

Consultation on raising the threshold at which energy suppliers are required to participate in DECC environmental and social programmes

December 2010

Purpose of this consultation

This consultation seeks views on a proposal to raise the customer account threshold for supplier involvement in the Carbon Emissions Reduction Target (CERT), Community Energy Saving Programme (CESP) and Feed in Tariffs (FITs) from 50 000 to 100 000.

Government is also proposing that the Warm Home Discount, which is the subject of a parallel consultation, should also apply a 100 000 customer accounts threshold

Issued: 21 December 2010

Respond by: 9:00 am 24 January 2011

Enquiries and responses to:

Threshold Consultation
Department of Energy & Climate Change,
Area 4C
3 Whitehall Place, London,
SW1A 2AW

Email: threshold.consultation@decc.gsi.gov.uk

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

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Executive Summary

1. This consultation seeks views on a proposal to raise the customer account threshold for supplier involvement in the Carbon Emissions Reduction Target (CERT), Community Energy Saving Programme (CESP) and Feed in Tariffs (FITs) from 50 000 to 100 000. Government is also proposing that the Warm Home Discount, which is the subject of a parallel consultation, should also apply a 100 000 customer accounts threshold.
2. The aim of this proposal is to reduce a potential barrier to growth for small energy suppliers. Market entry and the threat of market entry are important in energy markets, as in other markets, to promote competition. Competitive markets are in the interests of consumers, since competition incentivises firms to innovate in order to reduce prices and improve the products and services they offer. It is also hoped that a higher threshold will reduce burdens on small suppliers, in line with Government's broader burden reduction agenda.
3. This consultation document is accompanied by an impact assessment. The impact assessment shows that an increase in the threshold to 100 000 customer accounts could reduce burdens to small energy suppliers by about **6.7 million pounds**. Increasing the customer account threshold beyond 100 000 would not be expected to lead to greater cost savings to small suppliers than a 100 000 threshold in the next few years. Government plans to review the customer account threshold for its programmes in 2-3 years, in the light of the effectiveness of other likely measures to address barriers to market entry and growth.
4. This consultation document also seeks general comments on how DECC can design future supplier obligations in a way which minimises disproportionate impacts on smaller suppliers and overall burdens on suppliers. The consultation closes at 9:00 am on **24 January 2011**.
5. The proposals in this consultation document apply in England, Scotland and Wales, consistent with the scope of CERT, CESP, FITs and the Warm Home Discount.

How to take part

This Consultation was issued on 21 December 2010 and will close on 24 January 2011.

When responding, please state whether you are responding as an individual or representing the views of an organisation. Please make it clear on the Response Form who the organisation represents, and where applicable, how the views of members were assembled.

For your ease, you can reply to this consultation online at:

<http://www.decc.gov.uk/en/content/cms/consultations/threshold/threshold.aspx>

A copy of the Response Form is available electronically at the same address.

The form can also be submitted by letter, fax or email to:

Thresholds Consultation

Department of Energy and Climate Change

Area 4C

3 Whitehall Place

London SW1A 2HD

Threshold.consultation@decc.gsi.gov.uk

Additional copies

You may make copies of this document without seeking permission. Further printed copies of the consultation document can be requested by e-mailing:

Threshold.consultation@decc.gsi.gov.uk

Other versions of the document such as Braille, audiocassette or large print are available on request. This includes a Welsh version.

Confidentiality and Data Protection

6. Information provided in response to this Consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including any personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.
7. In view of this, 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, in itself, be regarded as binding on the Department.

Help with queries

8. Questions about the policy issues raised in this document, and completed response forms, can be addressed to:

Thresholds consultation

Department of Energy and Climate Change

Area 4C

3 Whitehall Place

London SW1A 2HD

Threshold.consultation@decc.gsi.gov.uk

Next steps

9. Once the responses have been considered, the Government will be issuing a response and a final Impact Assessment. Depending on the outcome of this consultation and the Warm Home Discount consultation, Government will set an appropriate customer accounts threshold for the Warm Homes Discount through regulations that Government intends to come into force in April 2011. Any changes to the thresholds for CERT and CESP will take effect from April 2012 and any changes to FITs as soon as is practicable.

Consultation Questions

1.	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 (please provide supporting evidence)?
2.	What factors should DECC take into account in determining the threshold?
3.	Do you agree there should be a single threshold for all supplier programmes?
4.	What options for design of future DECC programmes should the Government consider in order to reduce the burdens they place on small and large suppliers?

Introduction: Competition in Energy Retail Markets

10. Competition is a key means of protecting consumers and ensuring well-functioning markets. Competition has an important role to play in exerting downward pressure on prices, to the benefit of consumers. In energy, as well as other markets, new entrants have an important role to play in delivering effective competition and encouraging innovation and efficiency. Removing barriers to entry and growth in a particular market increases competition, since new entrants tend to force existing market players to respond through lower prices and/or better products and services. Both actual market entry and the threat of market entry will drive innovations that improve products or services and reduce costs, benefitting consumers. Hence open, competitive markets without unnecessary barriers to entry put downward pressure on prices, to the benefit of consumers.
11. It is very important that energy markets benefit from this downward pressure on prices. There are expected to be upward pressures on energy prices over the next decade, as a consequence of rising global demand and the need to invest in reducing greenhouse gas emissions from electricity and replacing retiring plant. Government is taking action to help consumers control their bills through energy efficiency measures through the recent CERT extension and through measures in the recently introduced Energy Bill to facilitate household energy efficiency measures that can reduce consumer bills, through an Energy Company Obligation and through Green Deal energy efficiency finance. It is also important in this context of anticipated upward pressure on prices to ensure competition works to the benefit of consumers in energy markets.
12. Ofgem undertook an 'energy supply probe'¹ in 2008, which considered the operation of the GB gas and electricity retail markets. The Probe found that the transition from monopoly gas and electricity supply markets to competitive markets was well advanced and continuing to develop and many consumers had benefited. It also found some areas where the transition to competitive markets needed to be accelerated and introduced a number of new measures aiming to improve consumer engagement in energy markets and information for potential market entrants. Ofgem recently announced a review of retail energy markets, which is expected to consider the effectiveness of the measures introduced².
13. Ofgem's probe showed that there are still barriers to entry in energy markets. Since UK gas and electricity privatisation, new entrant small suppliers have struggled to build up market share, many have subsequently exited or been taken over and none has grown to a size which rivals the "Big 6"³ energy suppliers. There are currently a number of independent energy suppliers in the household supply market, but their combined market share remains under 1%. There is evidence that the current set of small suppliers are influencing the pricing strategies of the Big Six firms, but only in the online market, which it is estimated currently accounts for only 13% of domestic consumers⁴.

¹ Ofgem's energy probe initial findings report can be found at:

<http://www.ofgem.gov.uk/Markets/RetMkts/ensupro/Documents1/Energy%20Supply%20Probe%20-%20Initial%20Findings%20Report.pdf>

² Ofgem's press release can be found at

<http://www.ofgem.gov.uk/Media/PressRel/Documents1/Retail%20Market%2026%20November.pdf>

³ The "Big 6" suppliers are Centrica, EDF, EoN, RWE Npower, Scottish and Southern Energy, and Scottish Power.

⁴ See <http://www.bbc.co.uk/news/business-11787658>

14. The online energy market is the most price sensitive: companies entering this market must price keenly to compete. Offline energy deals, in which small suppliers compete less vigorously, remained less competitive – figure 2.5 in the Impact Assessment accompanying this consultation document illustrates how internet offers compare with standard prices⁵. Furthermore, Ofgem’s probe found that by July 2008 44% of customers had never switched electricity supplier and 40% had never switched gas supplier⁶. The ‘Big Six’ suppliers therefore benefit from a significant base of ‘sticky’ customers which new entrants do not have: Ofgem’s probe showed that margins on those customers are higher than on online customers⁷.
15. Ofgem’s probe identified a number of other barriers to entry. Inadequate liquidity in wholesale markets, particularly in electricity, is cited as a significant barrier. Ofgem issued a consultation in February, followed by an assessment of industry performance in respect of liquidity in the summer. Ofgem’s review into the liquidity of the electricity wholesale market is an essential companion to the Electricity Market Reform proposals Government is currently consulting on. This liquidity review is needed to safeguard the competitiveness of the market, and the ability for new firms to enter and compete alongside incumbents. The Government believes current levels of liquidity are likely to be inadequate and are impeding the operation of the electricity market.
16. Regulatory compliance costs are also cited as a significant barrier to market entry. This consultation is concerned with specific compliance costs falling on suppliers as a result of obligations flowing from some of DECC’s environmental and social programmes and the obligations they place on suppliers. It is important these do not act as unnecessary barriers to entry or unnecessarily reduce competition.

Thresholds for DECC’s environmental and social supplier obligations

17. DECC programmes play a crucial role in helping the Government achieve its social and environmental goals. They are an important means of reducing carbon emissions from domestic energy consumption and increasingly contribute to tackling fuel poverty by helping some of the poorest consumers with energy efficiency and, from 2011, with their bills. These programmes are delivered through supplier obligations.
18. Household energy suppliers were chosen as the agents for these DECC programmes because they are generally well-placed to deliver them. They have enduring relationships with their customers and access to information about their energy consumption. They are also able to achieve economies of scale in sourcing measures such as energy efficiency and in dealing with the internal administration of the obligations.

⁵ Consultation on raising the threshold at which energy suppliers are required to participate in social and environmental programmes – Impact Assessment p. 6, DECC 2010

⁶ Energy Supply Probe Initial Findings Report, p. 48 Ofgem 2008

⁷ Energy Supply Probe Initial Findings Report pp. 63-4 and chapter 7, Ofgem 2008

19. Three of the current DECC programmes, the Carbon Emissions Reduction Target, Community Energy Saving Programme and Feed in Tariffs, only place obligations on suppliers with more than 50 000 customer accounts. Annex 1 provides a brief overview of the supplier obligations arising from these programmes and the new Warm Home Discount. The 50 000 threshold recognises that in comparison with the bigger suppliers, smaller suppliers are likely to suffer disproportionately larger costs both in setting up the necessary systems and in their ongoing administration. For CERT, CESP and FITs therefore, the Government decided that participation should only be on a mandatory basis where the supplier has more than 50,000 customer accounts. The aim of this was to exclude small suppliers from obligations whose fixed costs would be expected to have a disproportionate impact on them. In effect, this means that only the “Big 6” are obligated to participate in all of the schemes. Smaller suppliers can opt to participate voluntarily in FITs and some do so where this fits with their business model. Smaller suppliers will also be able to opt in to parts of the forthcoming Warm Home Discount scheme.
20. This consultation is seeking views on whether this customer accounts threshold should be increased to 100 000. In parallel with this consultation, the Government is also consulting on the detailed rules for the Warm Home Discount, which is scheduled to commence in April 2011. The threshold for mandatory supplier participation will be set in accordance with other programmes, informed by the outcome of this consultation and the Warm Home Discount consultation.
21. A number of small suppliers have expressed concerns that the costs of CERT, CESP and FITs for small suppliers compared to larger ones would continue to be disproportionate as their businesses grew to and beyond 50 000 customer accounts. Until recently, no small supplier seemed likely imminently to grow beyond the 50 000 threshold, hence it was achieving the policy objective of excluding small suppliers from the obligations that would be expected to have a disproportionate impact on them. However, there are indications that some small suppliers could grow beyond 50 000 customer accounts in the next 12-24 months. This being the case, the 50 000 threshold may no longer meet this policy objective.
22. We estimate that the cost of complying with CERT, CESP and FITs is around 3% of a consumer bill – but this proportion is likely to be higher in the case of smaller suppliers. In general, the costs of the programmes are passed on to consumers through higher prices and so if the cost per customer is higher for a smaller supplier then this will mean that they may have to increase the prices they charge to consumers by a higher amount than would be the case for a larger supplier. This will potentially undermine their competitiveness by making it more difficult for them to hold on to their existing customers and acquire new customers. If they try to absorb these costs without increasing prices, this could affect their profitability and ultimately their viability as businesses.
23. We are therefore concerned the 50 000 threshold is too low. In recent years, smaller suppliers have not been approaching the threshold. Now it seems possible that some will and, this being the case, increasing the 50 000 threshold should remove a potential barrier to small supplier growth. We see good arguments for increasing the threshold, particularly now an additional programme – the Warm Home Discount - is being introduced. Also, as discussed above, there are many other aspects of the retail energy markets that make it harder as a small supplier to compete with larger suppliers. In this context an increase in the threshold from 50 000 to 100 000 would not be expected to confer an advantage on small suppliers such that larger suppliers cannot compete with them.

24. We are proposing to increase thresholds to 100 000: our impact assessment shows that this would have significant benefits for small suppliers, without imposing extra costs on suppliers as a whole. We do not currently see a case for a higher threshold: as outlined in the impact assessment, a 250 000 threshold would not have greater benefits to business than a 100 000 threshold, based on our assumptions about the likely growth of small suppliers. We would propose to review this new threshold 2-3 years from implementation, as we would expect that other measures to improve competition will have taken effect by this point.
25. In the short term, we do not expect this change to make any difference to the effectiveness of the various DECC programmes or materially to increase the burden on participating suppliers. It would not exempt any suppliers who already participate in them and would not lead to a higher target being imposed on the participating suppliers.
26. We propose the same customer accounts threshold should apply to CERT, CESP, FITs and the Warm Home Discount, in order to avoid unnecessary complexity in the regulatory regime. Our initial view is that having a single threshold is easier for businesses, but we would welcome evidence on whether there is a strong case for separate thresholds tailored to individual obligations and how these should be set. Subject to the outcome of this consultation and the consultation on that scheme, we would expect the new threshold to apply to the Warm Home Discount from April 2011 and to CERT and CESP from April 2012⁸. The threshold for FITs would be increased as soon as is practicable.
27. We invite views on whether this is an appropriate threshold and, if not, what would be and why. We would also be interested in views on factors to be considered when determining thresholds.

Q. 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 (please provide supporting evidence)?

Q. What factors should DECC take into account in determining thresholds?

Q. Do you agree there should be a single threshold for all supplier programmes?

28. DECC is also developing a new Energy Company Obligation to replace CERT and CESP and other future programmes may be required. Government would welcome views and evidence on how to design future programmes in order to minimise burdens on small and

⁸ In the case of CERT and CESP, the effective trigger date for determining participation is December of the previous year. We therefore anticipate that companies which had more than 50,000 customers as at December 2010 would receive and retain an obligation; but that (subject to the outcome of this consultation) companies which reached that threshold subsequently, but did not have more than 100,000 customers as at December 2011, would be exempt and would never receive any obligation.

large suppliers and avoid disproportionate burdens on smaller suppliers, while using suppliers' roles and relationships to deliver social and environmental programmes.

29. Some of the supplier obligations arising from DECC programmes apply to all suppliers regardless of size and would be expected to have the same 'per customer' cost to all suppliers. The **Renewables Obligation (RO)** gives suppliers the option of buying out their obligation: we understand that smaller suppliers often do this in order to avoid the fixed costs of full participation. Consequently, our view is that the renewables obligation does not impose disproportionate burdens on smaller suppliers and will continue to apply to all suppliers.

Q. 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?

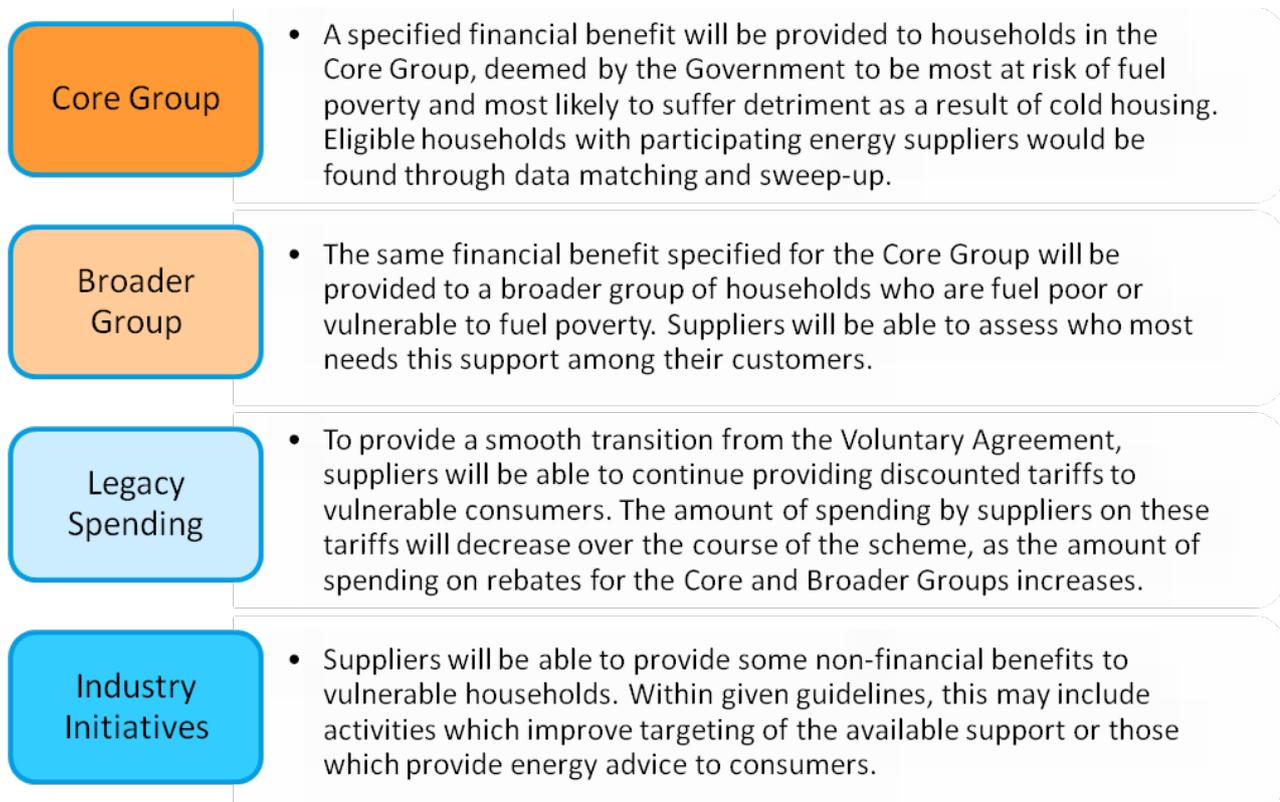
Annex 1 – brief overview of the CERT, CESP and FITs obligations and proposed Warm Homes Bonus Obligations

30. The **Carbon Emissions Reduction Target (CERT)** is an obligation placed on suppliers with more than 50,000 domestic customer accounts. 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 to is £43 per household per year⁹.
31. The **Community Energy Savings Programme (CESP)** applies to suppliers with more than 50,000 domestic customer accounts 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 their obligations or transfer or trade them to other obligated parties. DECC estimates that the average annual cost to all obligated parties is £120m.
32. 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. This takes account of the likely difference in costs for mandatory and voluntary participants' administration costs (voluntary participants are able to claim an additional £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.

⁹ Impact assessment accompanying the consultation on the role of consumer electronics and appliances in CERT – Table 2

33. The **Warm Home Discount** will require suppliers primarily to give direct financial support with energy costs to more of their most 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 spend £250 million in 2011/12 rising to £310 million by 2014/15.

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



35. Government has proposed that data matching should be used to identify the Core Group within this scheme who are eligible for support. 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.

36. 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.

37. In the consultation on the Warm Home Discount, Government has proposed 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 can be found at <http://www.decc.gov.uk/assets/decc/Consultations/warm-home-discount/956-consultation-warm-home-discount.pdf> .

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