Regulatory Policy Committee

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Baroness Verma of Leicester
Parliamentary Under Secretary of State for Energy and Climate Change
Department for Energy and Climate Change
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Ref: RPC14-DECC-2104

Dear Lady Verma,

Reconciliation of the costs of CERT, CESP and ECO

The Regulatory Policy Committee (RPC) has been reviewing DECC's recent submission reconciling the costs of the Carbon Emission Reduction Target (CERT) programme with its successor, the Energy Company Obligation (ECO)[1]. The Committee seems to have reached something of an impasse with DECC on this and I am, therefore, writing to you in the hope of moving this forward.

First, some necessary background. CERT (along with the Community Energy Saving Programme, CESP) was introduced before the Government's One-in, One-out (OIOO) policy started in 2011. However, CERT (after being extended) expired at the end of 2012, well within OIOO. OIOO became One-in, Two-Out from 2013. CERT was immediately followed by ECO. In line with all significant new regulatory proposals, ECO was subject to RPC scrutiny and we validated DECC's estimated equivalent net cost to business (EANCB) of £1.3 billion in 2012. This is the value that would be 'scored' as an 'IN' on the OIOO account. For completeness, we note that the CERT Extension impact assessment was included in the Government's Statement of New Regulation (April 2011) as an IN awaiting confirmation by the RPC. No RPC opinion was issued.

[1] "Reconciliation of the Costs of CERT, CESP and ECO", submitted on 15 May 2014.

In line with the Government's subsequent decision on OIOO/OITO methodology for time limited measures[2], the expiry of the extended CERT/CESP on 31 December 2012 could be treated as an 'OUT' in the OIOO account. In July 2013, it was proposed to the Committee that the costs of CERT and ECO (as expressed by the EANCBs) would be equivalent, with the 'OUT' from CERT entirely offsetting the 'IN' from ECO; the RPC was informed that this was the intention of Ministers at the time. This would have meant, in effect, that both sets of measures could, therefore, be taken out of the OIOO system. The Committee's position was that these measures must not be taken out of the Government's account, but they could be taken to be equivalent on the OIOO account if satisfactory evidence were provided to support this. DECC's view was that the only practicable way to put the costs on a comparable basis was to apply the costing method used for ECO to CERT.

The reconciliation note estimates an EANCB of £1.66 billion for CERT. As noted above, under the OIOO methodology this would be an 'OUT'. Since it more than offsets the £1.3 billion 'IN' for ECO, the net effect would be a £0.36 billion OUT on the OIOO account.

We have been trying to establish with DECC why there is such a significant difference in regulatory burden between CERT and ECO, and with ECO less costly. This is a puzzle because the cost of each energy efficiency measure is expected to be higher under ECO than CERT. The easier and cheaper installations have already been made. Based on the reconciliation note, the only explanation we could derive was that the carbon targets in CERT were much higher than under ECO. We, therefore, sought, in particular, to establish with DECC what the relative carbon targets were, with a view to seeing whether this is the explanation for the higher relative cost of CERT. DECC's response (email dated 10 July 2014) argued that to provide comparable data on carbon targets would be very difficult in practice. Particularly surprising was that the response also seemed to indicate that the relative carbon targets were, in any case, not an essential part of the explanation for why CERT costs are significantly more than those for ECO. However, DECC has since stated that *"…the size of the carbon targets, if put on a comparable basis, would likely be larger under CERT and CESP than under ECO"* (24 July 2014). However, there are no definite figures on the size of this difference, nor whether it would explain the difference in cost between the two measures.

In order to be able to validate the £1.66 billion EANCB for CERT and a net 'OUT' of £0.36 billion, the Committee needs to understand why, under DECC's estimates, CERT involves a substantially higher regulatory cost burden than ECO. The RPC recalls frequent advice from officials that the replacement for CERT was intended to be very similar in terms of net cost to business.

In summary, it is not clear to the RPC what accounts for the higher cost of CERT – does ECO have a lower policy ambition than CERT (perhaps reflecting concerns

[2] As reflected in paragraph 1.9.24 of the Better Regulation Framework Manual, July 2013.

about the cost to business of CERT)? If so, is this expressed in lower carbon targets or some other policy standard? If the policy ambition is not significantly lower, how is it that the cost to business of meeting the same ambition is so much higher under CERT, particularly given the expected increase in the unit cost of the energy efficiency measures over time? The Committee needs to be confident that the estimated difference in cost between CERT and ECO reflects a genuine reduction in the regulatory burden on business, and not any differences in the modelling approach used to assess the costs of the two policies.

We have been advised that further work may be difficult to provide or resource-intensive, in particular with regard to relative carbon abatement targets. At the same time, the Committee is not at present in a position to validate the EANCB of £1.66 billion for CERT and an OUT of £0.36 billion. To do so, the Committee would need further information from DECC that would give us confidence that the regulatory burden is genuinely lower under ECO. In the absence of this information, and given repeated advice from DECC that the intention of ECO was to be designed to succeed CERT with a similar level of burden on business, the Committee would be prepared to consider the two carbon reduction programmes equivalent in cost terms.

The Committee is keen to resolve this long outstanding legacy measure and bring the matter to a conclusion. Moreover, we have always made it clear that the resolution of this case is needed for the impact of the new ECO policy (as introduced in April 2014) to be scored on the OIOO/OITO account.

(The RPC is aware that the treatment of ECO in the OIOO account still depends on the outcome of the Office for National Statistics' (ONS) consideration of whether ECO should be classified as a tax. If the ONS was to decide that ECO - and, by implication, the new ECO - is a tax, these policies would then be out of scope of OITO and would not, therefore, score in the account.)

The Committee may wish to publish this letter for the purposes of transparency.

I am copying this letter to Matthew Hancock, Stephen Lovegrove DECC, Steven Fries DECC and Graham Turnock BRE.

Yours sincerely,

MICHAEL J S GIBBONS OBE
Chairman