

Price Cap - Decision on the Energy Company Obligation scheme and Warm Home Discount scheme allowance methodologies in the default tariff cap

Subject	Details
Publication date:	4 February 2022
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We consulted in November and December 2021 on the Energy Company Obligation (ECO) and Warm Home Discount (WHD) scheme allowance methodologies in the default tariff cap ('cap'). This document describes our decisions on determining the ECO and WHD allowances in the cap from cap period eight (April 2022 – September 2022) onwards. It also describes our decisions on how we would correct for any material under or over-allowance of these costs for cap period eight in the event that the scheme does not proceed or there is a material change in costs.

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Executive summary

We introduced the default tariff cap ('cap') on 1 January 2019, which currently protects around 22 million households on standard variable and default tariffs (which we refer to collectively as "default tariffs"). The cap protects domestic customers on default tariffs, ensuring that they pay a fair price for their energy, reflecting its underlying costs.

The cap includes a policy cost allowance to ensure that suppliers are able to recover the costs related to their obligations under different government environmental and social programmes. This document sets out our decisions on determining the Energy Company Obligation (ECO) and Warm Home Discount (WHD) scheme allowances in the cap from cap period eight (April 2022 – September 2022) onwards.

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 Great Britain (GB). ECO3 is the current policy in place, which will end on 31 March 2022. The Department for Business, Energy, and Industrial Strategy (BEIS) has proposed to extend ECO. The next phase of the scheme is ECO4, which would cover the period April 2022 - March 2026.

The WHD scheme is a government programme with the aim of alleviating fuel poverty. Under the scheme, currently in scheme year 11, obligated suppliers are required to provide rebates to the energy bills of eligible low-income and vulnerable customers. The rebate is paid to eligible customers as a one-off discount during the winter months (between October and March). BEIS is currently consulting on extending the WHD scheme through to scheme year 15 ending in 2026 and expanding it to reach around 3 million low-income households.¹

BEIS has indicated its intention to publish responses and introduce draft legislation to Parliament for both schemes in the coming months. BEIS has also indicated that suppliers should continue to proceed as if the ECO4 scheme is in place from April 2022, as this would help minimise the impact on the supply chain from a hiatus in delivery.²

¹ BEIS (2020), Energy white paper: Powering our net zero future.

<https://www.gov.uk/government/publications/energy-white-paper-powering-our-net-zero-future>

² BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraphs 75-77.

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

Setting the scheme allowances

We have decided to use the latest information on BIES's scheme costs as the inputs to estimate the annualised scheme year allowances for ECO and WHD from cap period eight onwards. This is to ensure that the cap reflects the costs we expect suppliers to face.

This represents an ECO allowance of approximately £38 per typical dual fuel customer per year,³ which is an increase of approximately £7 compared to the last cap period. This also represents a WHD allowance of approximately £19 per typical dual fuel customer per year, which is an increase of approximately £5 compared to the last cap period.

Allowance correction

Given the lack of formal decisions for both schemes at the time of publishing this decision, we have decided how we could correct any under or over-allowance for cap period eight.

In the event that BEIS makes material changes to ECO4 or WHD scheme costs after our February 2022 cap updates, we will use an allowance correction mechanism in the next cap period,⁴ provided the required information is available with sufficient time to enable us to make this amendment. We will consult on the level of the proposed allowance correction to reflect any material under or over-allowance which occurred in cap period eight. This is to ensure that we best reflect the efficient costs that suppliers incur in the cap.

In the event the ECO4 or WHD scheme does not proceed, we will not provide an ECO or WHD allowance from the next cap period onwards and will seek to recover the over-allowance which occurred in cap period eight. We will consult stakeholders on the specifics to deliver the allowance correction mechanism for both schemes. We will consult stakeholders on the efficient ECO4 costs suppliers have incurred in cap period eight and the level of proposed allowance correction. For WHD, we intend to recover the full amount of the WHD allowance provided during cap period eight, as we expect suppliers would only pay out rebates when the legislation is in force.

³ Dual fuel, at the typical consumption values used to set the cap (3,100kWh for single rate electricity and 12,000kWh for gas). This allowance has increased slightly (£0.80) from our November 2021 consultation proposal, as we have adjusted for inflation to uprate the annualised ECO4 scheme costs to 2022 prices, since they are in 2021 prices.

⁴ By the next cap period, we mean the cap period after any decision not to approve or introduce the scheme

1. Introduction

What are our decisions?

1.1. We introduced the default tariff cap ('cap') on 1 January 2019, which currently protects around 22 million households on standard variable and default tariffs (which we refer to collectively as "default tariffs"). The cap protects domestic customers on default tariffs, ensuring that they pay a fair price for their energy, reflecting its underlying costs. The cap is one of the key activities which fall within the outcome "consumers pay a fair price for energy and benefit from rights and protections" within our Forward Work Programme for 2021-22.^{5, 6} We set the cap by considering the different costs suppliers face. The cap is made up of a number of allowances which reflect these different costs.

1.2. The cap includes a policy cost allowance to ensure that suppliers are able to recover the 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 the gas and electricity licences.⁷ There are currently six policy schemes⁸ in operation which are accounted for in this allowance. These schemes include the Energy Company Obligation (ECO) and Warm Home Discount (WHD) schemes.

1.3. This document sets out our decisions on determining the ECO4 and WHD allowances in the cap from cap period eight (April 2022 – September 2022) onwards.

⁵ Ofgem (2021), Forward work programme 2021/22

<https://www.ofgem.gov.uk/publications/forward-work-programme-202122>

⁶ We are currently consulting on our draft Forward Work Programme for 2022-23. Ofgem (2022), 2022/23 Forward Work Programme Consultation.

<https://www.ofgem.gov.uk/publications/202223-forward-work-programme-consultation>

⁷ Licence Conditions on Ofgem website.

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

⁸ At the same time as this decision, we have also published a decision on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap. The policy cost allowance model will include seven policy costs from cap period eight, following our decision to include an allowance for the Green Gas Levy from cap period eight onwards.

Ofgem (2022), Decision on changes to 'Annex 4 - Policy cost allowance methodology' of SLC 28AD to include a Green Gas Levy allowance in the default tariff cap.

<https://www.ofgem.gov.uk/publications/price-cap-decision-changes-annex-4-policy-cost-allowance-methodology-slc-28ad-include-green-gas-levy-allowance-default-tariff-cap>

ECO4 scheme

1.4. We have decided to use the latest 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’s latest ECO4 impact assessment.⁹

1.5. We have decided to maintain our current methodology to calculate the ECO4 allowance in the cap. We have calculated the ECO4 allowance for cap period eight will be approximately £38 per typical dual fuel customer per year.

1.6. In the event the draft ECO4 legislation is not approved by Parliament, or BEIS decides not to introduce the ECO4 scheme, we will not provide an ECO allowance from the next cap period onwards. We will seek to recover the over-allowance which occurred in cap period eight and consult stakeholders on the specifics to deliver the allowance correction mechanism. We will work with stakeholders to gather and analyse the relevant data on the ECO4 costs suppliers have incurred in cap period eight. We will consult on determining the level of efficient costs suppliers incurred in cap period eight and the level of the proposed allowance correction.

1.7. If the government response and updated impact assessment indicate a material change in the costs of the ECO4 scheme after our February 2022 cap update, we will use an allowance correction mechanism in the next cap period, provided the required information is available with sufficient time to enable us to make this amendment. We will consult on the level of proposed allowance correction to reflect any material under or over-allowance which occurred in cap period eight.

WHD scheme

1.8. For the WHD scheme, we have decided to use the latest available information from BEIS on the WHD scheme costs at the time we set the cap as the input to estimate the

⁹ BEIS (2021), ECO4 consultation stage impact assessment.
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

annualised scheme year WHD allowance. At this stage this is BEIS’s latest WHD consultation.¹⁰

1.9. We have decided to maintain our current methodology to calculate the WHD allowance in the cap. We have estimated the WHD allowance for cap period eight which will be approximately £19 per typical dual fuel customer per year.

1.10. In the event that the draft WHD legislation is not approved by Parliament or BEIS decides not to introduce the WHD scheme, we will not provide a WHD allowance from the next cap period onwards and will seek to recover the over-allowance which occurred in cap period eight. We will consult stakeholders on the specifics to deliver the allowance correction mechanism. Under this event, we intend to recover the full amount of the WHD allowance provided during cap period eight, as we expect suppliers would only pay out rebates when the legislation is in force.

1.11. Like ECO4, if the government response or updated impact assessment indicate a material change in the costs of the WHD scheme after our February 2022 cap update, we will use an allowance correction mechanism in the next cap period, provided the required information is available with sufficient time to enable us to make this amendment. We will consult on the level of proposed allowance correction to reflect any material under or over-allowance which occurred in cap period eight.

Structure of this decision document

1.12. This decision document has the following structure:

- Chapter 1 summarises our decisions and the structure of this document. It also provides a general introduction to the cap, ECO and WHD schemes.
- Chapter 2 outlines our decision-making process.
- Chapter 3 sets out our decisions on determining the ECO4 cost allowance in the default tariff cap from cap period eight onwards.

¹⁰ BEIS (2021), Warm Home Discount: better targeted support from 2022. <https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>

- Chapter 4 sets out our decisions on determining the WHD cost allowance in the default tariff cap from cap period eight onwards.
- Appendices include details of the scheme allowances and a glossary.

The default tariff cap

1.13. We set the cap with reference to the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('Act'). The objective of the Act is to protect current and future default tariff customers. We consider protecting customers to mean that prices reflect underlying efficient costs. In doing so, we must have regard to four matters:¹¹

- the need to create incentives for holders of supply licences to improve their efficiency;
- the need to set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts;
- the need to maintain incentives for domestic customers to switch to different domestic supply contracts; and
- the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.

1.14. The requirement to have regard to the four matters identified in section 1(6) of the Act does not mean that we must achieve all of these. In setting the cap, our primary consideration is the protection of existing and future consumers who pay standard variable and default rates. In reaching decisions on particular aspects of the cap, the weight to be given to each of these considerations is a matter of judgment. Often a balance must be struck between competing considerations.

1.15. In setting the cap, we may not make different provisions for different holders of supply licences.¹² This means that we must set one cap level for all suppliers.

¹¹ Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6).
<http://www.legislation.gov.uk/ukpga/2018/21/section/1/enacted>

¹² Domestic Gas and Electricity (Tariff Cap) Act 2018, section 2(2).
<http://www.legislation.gov.uk/ukpga/2018/21/section/2/enacted>

The ECO scheme and ECO4

1.16. 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 Great Britain (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 deemed to be in fuel poverty. Each obligated supplier has an overall target, based on its share of the domestic energy market in GB, which it is obligated to meet.

1.17. The ECO scheme was first introduced in 2013 and has delivered over 3.2 million energy efficiency measures in over 2.3 million homes.¹³ There have been three previous phases of the ECO scheme, which were ECO1, ECO2 and ECO2t. The ECO3 scheme is the current policy in place, which began on 3 December 2018, and ends on 31 March 2022.

1.18. The next phase of the scheme, ECO4, is proposed to run from April 2022 until March 2026 by BEIS.¹⁴ The ECO4 scheme maintains most of the fundamental structure of the ECO3 scheme, with the continued focus on improving the least energy efficient housing stock occupied by low income and vulnerable households. BEIS said that the scheme will help keep eligible households warmer, reduce energy bills and carbon emissions.

1.19. BEIS's 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 2026.¹⁵ The proposed notional annual bill saving target for obligated suppliers is £94 million, which is to

¹³ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraphs 1-3. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

¹⁴ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraph 1-3. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

¹⁵ BEIS (2021), ECO4 consultation stage impact assessment, paragraph 65. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

be achieved by March 2026.¹⁶ BEIS has estimated that the policy could deliver an average gross saving of approximately £300 for eligible customers' dual fuel bill per year.¹⁷

The WHD scheme

1.20. The WHD scheme is a government programme with the aim of alleviating fuel poverty. Under the scheme, obligated suppliers are required to provide rebates to the energy bills of eligible low-income and vulnerable customers. The rebate is paid to eligible customers as a one-off discount during the winter months (between October and March). As part of the Industry Initiatives under the WHD scheme, obligated suppliers can currently also spend up to £40 million in total on projects to help households in need with financial and non-financial support.¹⁸ This has been proposed by BEIS to become mandatory for suppliers from 2022/23, in addition to paying rebates.

1.21. Since the introduction of WHD in 2011, the scheme has provided over £3 billion in rebates to low-income and vulnerable households.¹⁹ The government is currently consulting on extending the WHD scheme until 2026 and expanding it to reach around 3 million low-income households.²⁰ The government has committed to increase spending from £350 million to £475 million per year (in 2020 prices) meaning that around 780,000 more households will receive rebates off their energy bills each winter.²¹ For the new scheme, the rebate amount is proposed to increase to £150 from the current £140 per eligible household per year. This is to increase the support to the most vulnerable in helping them to heat their homes during the winter.

¹⁶ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraph 87. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

¹⁷ BEIS (2021), ECO4 consultation stage impact assessment, paragraph 78. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

¹⁸ BEIS (2021), Warm Home Discount: better targeted support from 2022, page 9,12. <https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>

¹⁹ BEIS (2021), Warm Home Discount: better targeted support from 2022, page 6-10. <https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>

²⁰ BEIS (2020), Energy white paper: Powering our net zero future. <https://www.gov.uk/government/publications/energy-white-paper-powering-our-net-zero-future>

²¹ BEIS (2021), Warm Home Discount: better targeted support from 2022, page 6-10. <https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>

2. Decision process

Our decision-making process

November 2021 ECO4 consultation

2.1. We published a consultation in November 2021 that set out our proposals on how we would determine the ECO4 cost allowance in the cap from cap period eight onwards. We proposed to use the latest available information from BEIS on the ECO4 scheme costs at the time we set the cap. We also consulted on how we would correct any material under or over-allowance of costs incurred in cap period eight. In the event the draft ECO4 legislation was not approved by Parliament, BEIS decided to not introduce ECO4, or the government response and updated impact assessment indicate a material change in the costs of the scheme. Stakeholders provided responses in December 2021.

December 2021 WHD consultation

2.2. We published a consultation in December 2021 on how we would determine the WHD cost allowance in the cap from cap period eight onwards. We proposed to use the latest available information from BEIS on the WHD scheme costs at the time we set the cap. We also consulted on how we would correct any material under or over-allowance of costs incurred in cap period eight in the event the draft WHD legislation is not approved by Parliament, or the government response and updated target spend indicate a material change in the costs of the scheme. Stakeholders provided responses in January 2022.

February 2022 decision and future process

2.3. This decision document sets out our decisions on how to determine the allowances for the ECO4 and WHD schemes in the cap for cap period eight onwards, starting on 1 April 2022.

2.4. The allowances will be updated for each subsequent cap period in the August and February updates.

Related publications

2.5. The main documents relating to the cap are:

- Domestic Gas and Electricity (Tariff Cap) Act 2018:
<http://www.legislation.gov.uk/ukpga/2018/21/contents/enacted>.

- Default Tariff Cap Decision:
<https://www.ofgem.gov.uk/publications-and-updates/default-tariff-cap-decision-overview>.

2.6. The main documents relating to reviewing the ECO and WHD schemes on the default tariff cap are:

- Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap ('November 2021 ECO4 consultation'):
<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>.
- Consultation on the Warm Home Discount scheme allowance methodology in the default tariff cap ('December 2021 WHD consultation'):
<https://www.ofgem.gov.uk/publications/price-cap-consultation-warm-home-discount-scheme-allowance-methodology-default-tariff-cap>.
- Design of the Energy Company Obligation ECO4: 2022-2026 ('BEIS's July 2021 ECO4 consultation'):
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>.
- ECO4 consultation stage impact assessment ('BEIS's July 2021 ECO4 consultation stage impact assessment'):
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>.
- Warm Home Discount Better targeted support from 2022 ('BEIS's June 2021 WHD consultation'):
<https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>.
- Impact assessment ('BEIS's June 2021 WHD consultation stage impact assessment'):
<https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>.

General feedback

2.7. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We would also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

Please send any general feedback comments to RetailPriceRegulation@ofgem.gov.uk.

3. Energy Company Obligation scheme allowance

Section summary

This chapter sets out our decisions on determining the ECO allowance from cap period eight onwards.

Context

3.1. As set out in our 2018 decision, we allow suppliers to recover the costs incurred due to the ECO scheme.²² We calculate the ECO cost allowance for each six-monthly cap level update, using scheme administration data from BEIS's forecast of annualised ECO scheme costs. These figures are taken from its most recent impact assessment at the time of the cap update.²³ We set the allowance to reflect the costs we would expect an obligated supplier to incur.²⁴

3.2. We have used BEIS's latest ECO3 impact assessment to determine the ECO allowance for cap period seven (October 2021 - March 2022).²⁵ However, the ECO3 scheme is due to end on 31 March 2022. BEIS has consulted on the ECO4 scheme which is proposed to commence on 1 April 2022.²⁶ BEIS will need to bring the draft legislation before Parliament for approval before the ECO4 scheme comes into force.

3.3. Therefore, we consulted on how we would determine the ECO4 allowance in the cap in our November 2021 ECO4 consultation, given the lack of a formal decision from BEIS.²⁷

²² Ofgem (2018), Decision – default tariff cap – Appendix 5 – policy and network costs.

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

²³ Ofgem (2018), Appendix 5 – Policy and network costs, Table A5.1.

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

²⁴ Energy suppliers with more than 150,000 domestic customer accounts are currently obligated to participate in the ECO scheme, subject to supply volumes.

²⁵ BEIS (2019), Final Impact Assessment, Table 8.

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

²⁶ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraphs 1-3.

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

²⁷ Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap.

<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

This is because we needed time to consult and make a decision on the ECO allowance ahead of the February 2022 cap update for cap period eight.

3.4. At the time of publication of this decision document, BEIS has yet to publish the draft ECO4 legislation and government response. BEIS has indicated its intention to publish these documents in the coming months.

Setting ECO4 costs

Context

3.5. In our November 2021 ECO4 consultation, we proposed 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.²⁸ BEIS's latest impact assessment estimated that the annual ECO4 scheme cost would be £1 billion per year across the retail market, rising with inflation, until March 2026.²⁹ BEIS has not published updates on its impact assessment of ECO4 scheme costs since our November 2021 ECO4 consultation.

Decision

3.6. We have decided to use the latest estimate of annualised scheme year ECO4 costs published by BEIS as an input 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.³⁰ This is to ensure the ECO cost allowance within the cap reflects our expectation of the efficient costs faced by suppliers.

3.7. Following our methodology set out in Annex 4, we used BEIS's latest scheme year cost to estimate an ECO4 cost allowance of approximately £38 per typical dual fuel

²⁸ Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap, paragraphs 3 and 14.

<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

²⁹ BEIS (2021), ECO4 consultation stage impact assessment, paragraph 65.

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

³⁰ BEIS (2021), ECO4 consultation stage impact assessment, paragraph 65.

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

customer per year.³¹ This has slightly increased (by £0.80) from our November 2021 ECO4 consultation proposal, as we have adjusted for inflation to uprate the annualised ECO4 scheme costs to 2022 prices.³² This is because the scheme cost that we used in our consultation was in 2021 prices. This is consistent with our approach for calculating the ECO allowance in previous cap periods.³³

3.8. A full breakdown of the estimated ECO cost allowance for electricity (single-rate and multi-register) and gas customers in cap periods seven and eight is shown in Table A1 in Appendix 1. These figures are for indicative purposes only.

3.9. We have decided not to make any other changes for setting the ECO4 costs as we consider the current methodology is sufficient for when the ECO4 scheme commences. We have decided to continue using the latest supply volumes of obligated suppliers to calculate the ECO allowance. This is because the structure of the ECO4 scheme remains similar to that of the ECO3 scheme.³⁴

3.10. In BEIS's July 2021 ECO4 consultation, it noted its intention to consult on designing and introducing a buy-out mechanism in the future.³⁵ We will consider whether there will be a material and systematic change in costs which would require us to revisit this methodology if and when the buy-out mechanism is available.

Overview of responses

3.11. In response to our November 2021 ECO4 consultation, we received responses from eleven stakeholders consisting of energy suppliers, consumer organisation and trade

³¹ The annualised cost estimate in cap period eight will be approximately £1.75 per MWh supplied for gas, and approximately £5.39 per MWh supplied for electricity. Consistent with our methodology in Annex 4, the ECO allowance would not be allocated to the standing charge.

³² Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap, paragraph 17.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

³³ Ofgem (2021), Annex 4 – Policy cost allowance methodology v1.9, tab '3e ECO'

³⁴ 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>

³⁵ 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>

bodies. Out of all stakeholders, nine agreed with our proposal to use BEIS's scheme year costs as an input to calculate the ECO allowance in cap period eight onwards.

3.12. One supplier who did not agree with our proposal commented on the carry-over costs. Another supplier mentioned the risks of Scotland withdrawing from the ECO scheme. We discuss these comments in the section below.

3.13. We received approximately 40,000 responses to our November 2021 ECO4 consultation through a petition website. Respondents commented on whether suppliers should be able to pass on additional costs onto their customers. 28,000 selected an answer that Ofgem should not be able to pass additional costs onto their customers.

Considerations

Methodology

3.14. The majority of industry stakeholders who responded to our November 2021 ECO4 consultation agreed with our proposal of using the latest available impact assessment from BEIS instead of the final stage impact assessment, given that the latter might not be finalised in time for the cap period eight decision.

3.15. We maintain this proposal. As highlighted in our November 2021 ECO4 consultation, this would ensure the ECO cost allowance within the cap continues to reflect the efficient costs faced by suppliers. We consider this is important given the costs associated with ECO4 are expected to be material.³⁶ BEIS has estimated that the annual cost to suppliers in delivering energy efficiency measures is set to increase from £640m in ECO3 to £1bn in ECO4.³⁷ Additionally, the approach of using scheme administration data is consistent with our calculation of other policy costs.³⁸

³⁶ Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap, paragraph 3 and 16.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

³⁷ BEIS (2021), ECO4 consultation stage impact assessment, paragraph 67 and Table 6.
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

³⁸ Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap, paragraph 11.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

3.16. No stakeholders commented on our proposal of using the latest supply volumes of obligated suppliers to calculate the ECO allowance. However, six stakeholders agreed with our overall approach of setting the ECO4 allowance. We have decided not to make any other changes for setting the ECO4 costs as we consider the current methodology is sufficient for when the ECO4 scheme commences.

3.17. We maintain our previous considerations from our November 2021 ECO4 consultation on the buy-out mechanism.³⁹ No stakeholders commented on this aspect of our consultation.

3.18. We received just under 40,000 responses related to our November 2021 ECO4 consultations through a petition website. Respondents commented on whether energy suppliers should be able to pass additional costs onto their customers. Of the individuals who responded, 28,000 individuals (72.5% of the total respondents) said that energy suppliers should not be able to pass additional costs onto their customers. While 2,000 individuals (5.8% of the total respondents) said they should, and 9,000 individuals (21.8% of respondents) had no views.

3.19. As set out in our 2018 decision, we set the cap to reflect forecast policy costs in the given six-month price cap period, to ensure the cap is cost reflective and reduce the risk of distorting competition in the wider market.⁴⁰ The ECO4 scheme costs are expected to be material. Additionally, under the Act, we must have regard to the ability of an efficient supplier to finance its licensed activities.⁴¹ We consider that including the ECO4 costs to reflect the costs that obligated suppliers are expected to incur is appropriate to achieve these aims.

³⁹ Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap, paragraph 21.

<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

⁴⁰ Ofgem (2018), Default Tariff Cap: Statutory Consultation, Appendix 5 – Policy and network costs, paragraph 2.1.

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

⁴¹ Ofgem (2018), Decision – Default tariff cap – Overview document, page 6.

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

Carry-over costs

3.20. Suppliers may deliver excess energy efficiency measures of up to 10% above their required ECO3 obligations to contribute towards their ECO4 obligations. They would incur costs in doing so – we refer to these as ‘excess action costs’.

3.21. One supplier said that BEIS’s impact assessment would attribute the excess action costs to ECO3 rather than to ECO4. As such it was concerned that our approach in using BEIS’s ECO scheme year cost would risk the allowance systematically understating the costs that suppliers would efficiently incur because the ECO allowance in the cap would not reflect the carry-over costs.

3.22. We are setting the ECO allowance in the cap to reflect suppliers’ obligations under ECO4 proposed by BEIS. From the perspective of the cap, it does not matter whether suppliers meet these obligations through delivery during ECO4 or through carry-over from ECO3. We note that BEIS has proposed to put in place a carry-over mechanism where suppliers will be allowed to carry-over a maximum of 10% of their ECO3 obligation.⁴²

ECO4 scheme in Scotland

3.23. One supplier mentioned that if Scotland withdrew from the ECO scheme, it could see the scheme cost from the final impact assessment not fully reflecting the costs of future supplier obligations across GB (as it would only contain the budget for England and Wales).

3.24. In BEIS’s latest impact assessment, the ECO4 scheme cost estimate is a GB-wide cost.⁴³ We note that there has been no decision to progress with the ECO4 scheme as a non-GB wide scheme before our February 2022 cap update. In addition, we note that if Scotland were to have separate rules for the ECO scheme, BEIS would expect to apportion the overall ECO4 target between Scotland and the rest of GB.⁴⁴ As a result, the efficient costs faced by obligated suppliers across GB would be reflected in the scheme cost

⁴² BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraphs 58-67. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

⁴³ BEIS (2021), ECO4 consultation stage impact assessment, paragraphs 2, 4 and 34. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

⁴⁴ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraphs 357-368. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

published by BEIS. Therefore, we consider that our approach of using the latest BEIS's ECO4 scheme year cost is appropriate to set the ECO allowance across GB.

3.25. If Scotland were to have a separate scheme after cap period eight from England and Wales, we would consider whether there were material and systematic changes which required us to revisit our methodology. If there were, then we would consult with stakeholders when the information was available, to ensure the ECO cost allowance within the cap reflected the efficient costs faced by suppliers.

Allowance correction

Context

3.26. In our November 2021 ECO4 consultation, we said that we needed to consider how we could correct for any under or over-allowance which occurred in cap period eight given the lack of formal decisions at the time of the publication.⁴⁵ We proposed to use an allowance correction mechanism in cap period nine if needed, provided that the required information would be available with sufficient time to enable us to make this amendment. This would ensure that the cap reflects the efficient costs faced by suppliers and the cap does not materially depart from an efficient level of costs.

Decision

3.27. In the event that the draft ECO4 legislation is not approved by Parliament, or BEIS decides not to introduce the ECO4 scheme, we will not provide an ECO allowance from the next cap period⁴⁶ onwards and will seek to recover the over-allowance which occurred in cap period eight. We will consult stakeholders on the specifics to deliver the allowance correction mechanism.

3.28. In addition, for the correction of the cap period eight ECO allowance, we will work with stakeholders to gather and analyse the relevant data on the ECO4 costs suppliers have incurred in cap period eight. We will consult on determining the level of efficient costs

⁴⁵ Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap, paragraph 5.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

⁴⁶ By the next cap period, we mean the cap period after any decision not to approve or introduce the ECO4 scheme

suppliers incurred in cap period eight and the level of proposed allowance correction. This will ensure that the ECO4 allowances over time in the cap incorporates the efficiently incurred ECO4 costs from cap period eight if such an event happens.

3.29. In the event that BEIS's government response or updated impact assessment indicate a material change in the costs of the ECO4 scheme after our February 2022 cap update, we have decided to use an allowance correction mechanism in the next cap period, provided the required information is available with sufficient time to enable us to make this amendment. We will consult on the level of proposed allowance correction to reflect any material under or over-allowance which only occurred in cap period eight. This is to ensure that we best reflect the efficient costs that suppliers incur in the cap.

3.30. If BEIS makes an immaterial change in the ECO4 scheme costs for the first scheme year after our February 2022 cap update, we will reflect the updated value in our calculations for the next cap update and the immaterial misalignment of costs and allowances would only last for one cap period.

Overview of responses

3.31. In responding to our November 2021 ECO4 consultation, four stakeholders supported our proposal to use an allowance correction mechanism in cap period nine to reflect any under or over-allowance in cap period eight.

3.32. Four suppliers did not agree with our proposals and said that we must not claw back any allowance already spent if the scheme did not proceed.

Considerations

Correcting allowance if the ECO4 scheme does not proceed

3.33. Three suppliers disagreed with our proposal and said that they were being encouraged by BEIS to prepare for and deliver ECO4 projects between 31 March 2022 and when the legislation would be approved by Parliament. BEIS said that this would minimise the impact on the supply chain.⁴⁷

⁴⁷ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraph 75. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

3.34. Four suppliers said that because of BEIS's indication, Ofgem must not seek to claw back any allowance which had already been reasonably spent, and instead the ECO allowance would need to reflect the true sunk cost incurred. One supplier added that customers would have benefited from early ECO4 delivery, and therefore suppliers should be able to recover these costs.

3.35. In our November 2021 ECO4 consultation we said, "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".⁴⁸ We understand that BEIS had indicated in its consultation that it would allow suppliers to deliver ECO4 eligible projects in the period between 31 March 2022 and when the ECO4 regulations come into force.⁴⁹ BEIS noted that allowing early delivery, would prevent a hiatus⁵⁰ in delivery while also minimising the impact on suppliers and the supply chain.

3.36. We recognise that suppliers may incur costs to deliver ECO4 eligible projects during the period between 31 March 2022 and when the legislation goes through Parliament by following guidance which is currently laid out in BEIS's July 2021 ECO4 consultation.⁵¹ This means that if after 31 March 2022, the draft ECO4 legislation is not approved by Parliament, or BEIS decides to not introduce ECO4 scheme, suppliers may incur costs associated with the ECO4 scheme.

3.37. Therefore, in the event of ECO4 does not proceed, will seek to recover the over-allowance which incurred in cap period eight and consult stakeholders on the specifics to deliver the allowance correction mechanism. We will work with stakeholders to gather and analyse the relevant data on the ECO4 costs suppliers have incurred in cap period eight. We will consult on determining the level of the efficient costs that suppliers incurred in cap period eight and the level of proposed allowance correction.

⁴⁸ Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap, paragraph 24.

<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

⁴⁹ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraphs 75-77.

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

⁵⁰ A hiatus would be a break in the continuity of the ECO scheme.

⁵¹ BEIS (2021), Design of the Energy Company Obligation ECO4: 2022-2026, paragraphs 75-77.

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

3.38. We would assess the typical level of efficiently incurred costs across suppliers, and we would not seek to recover these costs through an allowance correction. Individual suppliers may incur different costs, but we must set a single cap level across all suppliers.⁵² This would ensure that the ECO cost allowance within the cap continues to reflect the efficient costs faced by suppliers.

Correcting allowance if BEIS makes a material change to the ECO4 scheme costs

3.39. One supplier said that if we expected to take a clawback approach, then we should agree with BEIS that ECO4 should be delayed and make no allowance. It added that suppliers could not be expected to manage these risks, and this would fail the test of a reasonable, prudent regulator.

3.40. We would not usually have a mechanism to change the allowance for ECO4 costs in cap period eight,⁵³ if BEIS makes a material change to the ECO4 scheme costs after our February 2022 cap update. If this event happens, we will use an allowance correction mechanism in the next cap period, provided the required information is available with sufficient time to enable us to make this amendment. This is to ensure that the cap does not materially depart from BEIS's updated level of the ECO4 scheme costs. We still consider that we cannot wait until BEIS publishes its government response and draft ECO4 legislation before deciding on how we will reflect the annualised scheme costs attributed to ECO4 in the cap. Given the materiality of ECO4 costs, we consider this would risk significantly underfunding suppliers for ECO4 costs if and when the ECO4 obligations are implemented.

3.41. One supplier said that we should not prejudge hypothetical future adjustments to respond to each contingency option without another consultation. This supplier suggested that it would be appropriate for our approach to depend on the facts. A different supplier

⁵² Domestic Gas and Electricity (Tariff Cap) Act 2018, section 2(2).

<http://www.legislation.gov.uk/ukpga/2018/21/section/2/enacted>

⁵³ At the same time as this decision, we have also published a decision on the process for updating the Default Tariff Cap methodology and setting maximum charges. This would allow us to make changes to allowances outside the scheduled cap updates in certain exceptional circumstances. However, we would expect a situation to meet a number of tests for us to be able to use that mechanism.

Ofgem (2022), Price Cap – Decision on the process for updating the Default Tariff Cap methodology and setting maximum charges.

<https://www.ofgem.gov.uk/publications/price-cap-decision-process-updating-default-tariff-cap-methodology-and-setting-maximum-charges>

said that we should not later retrospectively amend our approach. It highlighted that our approach must be applied fairly without discrimination.

3.42. We will consult stakeholders before any use of the allowance correction mechanism in the event that BEIS makes a material change to the ECO4 scheme costs. This consultation would seek comments on whether the change was material and, if so, what level we should set the allowance correction at. This would provide stakeholders with an opportunity to engage with our proposals. As highlighted above, we would also assess the typical level of efficiently incurred costs across suppliers, and we would not seek to recover these costs. We are setting out our intended process in advance, so that stakeholders understand how we would proceed if we considered that an allowance correction might be necessary.

Immaterial change to the ECO4 scheme costs

3.43. If BEIS make an immaterial change in the ECO4 scheme costs for the first scheme year after our February 2022 cap update, then we will reflect the updated value in our calculations for the next cap update and the immaterial misalignment of costs and allowances would only last for one cap period. We maintain our proposal and considerations from our November 2021 ECO4 consultation.⁵⁴

Other responses

3.44. One stakeholder said that when the ECO scheme was first introduced, BEIS's impact assessment significantly under-estimated the delivery costs which led to a reduction in the policy target. This stakeholder said that these costs needed to be accounted for in the cap.

3.45. The first ECO scheme ran from 2013 to 2015 which was before the inception of the cap at the beginning of 2019. We consider that suppliers could have accounted for these costs in their tariffs at that time. Therefore, we consider the point raised as out of scope for this decision.

⁵⁴ Ofgem (2021), Consultation on the Energy Company Obligation scheme allowance methodology in the default tariff cap, paragraph 28-29
<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

3.46. One supplier said that the approach to reconcile actual and allowed costs has not been applied to other exogenous costs consistently. It said that it would welcome a reconciliation of energy supply costs for the prepayment meter (PPM) cap between its commencement in April 2017 and alignment in October 2019 with the default tariff cap, as it said that there was no reason why other over or under-exogenous costs had not been subject to previous reconciliations.

3.47. We consider this supplier's comments are not related to the decisions we are making for the ECO4 scheme allowance in the cap. Since this decision is for the ECO4 allowance only, other exogenous costs are out of scope for this decision.

4. Warm Home Discount scheme allowance

Section summary

This chapter sets out our decisions on determining the WHD allowance from cap period eight onwards.

Context

4.1. Similar to the ECO scheme, we allow suppliers to recover the costs incurred due to the WHD scheme as set out in our 2018 decision.⁵⁵ We set the allowance to reflect the costs that we would expect an obligated supplier to incur by using target spend data from BEIS's consultation on the WHD scheme.⁵⁶

4.2. We have used BEIS's target spend for WHD scheme year 2021/22 to determine the WHD allowance in the cap for cap period seven.⁵⁷ BEIS has proposed to extend and expand the WHD scheme until 2026 to protect low-income and vulnerable households by helping them to heat their homes during winter.⁵⁸

4.3. Like the ECO scheme, we consulted on the WHD allowance methodology ahead of BEIS's government response and draft legislation being published, given the lack of a formal decision and the time needed to decide on the WHD allowance for cap period eight. This is to reduce the risk of underfunding suppliers for WHD costs once the WHD policies are implemented. However, we expect that suppliers would only pay out rebates when the legislation is in force.

⁵⁵ Ofgem (2018), Decision – default tariff cap – Appendix 5 – policy and network costs.

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

⁵⁶ Energy suppliers with more than 150,000 domestic customer accounts are currently obligated to participate in the WHD scheme. We also note that in BEIS's documents, it uses 'target spend, spending target and spending envelope interactively. In this decision document we use 'target spend' for consistency.

⁵⁷ BEIS (2020), Warm Home Discount Scheme 2021/22 Extension final impact assessment, paragraph 4.

<https://www.gov.uk/government/consultations/warm-home-discount-scheme-2021-to-2022>

⁵⁸ BEIS (2020), Energy white paper: Powering our net zero future, page 17 and 109.

<https://www.gov.uk/government/publications/energy-white-paper-powering-our-net-zero-future>

Setting WHD costs

Context

4.4. In our December 2021 WHD consultation, we proposed to use BEIS’s estimate of WHD target spend of £475 million per year (in 2020 prices)⁵⁹ as the input to calculate the WHD allowance. BEIS has not published updates on its impact assessment of WHD target spend since our December 2021 WHD consultation.

Decision

4.5. We have decided to use the latest estimate of annualised WHD target spend published by BEIS as an input to calculate the WHD allowance from cap period eight onwards in ‘Annex 4 –Policy cost allowance methodology’ of SLC 28AD of the gas and electricity licences.⁶⁰ This is to ensure the WHD cost allowance within the cap reflects the efficient costs we expect suppliers to face.

4.6. Following our methodology set out in Annex 4, we used BEIS’s latest target spend cost to estimate a WHD cost allowance of approximately £19 per typical dual fuel customer per year.⁶¹ This is unchanged from our consultation proposal.⁶² A full breakdown of the estimated WHD cost allowance for electricity (single rate and multi-register) and gas customers in cap periods seven and eight is shown in Table A2 in Appendix 2. These figures are for indicative purposes only.

4.7. We have decided to not make any other changes for setting the WHD costs as we consider the current methodology is sufficient for when the WHD scheme commences. We have decided to continue using the latest number of customers of obligated suppliers to calculate the WHD allowance.

⁵⁹ BEIS (2021), Consultation stage impact assessment, paragraph 7-9.

<https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>

⁶⁰ Licence Conditions on Ofgem website.

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

⁶¹ The WHD allowance is allocated to the standing charge through the cap at the nil consumption level.

⁶² Ofgem (2021), Consultation on the Warm Home Discount scheme allowance methodology in the default tariff cap, paragraph 18.

<https://www.ofgem.gov.uk/publications/price-cap-consultation-warm-home-discount-scheme-allowance-methodology-default-tariff-cap>

Overview of responses

4.8. In response to our December 2021 WHD consultation, we received responses from eight stakeholders consisting of energy suppliers, consumer organisation and trade bodies. Out of all stakeholders, seven agreed with our proposal to use BEIS’s estimate of WHD target spend as an input to calculate the WHD allowance from cap period eight onwards.

Considerations

4.9. Two suppliers agreed with our overall approach of setting the WHD allowance. No stakeholders commented on our proposal of using the latest number of customers of obligated suppliers to calculate the WHD allowance. We maintain our proposals for using the current methodology to set the WHD allowance for cap period eight onwards. For more detail on our considerations, please see our December 2021 WHD consultation.⁶³

4.10. One supplier suggested that the current methodology gave suppliers an upfront cash boost even though the cost to suppliers of implementing the WHD scheme would not significantly affect suppliers until cap period nine. Instead, it said that we could set the cap period eight allowance at the same level as in a previous cap period. It also suggested that we could then use the cap period nine allowance to collect the difference in costs as this would prevent overcollection in cap period eight.

4.11. We have decided to not make any changes to our approach following this stakeholder comment, for the reasons set out below.

4.12. First, our methodology set out in Annex 4 allows suppliers to collect the annualised WHD allowance through two cap periods, rather than seeking to mirror when suppliers incur costs. This prevents customers from facing a bill shock in the winter period from the WHD allowance. This funding process is consistent to how energy suppliers have historically recovered WHD scheme costs through the WHD allowance in the cap.

4.13. Second, although suppliers would normally pay rebates to eligible customers in the winter months, they may incur some costs on the Industry Initiatives portion of the WHD

⁶³ Ofgem (2021), Consultation on the Warm Home Discount scheme allowance methodology in the default tariff cap, paragraph 17-21.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-warm-home-discount-scheme-allowance-methodology-default-tariff-cap>

scheme during a summer cap period. Therefore, even if the aim was to reflect the profile of suppliers' spending, we would still need to provide a WHD allowance in cap period eight.

4.14. Third, we have decided to use an allowance correction mechanism in the next cap period if required (the section below explains this in more detail). This is to ensure the cap reflects the efficient costs faced by suppliers. Therefore, we do not consider that it is necessary to set the WHD allowance low at first to avoid the risk of over-recovery.

Other responses

4.15. Two suppliers suggested that the WHD rebate value should be doubled to provide more support to the most vulnerable households, and that the additional costs should be subjected to the current Core Group Reconciliation process. One of the suppliers also suggested that the WHD scheme should be expanded to all suppliers. BEIS is responsible for the design of the WHD scheme, therefore this is a matter for BEIS and is outside the scope of our consultation decision.

Allowance correction

Context

4.16. In our December 2021 WHD consultation, we said that we needed to consider how we could correct any under or over-allowance which occurred in cap period eight given the lack of formal decisions at the time of publication.⁶⁴ We proposed to use an allowance correction mechanism in cap period nine if needed, provided that the required information would be available with sufficient time to enable us to make this amendment. This would ensure that the cap reflects the efficient costs faced by suppliers and the cap does not materially depart from an efficient level of costs.

Decision

4.17. In the event that the draft WHD legislation is not approved by Parliament or BEIS decides not to introduce the WHD scheme, we will not provide a WHD allowance from the

⁶⁴ Ofgem (2021), Consultation on the Warm Home Discount scheme allowance methodology in the default tariff cap, paragraph 5.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-warm-home-discount-scheme-allowance-methodology-default-tariff-cap>

next cap period⁶⁵ onwards and will seek to recover the over-allowance which occurred in cap period eight. We will consult stakeholders on the specifics to deliver the allowance correction mechanism. Under this event, we intend to recover the full amount of the WHD allowance provided during cap period eight, as we expect suppliers would only pay out rebates when the legislation is in force.

4.18. In the event that BEIS's government response or updated impact assessment indicate a material change in the costs of the WHD scheme after our February 2022 cap update, we have decided to use an allowance correction mechanism in the next cap period, provided the required information is available with sufficient time to enable us to make this amendment. We will consult on the level of proposed allowance correction to reflect any material under or over-allowance which occurred in cap period eight. This is to ensure that we best reflect the efficient costs that suppliers incur in the cap.

4.19. If BEIS makes an immaterial change in the WHD target spend for the 2022/23 scheme year after our February 2022 cap update, we will reflect the updated value in our calculations for the next cap update and the immaterial misalignment of costs and allowances would only last for one cap period.

Overview of responses

4.20. In responding to our December 2021 WHD consultation, three stakeholders supported our proposal to use an allowance correction mechanism in cap period nine to reflect any under or over-allowance in cap period eight.

4.21. Four suppliers expressed concerns with the allowance correction methodology, with one mentioning that any recovery of costs should reflect the additional unavoidable costs they might incur if the scheme did not proceed.

Considerations

Correcting allowance if the WHD scheme does not proceed

4.22. One supplier suggested that if notice of scheme changes were delayed then suppliers might have already started spending to deliver the schemes in a timely manner. It said that

⁶⁵ By the next cap period, we mean the cap period after any decision not to approve or introduce the ECO4 scheme.

unavoidable spend should be reflected in any future allowance correction. It mentioned that recouping an allowance would be reasonable if suppliers had received sufficient notice. It also suggested we should delay the implementation of the WHD scheme if the allowance correction would not reflect these unavoidable costs from the delayed notice as suppliers could not be expected to risk expenditure which might not be recoverable.

4.23. Suppliers spend the WHD allowance differently. We note that suppliers typically pay the WHD rebate to eligible customers as a one-off discount during the winter months (between October and March). We recognise that some suppliers may spend at least some of the Industry Initiatives⁶⁶ element of the WHD scheme before the legislation is in force. However, we expect that any such spend until legislation is approved would be small when compared to the total allowance.

4.24. One supplier commented that it was unlikely the WHD scheme would not be extended. However, it said that we should not prejudge the allowance correction and should consult further if an adjustment was required.

4.25. BEIS indicated its intention to publish a government response and lay regulations in order to ensure a scheme is in place from 2022 onwards.⁶⁷ However, we still need to set out our approach for the event that WHD scheme does not proceed. It is also our intention to use an allowance correction mechanism to correct any material under or over-allowance, if it is required (the section below explains this in more detail). This does not prejudge the outcome of BEIS's consultation process, but it will enable us to respond to different possible outcomes. We would consult stakeholders on the specific calculations to deliver the allowance correction mechanism.

Correcting allowance if BEIS makes a material change to the WHD target spend

4.26. One supplier said that if the government used the WHD scheme as a policy response to the rising energy prices, then any special WHD measures related to this crisis should be

⁶⁶ The Industry Initiatives element of the WHD scheme allows suppliers to help fuel-poor customers through third parties.

⁶⁷ BEIS (2021), Warm Home Discount: better targeted support from 2022, page 6. <https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>

reflected in the next cap period to ensure that suppliers would be able to recover their incurred costs as quickly as possible.

4.27. If BEIS were to review the target spend for the scheme year beginning April 2022 in the government response or were to update its impact assessment after our February 2022 cap update, we would not usually have a mechanism to change the WHD allowance during cap period eight.⁶⁸ For this reason, we need to consider how we will correct for any material under or over-allowance in the next cap period in this situation.

4.28. Stakeholders who agreed with our allowance correction proposals, said that the final WHD target spend could deviate from current estimates and the allowance correction mechanism would enable any material under or over-allowance to be corrected in the cap period nine. However, one supplier said that we had not defined our interpretation of material change to WHD target spend.

4.29. We maintain our view and considerations from our December 2021 WHD consultation on the allowance correction mechanism.⁶⁹ In terms of the definition of materiality, given BEIS has not published its government response, it is difficult for us to predict the materiality of the changes to the BEIS's WHD target spend. We would gather stakeholders' views on the definition of materiality once BEIS publishes its decision.

4.30. One stakeholder commented that it would be appropriate for us to be flexible on when our allowance correction approach would take place. It said that if a correction might lead to bill increases, then it could be appropriate to defer that correction to the summer cap period (cap period ten), as this may be necessary given our statutory duty to protect customers.

⁶⁸ At the same time as this decision, we have also published a decision on the process for updating the Default Tariff Cap methodology and setting maximum charges. This would allow us to make changes to allowances outside the scheduled cap updates in certain exceptional circumstances. However, we would expect a situation to meet a number of tests for us to be able to use that mechanism.

Ofgem (2022), Price Cap – Decision on the process for updating the Default Tariff Cap methodology and setting maximum charges.

<https://www.ofgem.gov.uk/publications/price-cap-decision-process-updating-default-tariff-cap-methodology-and-setting-maximum-charges>

⁶⁹ Ofgem (2021), Consultation on the Warm Home Discount scheme allowance methodology in the default tariff cap, paragraph 25 - 32.

<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

4.31. Our current methodology in Annex 4 spreads the annual WHD cost between the winter and summer cap periods, to avoid a bill shock to customers in the winter cap period. If an allowance correction led to a material increase in customers' bills, we will consult on the level of proposed allowance correction.

Immaterial change to the WHD target spend

4.32. If BEIS make an immaterial change in the WHD target spend for the 2022/23 scheme year after our February cap update, then we will reflect the updated value in our calculations for the next cap update and the immaterial misalignment of costs and allowances would only last for one cap period. We maintain our proposal and considerations from our December 2021 WHD consultation.⁷⁰

⁷⁰ Ofgem (2021), Consultation on the Warm Home Discount scheme allowance methodology in the default tariff cap, paragraph 28 - 30.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-energy-company-obligation-scheme-allowance-methodology-default-tariff-cap>

Appendices

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Appendix 1 – Detailed ECO allowance estimate

1.1 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 allowances (GB average)

	Electricity (single rate) (£)		Electricity (multi-register) (£)		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	16.72	N/A	22.66	N/A	21.05

Source: Ofgem calculations based on data from BEIS’s impact assessments.^{71, 72}

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.

⁷¹ BEIS (2019), Final Impact Assessment, Table 8.
<https://www.gov.uk/government/consultations/energy-company-obligation-eco3-improving-consumer-protection>

⁷² 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 – Detailed WHD allowance estimate

1.1 Table A2 sets out our estimate of the WHD allowance in cap periods seven and eight.

Table A2: Estimates of the annualised WHD allowances (GB average)

	Electricity (single rate) (£)		Electricity (multi-register) (£)		Gas (£)	
	Nil	TDCV	Nil	TDCV	Nil	TDCV
Cap period seven	6.98	6.98	6.98	6.98	6.98	6.98
Cap period eight	9.63	9.63	9.63	9.63	9.63	9.63

Source: Ofgem calculations based on data from BEIS’s impact assessments.^{73, 74}

Notes: Schemes costs are same at Nil and Typical Consumption Levels (3,100 kWh for electricity single rate, 4,200 kWh for electricity multi-register and 12,000 kWh for gas).

⁷³ BEIS (2021), Warm Home Discount Scheme 2021/22 Extension final impact assessment, paragraph 4.

<https://www.gov.uk/government/consultations/warm-home-discount-scheme-2021-to-2022>

⁷⁴ BEIS (2021), WHD consultation stage impact assessment, paragraph 9.

<https://www.gov.uk/government/consultations/warm-home-discount-better-targeted-support-from-2022>.

Appendix 3 – Glossary

1.1 This appendix provides a high-level definition for the relevant terms used in this decision document.

Term (Abbreviation)	Definition
Annex 4 – policy cost allowance methodology	The model which calculates the value of the policy cost allowance, used to update the level of the default tariff cap. The value is calculated by combining information on forecast trends in the costs of seven different schemes.
Business, Energy & Industrial Strategy (BEIS)	The Department for Business, Energy and Industrial Strategy (BEIS) is a ministerial department of the government of the United Kingdom.
Cap period	Cap period seven - October 2021 – March 2022 Cap period eight - April 2022 – September 2022 Cap period nine - October 2022 – March 2023
Energy Company Obligation (ECO)	The Energy Company Obligation (ECO) is a government energy efficiency scheme in Great Britain to help tackle fuel poverty and reduce carbon emissions.
Fuel poverty	BEIS defines a household as being in fuel poverty, if they are on a lower income and unable to heat their home for a reasonable cost. ⁷⁵
Impact Assessment (IA)	Impact Assessment (IA) is a tool to help explain the impact of regulatory proposals on consumers, industry participants, and social and environmental issues.
Legislation	Legislation is a law or a set of laws that have been passed by Parliament.
Multi-register	Use of one or more electricity meters for the purpose of a tariff whereby a domestic customer’s electricity consumption at certain times and/or for certain purposes (for example, heating) is separately recorded – on one or more registers.
WHD Scheme Year 11-15	Scheme Year 11 – April 2021 – March 2022. Scheme Year 12 – April 2022 – March 2023.

⁷⁵ BEIS (2021), Sustainable Warmth Protecting Vulnerable Households in England, page 7. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/960200/CCS207_CCS0221018682-001_CP_391_Sustainable_Warmth_Print.pdf

	<p>Scheme Year 13 – April 2023 – March 2024.</p> <p>Scheme Year 14 – April 2024 – March 2025.</p> <p>Scheme Year 15 – April 2025 – March 2026.</p>
Single rate	Use of one electricity meter for the purpose of a tariff whereby a domestic customer’s electricity consumption is recorded at all times and purposes and recorded on one register.
Supply volume	Supply volumes of obligated suppliers is used in the Annex 4 model to calculate the ECO allowance. The supply volumes values used are the amount of gas or electricity supplied to domestic customers as of 31 December from the previous calendar year and are measured in MWh. This information is collected from suppliers by Ofgem.
Typical Domestic Consumption Values (TDCV)	The TDCVs are industry standard values for the annual gas and electricity usage of a typical domestic consumer.
Warm Home Discount (WHD)	The Warm Home Discount (WHD) scheme is a government programme with the aim of alleviating fuel poverty. Under the scheme, obligated suppliers are required to provide rebates to the energy bills of eligible low-income and vulnerable customers.