

Suppliers, consumer groups and
other interested parties

Email: RetailPriceRegulation@ofgem.gov.uk

Date: 19 November 2021

Response deadline: 17 December 2021

Dear stakeholder,

Price Cap – Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap

1. The purpose of this letter is to consult stakeholders on how we propose to determine the Energy Company Obligation (ECO) cost allowance in the default tariff cap ('cap') from cap period eight (April 2022 – September 2022) onwards.¹
2. We currently use the Department for Business, Energy, and Industrial Strategy's (BEIS) latest ECO3 impact assessment to determine the ECO allowance.² However, the ECO3 scheme is due to end 31 March 2022. BEIS have indicated its intention to bring draft legislation before Parliament, setting out the commencement of the ECO4 scheme from 1 April 2022.
3. We need to consider how we reflect the annualised scheme costs attributed to ECO4 from cap period eight onwards to ensure the ECO cost allowance within the cap

¹ The ECO scheme is a policy cost, which is covered in 'Annex 4 - Policy cost allowance methodology' of SLC 28AD of the gas and electricity licences.

Ofgem (2021), Annex 4 – Policy cost allowance methodology v1.9.
https://www.ofgem.gov.uk/sites/default/files/2021-08/Annex_4_-_policy_cost_allowance_methodology_v19.xlsx

² BEIS (2019), Final Impact Assessment, Table 8.
<https://www.gov.uk/government/consultations/energy-company-obligation-eco3-improving-consumer-protection>

continues to reflect the efficient costs faced by suppliers. **We propose to use the latest available information from BEIS on the ECO4 scheme costs at the time we set the cap as the input to estimate the annualised scheme year ECO allowance.** At this stage, this is BEIS' latest ECO4 impact assessment.³

4. We estimate using BEIS' latest impact assessment that the ECO4 cost allowance will be approximately £37 per typical dual fuel customer per year. This is an increase of approximately £7 per typical dual fuel customer per year, compared to the cap period seven (October 2021 – March 2022) ECO cost allowance under ECO3.
5. In addition, we need to consider how to ensure that we correct any under or over-allowance for cap period eight in the event the draft ECO4 legislation is not approved by Parliament, BEIS decides to not introduce ECO4, or the government response and updated impact assessment indicate a material change in the costs of the scheme. **We propose to correct for any material under or over-allowance of these costs in cap period nine (October 2022 – March 2023).**
6. We welcome views on the considerations and proposals set out in this letter. We ask stakeholders to send any comments to RetailPriceRegulation@ofgem.gov.uk by close of business on **17 December 2021**.
7. We do not ask specific questions in this document. Rather, we welcome views on any of the matters discussed in this consultation.
8. We will publish the non-confidential responses we receive alongside a decision on our website at www.ofgem.gov.uk/consultations. Please see Appendices 2 and 3 for further detail on confidentiality and privacy.

Context

9. The cap includes a policy cost allowance to ensure that suppliers are able to recover the additional costs related to their obligations under different government environmental and social programmes. The policy cost allowance is set out in 'Annex 4 – Policy cost allowance methodology' of Standard Licence Condition (SLC) 28AD of

³ BEIS (2021), ECO4 consultation stage impact assessment.
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

the gas and electricity licences.⁴ There are currently six policy schemes in operation which are accounted for in this allowance, one of which is the ECO scheme.

10. The ECO scheme is a government programme to help tackle fuel poverty and reduce carbon emissions by delivering energy efficiency measures in the least energy efficient homes across GB. Under the scheme, obligated suppliers are required to fund or part-fund the installation of energy efficiency measures and work with installers to introduce efficiency measures into eligible households.
11. We calculate the ECO cost allowance for each six-monthly cap level update, using scheme administration data from BEIS' forecast of annualised ECO scheme costs. These figures are taken from its most recent impact assessment at the time of the cap update.⁵ The approach of using scheme administration data is consistent with our calculation of other policy costs. We set the allowance to reflect the costs we would expect a fully obligated supplier to incur.⁶

Setting ECO4 costs

12. The current ECO3 scheme is due to end 31 March 2022 and the ECO4 scheme has been proposed by BEIS to commence 1 April 2022.⁷ At this stage, the draft ECO4 legislation and government response have not been published by BEIS. The legislation would need to be approved by Parliament before the ECO4 scheme comes into force.
13. We cannot wait until BEIS publishes its government response and draft ECO4 legislation before launching a consultation on how we reflect the annualised scheme costs attributed to ECO4 in the cap. This is because we would not have sufficient time to make a decision on the ECO allowance ahead of the February 2022 cap announcement for cap period eight. Given the materiality of ECO costs, we consider this would risk significantly underfunding suppliers on ECO costs once the ECO4 obligations are implemented.

⁴ Licence Conditions on Ofgem website.

<https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/licence-conditions>

⁵ Ofgem (2018), Appendix 5 – Policy and network costs, Table A5.1.

<https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview>

⁶ Energy suppliers with more than 150,000 domestic customer accounts are currently obligated to participate in the ECO scheme, subject to supply volumes.

⁷ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, page 1.

<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

Proposal

14. We propose to use the latest estimate of annualised scheme year ECO4 costs published by BEIS to calculate the ECO allowance from cap period eight onwards in 'Annex 4 – Policy cost allowance methodology' of SLC 28AD of the gas and electricity licences. The most recent scheme year estimate is currently from BEIS' June 2021 ECO4 consultation stage impact assessment.
15. We do not propose to make any other changes for setting the ECO4 costs as we consider the current methodology is sufficient for when the ECO4 scheme commences. This is based on the current proposals of the structure of ECO4, which are similar to that of ECO3.

Considerations

16. The costs associated with ECO4 are expected to be material, so we consider it appropriate to amend the ECO allowance from cap period eight onwards to allow suppliers to continue to recover these costs. BEIS' latest impact assessment estimates that the annual ECO4 scheme cost would be £1 billion per year across the retail market, rising with inflation, until March 2026.⁸
17. Following our methodology set out in Annex 4, we estimate the ECO allowance in cap period eight will be approximately £37 per typical dual fuel customer per year. This is an increase of about £7 per typical dual fuel customer per year than the cap period seven allowance, under ECO3. We calculate this estimate using the annual scheme costs for ECO4 divided by the supply volumes of obligated suppliers used in cap period seven.^{9, 10} We set the GDP deflator to 0%, as the obligation is in real terms starting in 2022.
18. A full breakdown of the estimated ECO cost allowance for electricity (single-rate and multi-register rate) and gas customers in cap periods seven and eight is shown in Table A1 in Appendix 1. These figures are for indicative purposes only.

⁸ BEIS (2021), ECO4 consultation stage impact assessment, paragraph 65.
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

⁹ All values are measured for the typical consumption values used to set the cap (3,100 kWh for electricity and 12,000 kWh for gas).

¹⁰ The annualised cost estimate in cap period eight (under ECO4) will be approximately £1.72 per MWh supplied for gas, and approximately £5.28 per MWh supplied for electricity. For comparison the figures in cap period seven (under ECO3) are £1.41 and £4.33 respectively. Consistent with our methodology in Annex 4, the ECO allowance would not be allocated to the standing charge.

19. We propose to continue to update the ECO allowance in each cap period for subsequent scheme years, using the latest published figures which will be from the latest impact assessment, provided that the draft ECO4 legislation is approved by Parliament. This will ensure that we best reflect the costs that suppliers face in the cap.
20. We will continue to use the latest supply volumes of obligated suppliers to calculate the ECO allowance.¹¹ We consider that basing the supply volumes on the information we collect on the obligations continues to be appropriate given that the structure of the ECO4 scheme is similar to ECO3.¹²
21. BEIS noted that it intends to consult on designing and introducing a buy-out mechanism in the future. This additional scheme will not, however, be available at the beginning of the ECO4 scheme.¹³ We will consider whether there is a material and systematic change in costs which requires us to revisit this methodology once the scheme parameters have been set.

Allowance correction

22. We need to determine the cap level at the start of February 2022 for cap period eight to ensure that the cap reflects the costs faced by suppliers. There is a risk that the ECO4 scheme legislation may not be finalised in time to have certainty that this will be a cost incurred by suppliers. However, we need to consult now to identify an alternative input to reflect the costs associated with the ECO4 scheme from cap period eight onwards. This will avoid underfunding suppliers once the ECO4 obligations are implemented.
23. In the event that the scheme does not proceed or there is a material change in costs based on the government response and updated impact assessment, the cap period eight allowance will not reflect the ECO costs that suppliers have incurred. We need to consider how we can correct for any under or over-allowance in cap period nine.

¹¹ Supply volumes of obligated energy suppliers are based on information collected from suppliers by Ofgem.

¹² BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraph 15 - 37. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

¹³ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraph 45 - 57. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

24. For the avoidance of doubt, if an ECO scheme is not in force in cap period eight, then we do not expect suppliers to spend the cap period eight ECO allowance.

Proposal and considerations

25. If either the draft ECO4 legislation is not approved by Parliament, or BEIS decides to not introduce ECO4, then we propose to not provide an ECO allowance from cap period nine onwards. We also propose to recoup any over-allowance during cap period nine, provided the required information is available with sufficient time to enable us to make this amendment. In the event that the government response or impact assessment indicate a material change in the costs of the scheme, we propose to reflect any material under or over-allowance in our cap period nine allowance.
26. The allowance correction is to ensure that the cap does not materially depart from an efficient level of costs. If the draft ECO4 legislation is not approved by Parliament or BEIS decide to not introduce ECO4, then suppliers are not obliged to spend the allowance on installing energy efficiency and heating measures under ECO4 in cap period eight.
27. If we are required to use the allowance correction, then we would recover any under or over-allowance which incurred in cap period eight over cap period nine only, provided the required information is available with sufficient time to enable us to make this amendment. The cap is set in annual terms each cap period, but we would recover costs over the six months. We would uplift the allowance to account for the share of annual demand in the six-month period.
28. BEIS may review the annualised ECO cost for the scheme year beginning April 2022 in the government response or updated impact assessment. We do not have a mechanism to change the allowance for ECO costs in cap period eight if BEIS change the scheme year costs after we determine the summer cap level at the beginning of February 2022.
29. If BEIS make any change to the ECO cost for the first scheme year after the February update, this will be taken into consideration in the August update for cap period nine. This means any misalignment of costs and allowances due to an updated ECO cost for the first scheme year would only last for one cap period if the misalignment is not material.

30. If the misalignment is material in cap period eight, then any under or over-allowance would be recouped in cap period nine, as described in paragraph 27.
31. For future cap periods after cap period eight, we propose to use the most up to date annualised ECO cost when determining the ECO cost allowance in both February and August updates going forwards.
32. For the avoidance of doubt, we are proposing that the allowance correction will only apply for any misalignment of costs between the beginning of cap period eight and when the ECO4 legislation comes into force.
33. In the event that the ECO4 legislation is not in force on 1 April 2022, BEIS have indicated that it will allow suppliers to deliver ECO4 projects between 31 March 2022 and when the ECO4 legislation is approved by Parliament.¹⁴ If this is the case, then we will consider whether there is a material and systematic change in costs which requires us to use the allowance correction.

Next steps

34. We invite stakeholder views on any aspect of this letter by **17 December 2021**. Stakeholders' responses will inform our decision, which we intend to publish by the beginning of February 2022.

Yours faithfully,

Leonardo Costa

Head of Price Cap Policy, Retail

¹⁴ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraph 75 - 77. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

Appendix 1: Detailed ECO cost estimate

Table A1 sets out our estimate of the ECO allowance in cap periods seven and eight under ECO3 and ECO4 respectively.

Table A1: Estimates of the annualised ECO scheme costs (GB average)

	Electricity (single rate) (£)		Electricity (multi-register rate) (£)		Gas (£)	
	Nil	TDCV	Nil	TDCV	Nil	TDCV
Cap period seven	N/A	13.41	N/A	18.17	N/A	16.88
Cap period eight	N/A	16.37	N/A	22.18	N/A	20.60

Source: Ofgem calculations based on data from BEIS' impact assessments.^{15, 16}

Notes: Typical Domestic Consumption Values (TDCV) are 3,100 KWh per year for electricity (single register), 4,200 KWh per year for electricity (multi-register) and 12,000 KWh per year for gas.

¹⁵ BEIS (2019), Final Impact Assessment, Table 8.

<https://www.gov.uk/government/consultations/energy-company-obligation-eco3-improving-consumer-protection>

¹⁶ BEIS (2021), ECO4 consultation stage impact assessment, paragraph 65.

<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

Appendix 2: Your response, data and confidentiality

You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you do wish to be kept confidential and those that you do not wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 3.

If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

Appendix 3: Privacy note on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR)

Note that this section only refers to your personal data (your name, address, and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk.

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest ie a consultation.

4. With whom we will be sharing your personal data

We may share consultation responses with BEIS.

5. For how long we will keep your personal data, or criteria used to determine the retention period

Your personal data will be held for six months after the project, including subsequent projects or legal proceedings regarding a decision based on this consultation, is closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete

- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

7. Your personal data will not be sent oversea

8. Your personal data will not be used for any automated decision making

9. Your personal data will be stored in a secure government IT system

10. More information

For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".