECO CSCO.

ECO Affordable Warmth

65. The ECO Affordable Warmth obligation will focus on providing support to private tenure low income households who are vulnerable to detrimental impacts from living in cold homes. These households will be identified by their entitlement to specific means tested benefits and tax credits listed in the scheme regulations⁷.
66. Energy suppliers will be able to score compliance from measures which result in a reduction in the heating costs for eligible households compared to how much they previously would have needed to spend to heat their home to an adequate level. We expected the bulk of measures installed under the Affordable Warmth Obligation to be loft insulation, cavity wall insulation, and heating systems. Further information on the detail of the Affordable Warmth Obligation is available in the Government's response to the Green Deal and ECO consultation. Specific to the Affordable Warmth Target, Government has consulted on and taken a number of steps to actively help energy suppliers find households likely to be in fuel poverty and in need of support under the Affordable Warmth Obligation.
67. Through the Warm Home Discount (WHD) scheme, Government has taken specific powers to identify to suppliers those within their customer base that are in receipt of elements of Pension Credit to enable energy suppliers to provide support automatically to these pensioners. Pension Credit is a benefit which can also lead to eligibility for Affordable Warmth. WHD support is in the form of discounts on energy bills and the enabling legislation also allows energy suppliers to use the information to make offers of energy efficiency measures. In 2013/14 the number of households identified to suppliers will be around 1 million, rising to around 1.3 million by 2014/15. Suppliers also help other groups of low income vulnerable households under the WHD scheme, with overlapping eligibility criteria for ECO Affordable Warmth, bringing the total number assisted to around 2 million annually. Government wishes to actively encourage suppliers to combine offers of assistance on energy bills and measures to have a long term impact on fuel poverty.
68. Government also consulted in November 2011, on a proposal to provide a referrals mechanism to help energy companies identify those eligible for support under the ECO Affordable Warmth obligation. This was warmly welcomed through the consultation process. Government is now pursuing a voluntary agreement with energy suppliers on the terms by which referrals provided by Government of customers would be passed on and followed up – including the minimum level of assistance that these households will receive and the necessary security arrangements governing the transfer of sensitive personal data about eligible households. Furthermore this agreement directly with energy suppliers will help to ensure that eligible households will receive a coherent package of support (where appropriate for their property) to help them manage their energy costs via both bills and measures. Government intends to follow this route of working collaboratively with suppliers, at this point, rather than exercising its powers to allow the Secretary of State to make provision requiring that particular households are supported by energy suppliers.
69. Assisting energy suppliers in identifying households who might be eligible for support through these mechanisms could help reduce engagement costs incurred by the suppliers, thereby reducing the overall costs of the obligation passed on to all energy consumers.

Examining delivery methods for ECO

⁷ <http://www.legislation.gov.uk/ukdsi/2012/9780111525456/schedule/1>

70. In meeting all their individual ECO targets, Energy Companies will have three main options for delivering the required carbon (for ECO Carbon Saving Obligation and ECO Carbon Saving Communities) and bill savings (Affordable Warmth).

71. **Self delivery:** Some energy companies will choose to deliver part of their ECO obligations through their own delivery arms or by sub-contracting directly with installers. Government expects that many energy companies will establish their own GDP business, offering Green Deal finance, and by contracting with their own (or other) installers. Energy companies will also be able to make best use of the information received and gathered under the Warm Home Discount scheme and customer referrals from the Energy Saving Advice Service (ESAS) when undertaking self delivery of Affordable Warmth – this will help to ensure a comprehensive package of support in is provided to low income vulnerable households.

72. There are a range of benefits to energy company self-delivery:

- They can make best use of significant levels of internal customer data;
- The transaction costs of a supplier negotiating contracts with external delivery agents would be removed;
- They can make efficiency savings through economies of scale. These savings can be passed on to customers.

73. However, there could be disadvantages to the wider Green Deal provider market:

- ECO subsidy may be used by the energy companies to support their own GD offering – potentially allowing them to gain market dominance in the Green Deal thereby discouraging potential new entrants into the market;
- There is little or no price transparency in the market, potentially further discouraging entry to the Green Deal provider market for potential new entrants;
- Longer term, if new entrants to the market are deterred, this could have a negative impact on competition in the Green Deal provider market and potentially on incentives to innovate in the supply chain;
- Current branding issues experienced by energy companies may limit their success when selling to their own customers.

74. **Bilateral partnerships:** Energy companies can choose to contract with third party providers for Carbon Saving and Affordable Warmth ECO delivery, who may in turn sub-contract within the supply chain. Often, they will already have established relationships with these partners as a result of previous obligations.

75. The benefits to customers and the companies include:

- Efficiency savings through economies of scale;
- Experienced delivery agents and installers with proven track records (where energy companies have undertaken their own due diligence before forming a contract);
- Local Authorities, Housing Association partners and local installers may have detailed knowledge on their own housing stock and the opportunities to deliver measures and could enable ECO works to be incorporated in existing programmes. Any funding from ECO could be supplemented by LA's with their own budgets for improving customers homes to reduce the costs passed on to bill-payers by energy suppliers in delivering ECO;

- Some opportunity for innovation and efficiency among established partners;
- Delivery agents with strong retail branding, or trusted brands like Local Authorities, charities and local installers, can utilise this in appealing to customers. Trust and experience in dealing with particular client groups may be particularly important in the delivery of Affordable Warmth to vulnerable customers.

Disadvantages include:

- Market could be dominated by a few players who have established relationships with energy companies;
- Very limited price transparency, providing prospective new entrants with limited certainty over revenues they could expect from participating in the market;
- Potentially discourage competition and innovation, reducing downward pressure on prices and innovation in the market ;
- The supply chain may be less able to react to peaks and troughs in demand in the absence of a transparent price signal;
- Fewer opportunities for smaller Providers to access ECO, as they may not be able to establish bilateral partnerships.

76. **Brokerage:** Brokerage is being introduced to address the some of the possible disadvantages associated with the two delivery methods above.

77. Advantages for companies and their customers if they choose to contract through brokerage may include:

- Reduced barriers to entry encouraging new, innovative market entrants leading to increased competition on price and potentially reducing long term costs of ECO passed through to customer bills;
- Improved price transparency for all market observers;
- Energy suppliers have also highlighted the difficulty in finding and indentifying eligible households – brokerage could increase the number of parties involved in this search and could effectively allow suppliers to outsource responsibility for finding eligible households.

Ideally, the use by companies of brokerage will allow the realisation of the benefits above *and* those associated with other delivery routes. In order for this to be the case, the volumes of ECO being channelled through the platform need to deliver the stated benefits of brokerage.

How much ECO would ideally be channelled by energy companies through brokerage?

78. The Government wants to ensure the objectives for brokerage are realised. We are therefore seeking views and evidence on what volumes, as a proportion of the overall delivery of ECO, would represent a sufficient level of trading on Brokerage to deliver benefits to the energy efficiency and Green Deal markets. We set out what we understand to be the advantages and disadvantages of different levels of trading across the type of ECO in the sections below, but we are interested in respondents' views on this issue.

79. In deciding on a final approach as to whether to regulate energy companies' use of brokerage, we will take into account responses to this consultation. We will also gather evidence from the wider operation of the ECO market and the brokerage platform, including monitoring its use, the level of supply brought forward, the prices being offered by sellers on the platform, how energy companies respond to the lots offered (including, but not exhaustively, are lots purchased, which energy company purchases them, and at what price). We will compare this with information with data on off-brokerage ECO delivery, reported by energy companies to Ofgem. We will also seek to understand the wider impacts of brokerage on the market.

80. We are therefore also seeking views from respondents on the level of ECO that they think would ideally be traded through brokerage, and why.

Advantages/ Disadvantages of different Volumes on Brokerage

81. Below we have set out what we consider could be the main advantages and disadvantages of trading low, medium and high volumes of ECO. Where advantages or disadvantages apply only if energy companies are regulated to trade in brokerage, we have indicated this. We have also indicated where advantages and disadvantages relate specifically to ECO Affordable Warmth as a sub-obligation and not to the ECO Carbon Saving Obligation or Carbon Saving Communities.

Proportion of ECO Commitment	Advantages	Disadvantages
<p>High %</p>	<p>All participants in the ECO market, including Government and Regulators, can see detailed and current information on the prices being paid to deliver the majority of the obligation. This information can inform business plans and future regulation.</p> <p>High liquidity on the platform should increase the stability of prices, enhancing the price signal provided to the market and potential new entrants.</p> <p>Providers of ECO measures, including new entrants to the Green Deal market, can potentially access the majority of ECO.</p> <p>Fair access to ECO and price information can be an enabler for new entrants and encourage competition in the wider energy efficiency market.</p> <p>A proliferation in providers of ECO compliance could improve the penetration of ECO measures and reduce the burden for finding eligible households on individual energy companies.</p> <p>Green Deal Providers can have confidence in accessing ECO and can develop their businesses early. This could strengthen the supply chain for the wider Green Deal.</p> <p>Brokerage could facilitate market responses to periods of high demand through broadcasting a price signal e.g. cold snaps. It may make it easier for capacity to come on line to deliver emergency boiler replacements.</p>	<p>If access to brokerage were to remain restricted to accredited Green Deal Providers, opportunities for Local Authorities and Housing Associations in the delivery of ECO will be limited to forming partnerships with Green Deal Providers or contracting directly with energy companies outside of brokerage (unless 100% of ECO is brokered). If contracting off brokerage is more burdensome, then funding from authorities/associations could potentially be limited and the price of ECO abatement subsequently higher than what it could have otherwise been.</p> <p>If access to brokerage is to be opened up as planned, the delivery risk of brokered measures could increase. The potential impact would be higher the greater the volume of ECO brokerage. Any increase in delivery risk poses a threat to meeting fuel poverty targets at risk with serious implications for vulnerable households.</p> <p>Potentially higher administrative costs of running the brokerage.</p> <p>Higher numbers of competing delivery agents could increase the risk of potential mis-selling to vulnerable customers.</p> <p>Additional disadvantages if ENERGY COMPANIES ARE REGULATED TO USE BROKERAGE:</p> <p>If high volumes on brokerage are required under a regulated system the flexibility of Energy Companies to deliver ECO at the lowest cost could be reduced</p> <p>Room for ESAS advice line referrals would be limited. This could harm the customer journey of vulnerable people who have contacted the service.</p> <p>Should suppliers working with customers identified under the WHD scheme or through the referrals mechanism be unable to deliver ECO AW measures at a price at or below that prevailing through brokerage, suppliers</p>

		<p>may have to withdraw support to these households. Additional benefits that suppliers might provide, such as tariff advice could be lost as a result.</p> <p>Potential benefits of energy companies delivering directly through their provider arms or through direct bilateral partnerships could be lost or reduced. This is particularly the case if self supply by energy companies' own delivery arms take the place of bilateral partnerships in the overall delivery profile. However, there is nothing to prevent these delivery routes so long as ECO compliance is undertaken anonymously via brokerage, rather than directly between the delivery agent and the energy company.</p>
Proportion of ECO Commitment	Advantages	Disadvantages
Medium %	<p>All participants in the ECO market, including Government and Regulators, can see detailed and current information on the prices being paid to deliver the obligation. This information can inform business plans (on and off brokerage) and future regulation.</p> <p>Moderate liquidity on the platform should increase the stability of prices, enhancing the price information and access to ECO.</p> <p>Providers of ECO measures, including new entrants, can access ECO.</p> <p>A proliferation in ECO providers could improve the penetration of ECO measures and reduce the burden for finding eligible households on individual Energy Companies.</p> <p>Energy Companies can balance their exposure to delivery risk⁸ by entering into a mix of brokered and non brokered contracts.</p>	<p>If access to brokerage remains restricted to accredited Green Deal Providers, rather than opened up as planned, opportunities for Local Authorities and Housing Associations in the delivery of may be reduced.</p> <p>Additional disadvantages IF ENERGY COMPANIES ARE REGULATED TO USE BROKERAGE</p> <p>The benefits of delivering ECO through bilateral partnerships could be reduced. This is particularly the case if self supply by Energy Companies' own delivery arms take the place of bilateral partnerships in the overall delivery profile.</p> <p>Confidence in accessing ECO for providers is reduced, compared to high mandated volumes.</p>

⁸ Brokerage does not increase the risk of non delivery if sufficient controls are in place. Evidence from CERT / CESP shows that those risks exist in bilateral contracts

	<p>Additional advantages if ENERGY COMPANIES ARE REGULATED TO USE BROKERAGE</p> <p>If medium – rather than high - volumes are required, Energy Companies will have improved flexibility in delivering their obligation. They can choose delivery routes, on or off brokerage, that offer the lowest costs.</p> <p>If medium, rather than high, volumes are mandated, there will be some scope for bilateral partnerships off brokerage.</p> <p>New entrants' confidence in accessing ECO, could be enhanced if medium, rather than low, volumes are mandated.</p>	
Proportion of ECO Commitment	Advantages	Disadvantages
Low %	<p>Energy Companies can balance their exposure to delivery risk⁹ by entering into a mix of brokered and non brokered contracts.</p> <p>Energy Companies will be able to make best use of the information that flows to them on eligible households through the referrals from ESAS and the Warm Home Discount scheme and customers identified through the WHD scheme</p> <p>Additional advantages if ENERGY COMPANIES ARE REGULATED TO USE BROKERAGE</p> <p>If low – rather than medium or high - volumes are mandated, Energy Companies will have good flexibility in delivering their obligation. They can choose delivery routes, on or off brokerage, that offer the lowest costs.</p>	<p>Low volumes could result in limited liquidity and volatile prices on the brokerage. Volatile prices could reduce the quality of price information and reduce the access to ECO brokerage for providers.</p> <p>Whilst only a small volume of ECO brokered should reveal the marginal cost, a lack of robust price information combined with volatile prices on brokerage could discourage new entrants.</p> <p>Confidence of new entrants in their ability to access ECO could be limited. This may discourage new entrants to the market and could impair competition.</p> <p>A lack of new entrants could weaken the ECO and Green Deal supply chain. Energy Companies may have to shoulder more of the burden for finding eligible households and increasing the penetration of ECO.</p>

⁹ Brokerage does not increase the risk of non delivery if sufficient controls are in place. Evidence from CERT / CESP shows that those risks exist in bilateral contracts

	<p>If low – rather than medium or high volumes are mandated – it leaves scope for direct bilateral partnerships off the brokerage, so that the benefits of any delivery route can be realised.</p>	
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QUESTION 1: What proportion of ECO Carbon Saving Obligation would ideally be traded on brokerage?

- Low
- Medium
- High

a) What percentage do you suggest? Why? Please provide evidence to support your answer.

QUESTION 2: What proportion of ECO Carbon Saving Communities Obligation would ideally be traded on brokerage?

- Low
- Medium
- High

a) What percentage do you suggest? Why? Please provide evidence to support your answer.

QUESTION 3: What proportion of ECO Affordable Warmth would ideally be traded on brokerage?

- a. Low
- b. Medium
- c. High

b) What percentage do you suggest? Why? Please provide evidence to support your answer.

Voluntary vs. Obligatory

Better Regulation

82. In line with the Government's Better Regulation policy, we look to deliver policy outcomes through non-regulatory or self-regulatory means, before moving to a regulatory approach if necessary.
83. With this in mind Government will therefore pursue in the first instance a voluntary approach to brokerage. Companies will not be required to use the platform but it will be made available for any early demand for ECO. Government expects that this will result in a platform that functions fully and delivers a transparent and competitive ECO market without the need for regulation. Additionally Government would be interested to hear suggestions for non-regulatory mechanism to encourage energy companies to use brokerage at levels that support the objectives of brokerage:

QUESTION 4: Do you have any suggestions for voluntary mechanisms for encouraging energy companies to use brokerage to deliver their Energy Company Obligation?

84. However, there are no guarantees that energy companies will purchase ECO delivery from brokerage at volumes sufficient to deliver the objectives for brokerage and provide benefits to the market. Therefore the Government is also considering whether to regulate energy companies to use brokerage.

Evidence for regulation

85. Detailed information on the functioning of the wider ECO market will be available to DECC through Ofgem. Additionally, the ECO order gives the Secretary of State power to request cost information from obligated energy companies regarding their delivery of ECO. DECC is working closely with energy companies and Ofgem to ensure it has a full picture of the costs and rate of delivery of ECO. As part of this DECC will have a good understanding of what role brokerage is playing in the delivery of ECO.
86. Once brokerage is fully operational, we will monitor trading data carefully to ascertain what proportion of ECO is being delivered through the platform. This consultation will help inform our view of whether this proportion is optimal for the efficient delivery of ECO.
87. Responses to the call for evidence questions in the consultation stage impact assessment (page 6)¹⁰ will also be valuable in assessing how brokerage is functioning in the context of the ECO market. We therefore welcome further evidence that respondents can provide in answering these questions.
88. Monitoring of ECO, in addition to evidence received from the consultation, will inform any decision we make about whether a regulatory approach to ECO brokerage is necessary or not. We also appreciate that, should the voluntary approach prove successful and deliver our objectives, there may be no need to impose regulated brokerage volumes.

¹⁰ <http://www.decc.gov.uk/consultations/Default.aspx?status=26&area=0>

When to regulate

89. DECC is aware that the delivery routes that are established for ECO in the initial period could set the tone for the entire first phase of the scheme. For example if, competitively priced ECO (relative to self-delivery, or delivery via bilateral partnerships) offered on brokerage is not purchased by energy companies this could impact on the longer term supply of measures to the platform and potentially drive up the costs of delivering the obligation. We therefore recognise that we may need to be in a position to regulate at an early phase of ECO brokerage.
90. If Energy Companies perceive self delivery or direct contracting off brokerage to be more advantageous, this could lead to low liquidity on the ECO Brokerage platform. Low liquidity could have serious implications for the success of ECO brokerage. Low levels of trading could limit the robustness of the price signal and potentially the certainty of access to ECO available to all market participants; two of the key objectives of ECO brokerage. We do, however, recognise that liquidity in the early period of ECO and Green Deal may be low while the market settles and will therefore be looking for trading volumes (as share of overall ECO delivery) to show signs of increasing during this consultation.
91. Obliging companies to trade a certain portion of their ECO compliance on the brokerage platform would ensure that the benefits associated with brokerage are not negated by a lack of liquidity or confidence in the market. A decision on whether to regulate will be based on an assessment of the costs and benefits of regulating brokerage versus continuing with a voluntary approach.

Charging For Brokerage

92. Government is also considering the option of potentially allowing the broker to charge companies (potentially both buyers and sellers) for the use of the brokerage service. Respondents to this consultation may wish to consider this when formulating their response.

State Aids

93. In implementing brokerage Government will ensure an approach that is consistent with European Union State Aid rules and will keep State Aid considerations under review.

QUESTION 5: Should we regulate energy companies to channel their Energy Company Obligation through brokerage?

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