

## Response to Energy Company Obligation Consultation

### Basis of response

The Energy Capital Partnership is the body responsible to the West Midlands Combined Authority and Mayor of the West Midlands for delivery of the regional energy strategy. It brings together the energy interests of 18 local authorities (including 7 metropolitan authorities) and three local enterprise partnerships; more than four million people living in two million homes. Several parts of the region have significant issues with fuel poverty, including large areas of Birmingham and the Black Country, particularly in private rented housing.

Following through on the recommendations of the King Commission into Regional Energy Policy<sup>1</sup>, the Mayor is requesting devolved control from government over £125M ECO spend in the region over the next four years. This is part of the regional energy strategy and a wider £500M package of joint public and private investment in support of the regional industrial strategy. The West Midlands has a population which is close to that of Scotland.

### Key points in response to the consultation

We particularly welcome the recognition in the consultation that a longer-term vision for ECO is needed and that fundamental change and improvement in the scheme will be enabled by new digital technologies and smart meters<sup>2</sup>. We also welcome recognition that devolved and local authorities can improve targeting and the quality of outcomes from the scheme, and that innovation has not been effectively encouraged to date and that this needs to change in order to support the government's wider industrial strategy and clean growth objectives.

You say in paragraph 159 that the government wants to give a clear signal now of an aspiration to fundamentally transform the market for the energy efficiency sector. We believe that waiting four years to initiate such a transformation is unnecessary and will result in higher costs and poorer outcomes for customers, as well as holding back our industrial ambitions.

However, we also recognise the risks and challenges in initiating such a transformation nationally, particularly given rapid technical developments and the diversity of issues and interests in this sector. Such risks are substantially higher from a national perspective than from a regional perspective, particularly in the West Midlands, where experienced teams in many of our local authorities have an intimate knowledge of their local housing stock and many years' experience of supporting appropriate interventions.

Our proposal is therefore that the West Midlands works with government as a region during the period 2018-22 to develop and pilot a radically new approach to improving the energy efficiency of housing – essentially the successor scheme to ECO3. This would build on the direction of travel you have already set out, namely:

- Devolved powers over significant aspects of ECO to regional authorities;

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<sup>1</sup> <https://www.energycapital.org.uk/energyinnovationcommission/>

<sup>2</sup> Although we do not agree with the comments about cost in paragraph 158. Home monitoring technologies are generally significantly over-specified and the approach taken to projecting costs in the sector is too academic and compartmentalised. Low cost, fit-for-purpose monitoring equipment is already available and if deployed for multiple purposes (and in particular only for policing outcomes, not analysing reasons) can be cost-effective and attractive now. The rapid rate of cost reduction in this (digital) sector also means that if we impose a four year deployment delay now we handicap the competitiveness of our industry in this sector globally.

- A much greater role for local authorities in targeting and policing the scheme (ultimately replacing energy companies altogether as the market makers);
- Much more flexibility in eligibility of solutions, ultimately aiming at an entirely performance-based scheme (which will drive innovation through competition and be entirely technology-neutral and independent of delivery body, without need for special rules);
- Significantly greater use of digital and smart technologies to support this;
- Better integration with local and national industrial strategies.

In such a scheme, government would focus on setting and policing standards (including consumer protection) and outcomes, and the market – governed and ‘made’ at local level where it can be effectively policed - will deliver the innovation and make the technology choices needed to optimise these.

The West Midlands regional pilot for a successor scheme should start this year and include:

1. Devolution of control over ECO3 for the region to the Mayor and CA (as in Scotland) in exchange for the Combined Authority taking responsibility for delivery of the allocated carbon targets and securing matched private finance for digital investments and new business models.
2. Allocation of a proportion of these ECO funds to the local authorities in the region to support local scheme market-making, management and policing.
3. A joint working group with government to manage the pilot and inform design of the successor national scheme from 2022 onwards.

The pilot will be incorporated as part of our local industrial strategy, enabling us to leverage significant private finance and investment to support targeted investment in digital technologies and new business models. This will be supported by continued devolution of powers supporting this, not only over ECO (as in Scotland) but also to enable small localised changes in housing, energy and planning regulations to facilitate innovation in energy efficiency retrofits<sup>3</sup>.

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<sup>3</sup> Examples include modifications to regulations which only apply to existing houses retrofitted to guaranteed zero carbon standards by third parties and similar.

Question	Response
1. Supplier obligation threshold	<p>The obligation should be taken off energy suppliers altogether and placed on local authorities (LAs), with funding continuing at nationally-set levels via energy bills and allocated to LAs in proportion to numbers of households<sup>4</sup>.</p> <p>The impact of having a threshold is to concentrate market power in the energy efficiency market artificially in the hands of 15 companies (in practice closer to 6): this is a significant distortion in a market that should naturally (like other home improvement markets) accommodate several thousand small installers and thus encourage innovation through competition.</p> <p>The market structure artificially created by the scheme means there are no incentives for quality in outcomes or innovation, so government is forced to add rules to try and encourage these things, which is inefficient and costly.</p> <p>In addition, control of ECO gives energy suppliers market power over local authorities and social landlords, which can also result in non-competitive and unintended outcomes which are not necessarily in the public interest or conducive to best value (e.g., where a supplier offers a LA access to ECO subsidy in exchange for exclusive strategic partnership in wider energy investment activities).</p>
2. Taper mechanism	No comment
3. Obligation phases	<p>You could use this or a similar structure to provide a framework for local authority performance management and incentivisation by government. It may be helpful to combine the first two phases into a single 18 month period: six months is extremely short to develop and deliver energy efficiency projects on housing at economic scale and assure quality outcomes.</p>
4. Carry over	<p>In principle carry-over is pragmatic and necessary. As you look towards reforming the scheme fundamentally (para 159) however, you will need to move away from this approach and consider ways to terminate supplier obligations definitively without impacting customers' bills. The keys will be giving sufficient notice and ensuring that the new scheme is well-designed and up and running ready to pick up the slack. A large scale well-bedded-in pilot across the West Midlands, in conjunction with the start of a separate Scottish scheme are a good way to achieve this.</p>
5. Carry under	<p>A better approach would be to require suppliers to buy themselves out of any outstanding undelivered obligation, and these funds be transferred to local authorities to kick-start the new scheme.</p>
6. Early delivery approach	<p>We agree that it's important to the supply chain to avoid creating a gap in the market. The approach proposed seems sensible.</p>
7. Affordable warmth	<p>Yes, although flexibility will be extremely important (e.g., where some residents of a block of flats or estates are fuel poor and others are not, the scheme should not encourage uneconomic solutions such as partial cladding).</p> <p>This is an area where local discretion could be very helpful in ensuring efficient delivery of policy objectives: the government should ideally focus on</p>

<sup>4</sup> With scope for adjustment to take account of levels of fuel poverty and/or delivery performance in the area.

Question	Response
	setting and monitoring targets for households taken out of fuel poverty by area, and not worry about how these targets are achieved at an individual household level or via what measures.
8. Rural sub-obligation	We agree that rural areas must be protected and allocate appropriate funding within the scheme. The LA area-based approach we are proposing will achieve this more simply, automatically, fairly and directly than the current scheme.
9. Inclusion of disability benefits	Again, there's nothing wrong with adding extra criteria like this, but the whole scheme would be considerably less complex and lower cost to administer if local authorities were used more to target the fuel poor as they have much richer data and understanding of the issues and opportunities in their areas.
10. Inclusion of Child Benefit	See answer to q. 9
11. Removal of income thresholds	See answer to q. 9
12. Self Declaration	See answer to q. 9
13. Social Housing eligibility	There will be diminishing returns on investment in poorer quality social housing (many E,F,G properties are relatively isolated and this negates the economic advantages of suppliers working with social landlords to achieve scale on schemes) but it is very important to retain eligibility for social housing in some form. Some flexibility as an incentive for high performing areas to start addressing C and D properties innovatively would be welcome <sup>5</sup> (e.g., C and D properties eligible only provided they are improved to A or better).
14. Mapping tool	This is the wrong approach. Investing in tools to help the wrong organisations (energy suppliers) consolidate their control over a market they shouldn't be in is highly inefficient and a waste of public money. It would be simpler just to transfer the obligation to local authorities (who already know where people and poor quality houses are).
15. Flexible eligibility	<p>In our region, energy suppliers have always worked extensively with local authorities to deliver the bulk of their ECO obligation, so the benefit of flexible eligibility isn't that it encourages partnerships, rather that it gives LAs some flexibility as to eligibility and a little more control over how the energy suppliers behave in the relationship.</p> <p>As indicated throughout this response, we are therefore strongly supportive of increasing the proportion of ECO delivered under the direct control of local authorities and would advocate the figure being at least 25% and preferably 100%, coupled with energy suppliers ceasing taking responsibility for delivering the scheme at all.</p>

<sup>5</sup> And may be a more effective way to incentivise innovation than the optional 10-20% allocation proposed.

Question	Response
16. Exclusion of oil and coal systems	Yes. Innovative solutions should be encouraged instead in such cases.
17. FTCH criteria	Yes.
18. Broken systems	Yes.
19. Combined measures	Yes, with considerable reservations that the scheme is becoming far too complex at this point to support efficient administration, and the sooner we move towards an energy performance-based approach that is essentially independent of technology (and automatically monitors and rewards quality) the better.
20. Solid walled homes	<p>We agree with targeting solid walled homes and would recommend targets by area with incentives and support for innovative approaches such as the Energiesprong model currently being piloted in Nottingham (and extensively in Holland).</p> <p>Given the opportunity to develop and deliver a pilot 'ECO4' approach in the West Midlands, one of the programmes we'd take forward at scale with industrial partners would be a large scale solid wall retrofit programme on Energiesprong principles using off-site manufacturing of external building shells and the latest digital surveying techniques.</p> <p>The keys to the Energiesprong model are that the householder ends up with net zero energy bills, and the full costs of the installation are recovered over 30 years by the construction company (which provides a performance warranty). This approach creates significant economic opportunities for our regional manufacturing base (already proven in Holland) but will never be supported by ECO in its current form because energy suppliers will clearly not invest in destroying their customer base, and the rules of ECO are far too prescriptive to support this kind of transformational, outcome-driven innovation.</p>
21. SWI-minimum	See response to q. 20
22. SWI level	See response to q. 20. The scheme is too prescriptive: these targets are essentially arbitrary and in many areas there may be scope and advantage in exceeding them.
23. 66% minimum requirement	<p>This is a critical issue for the economic viability of the scheme. While the principle is clear and the approach is necessary, a single percentage figure applied nationally will inevitably make tackling fuel poverty more expensive in some areas than others (depending on the configurations and occupancy of their housing stock).</p> <p>LAs should be able to negotiate individually to agree area-based infill percentages on an annual basis (using 66% as a guide and default value) in order to help BEIS meet overall targets efficiently.</p>

Question	Response
24. Infill mechanism	Removal of the energy supplier would simplify the process, otherwise the mechanism appears sensible.
25. Notification	Yes.
26. Infill proportion	We agree that a higher proportion should be permitted under flexible eligibility. The figure should be negotiable around a default value of 50% as described in the response to q. 23.
27. RHI eligibility	<p>Care needs to be exercised to ensure this does not prevent or inhibit innovative and potentially market-transformative approaches like Energiesprong from coming to market.</p> <p>ECO can have a significant market-distorting effect by encouraging and subsidising lower quality or sub-optimal outcomes and measures, which are installed piecemeal in preference to whole house solutions.</p> <p>Such whole house solutions might otherwise have delivered a better outcome and largely been privately-financed but can be excluded because administratively they are more challenging from an ECO perspective (e.g., if they include an element that might attract RHI).</p> <p>While the intention of this proposal is sensible, therefore, the detailed wording should be such that whole house solutions including RHI-eligible elements are not excluded automatically from ECO support on the other elements.</p>
28. Scoring	<p>We view the deemed approach as exceptionally crude and unhelpful in driving industrial productivity, actual carbon and fuel poverty reductions, innovation and quality outcomes - all of which have to be incentivised separately and inefficiently because deemed scores prevent competitive markets operating and installers and suppliers being rewarded on delivery performance.</p> <p>We should move as quickly as possible to a market design which empowers end customers (householders) to demand quality installations and performance. Smart meters and reduced costs of monitoring will help with this, but in the interim, local and regional authorities are better qualified and incentivised to be effective market makers and customers for energy efficiency interventions than energy suppliers, and the scheme should be modified to reflect this.</p>
29. Scottish formula	<p>The allocation should not be by amount of fuel used, as this creates perverse incentives when the objective of the scheme is to reduce fuel usage. It should instead be based on numbers of households, with modifiers reflecting policy priorities around numbers in fuel poverty and carbon emissions attributable to the geographic area. Some recognition that the climate in Scotland is colder than Cornwall (for example) is also necessary.</p> <p>There should also – in the course of time – be rewards for areas which deliver fuel poverty and carbon reductions most efficiently.</p>
30. Supplier apportionment	See above answers. We think ECO should be allocated directly to local authorities not suppliers.

Question	Response
31. Innovative products	<p>This is a very inefficient way to encourage innovation and will not deliver the government's industrial strategy objectives. A significant re-shaping of the scheme is required.</p> <p>Markets and competition drive innovation (particularly large scale and rapid deployment of market-ready innovation) not optional targets in the context of cost-driven utilities meeting obligations. Utilities are not naturally innovative organisations (or incentivised to support this kind of innovation) so the approach proposed is unlikely to have much impact.</p> <p>These are very weak proposals constrained by a scheme and industry structure which will continue to make large scale innovation very challenging until it is fundamentally reformed.</p> <p>True innovation at commercial scale in this sector will by definition challenge incumbent utilities in the way Amazon, Google, Tesla et al challenged incumbents in their sectors. This scheme gives those same utilities control of innovation in this market in the UK and a budget of £128M per year – we should not be surprised that real innovation remains in the US and China.</p> <p>Instead, why not invest the 10%-20% of annual ECO spend (£64M-£128M) in regional approaches to market-making for energy efficiency as outlined in this response and as a transition to a fundamentally new scheme (para 159)?</p>
32. Innovation routes	No – see previous answers.
33. Other approaches for suppliers	No – see previous answers. The suppliers are the wrong organisations to meet these targets cost-effectively, particularly now that the easy wins have largely been delivered nationally.
34. Reporting period extension	No views.
35. Removal of 5% provision	No views.
36. Obligation trading	Trading has a useful role in some scheme designs but should not be allowed to result in further concentration of market power in this sector, which is naturally diverse and competitive (in contrast to energy utilities, which are natural monopolies and oligopolies). The government has an important role in ensuring this doesn't happen.
37. Quality mark approval	Good quality schemes are helpful to support customer protection in this sector, yes. The government should invest more in supporting national quality and labelling schemes coupled with customer choice and local scheme management, and less on prescribing which measures go on what houses.
38. Lifetime dependent on quality mark	<p>Yes, although it is important that the scheme does not impose disproportionate or excessive costs on manufacturers and suppliers seeking to obtain the quality mark, as this will inhibit innovation.</p> <p>There is an obvious danger that those awarding the Quality Marks will have a dominant market position (a government-granted monopoly) and hence be</p>

Question	Response
	able to charge excessive fees. Government supervision to ensure this does not occur will be important.
39. Installation standards	Yes, but see q. 38 above.  Installation costs are typically at least 50% of the costs of energy efficiency installations and attention to detail in installation can be critical to delivering performance outcomes. PAS2030 and PAS2035 are basic standards (protecting customers from very poor work) and not a substitute for empowered customers and energy performance monitoring which will reward the quality of installation that really makes the fundamental difference to lifetime energy performance.
40. Installer certification	Yes, but see q 39.
41. Consumer protection	The levels of protection required for small communal heating systems should be proportionate and recognise the obligations of landlords. It should not be necessary to impose the same level of administration requirement as for large scale multi-building/multi-landlord district energy schemes.
42. General requirements	See introductory text. No further comments.

For clarifications or further information:

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