

Marcus McPhillips
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3 February 2023

Dear Marcus,

PRICE CAP: CONSULTATION ON REFLECTING THE PLANNED ECO+ SCHEME IN THE PRICE CAP

We welcome the opportunity to respond to Ofgem's consultation on reflecting the planned ECO+ scheme in the price cap.

In summary, we agree with Ofgem's proposals to:

- include an allowance for ECO+ in the price cap from cap period 10a onwards;
- adopt a similar methodology for setting the allowance as is used for ECO4; and
- consult with suppliers on an allowance correction mechanism should plans for the ECO+ scheme materially change.

We disagree with Ofgem's proposal to:

- apply a GDP deflator to adjust for inflation; we propose using the market-based CPIH index.

We expand on these elements in more detail in Annex 1.

Wider ECO+ policy considerations

We are supportive of the planned ECO+ expansion to the existing ECO4 scheme. In the context of increased gas prices and a focus on energy efficiency, the BEIS organised ECO+ scheme will enable growing numbers of consumers to become more energy efficient and save on their energy bills.

While we recognise that decisions regarding the overall funding approach towards the proposed ECO+ scheme are not within Ofgem's remit, we would encourage Ofgem to work with Government on its funding plans for the scheme. Questions remain over how

ECO+ will be funded, and early clarity on such questions will be important to the overall success of the scheme.

We welcome the step towards Government funding of ECO+ in the first year. We have long advocated this approach since it is less regressive than funding via consumer bills. Since it is likely that, in the event the price cap drops at or below the EPG, ECO+ (along with other green levies) will revert to being funded by consumer bills under the price cap, Ofgem should work with Government to consider how the scheme could be funded by Government for its full duration, and provide clarity on any funding approach as early as possible.

As well as engaging with Government to provide clarity on ECO+ as a priority, we consider that, in the medium-term, Ofgem should also work with Government on the approach to funding 'green levies' that is being broadly considered through the fairness and affordability work that is already underway. Steps towards Government funding in this regard also offer opportunities for better promoting heat decarbonisation by addressing the current distortion whereby such policy costs fall heavily and disproportionately on electricity bills (and not on gas bills).

Yours sincerely,



Richard Sweet
Director of Regulatory Policy

**CONSULTATION ON REFLECTING THE PLANNED ECO+ SCHEME IN THE
PRICE CAP – SCOTTISHPOWER RESPONSE**

1. Introduction

Following the BEIS consultation and impact assessment on the expanded ECO+ scheme, Ofgem has published a consultation on covering the forecast scheme costs with an allowance in the price cap.

We comment below on the following aspects of Ofgem's consultation:

- Timing of the allowance
- Methodology for calculating the allowance
- Implications of ECO+ funding arrangements for price cap
- Inflation adjustment
- Allowance correction

2. Timing of the allowance

We agree with Ofgem's proposal to reflect the additional obligations ECO+ places on suppliers by including an allowance in the price cap. An ECO+ allowance will ensure that the price cap reflects an efficient supplier's underlying costs of supplying default tariff customers while secondarily supporting quick delivery of the scheme. We agree that the ECO+ allowance should be included in the cap from cap period 10a onwards, which will align with the planned implementation of ECO+ in April 2023.

We are aware of the risks associated with the launch of the ECO+ scheme – for a planned implementation by price cap period 10a (April – June 2023), Ofgem will need to give notice of the allowance to suppliers by the end of February, yet BEIS's response to its ECO+ consultation and impact assessment is only due in March. In future, it would be helpful for Ofgem to collaborate with BEIS to better coordinate ECO+ publications around key price cap dates. It may be necessary to update the price cap allowance on an exceptional basis dependent on new BEIS impact assessments – we discuss this further in Section 6 below.

There will be some risk that the scheme is not in place by April 2023, but we agree with Ofgem that it is more appropriate to prepare a period 10a allowance and accept this risk, rather than to delay the allowance until period 11a, by which time suppliers are likely to have already begun incurring ECO+ costs.

3. Methodology for calculating the allowance

Under BEIS's proposals, it will be Ofgem's role to set individual annual targets to suppliers, based on market share, and administer compliance of the scheme. We agree with the proposals to use the same methodology for setting the allowance as is already used in ECO4 and consider that Ofgem should be consistent in its approach for both schemes.

Considering the risk that the scheme is not in place by April 2023, we ask Ofgem to work with BEIS to calculate how those individual targets will be affected by a delayed launch of the scheme. It may be useful to consider the impact of a delayed launch on targets at the close of

year 1, though any changes to scoring and targeting should be communicated beforehand with suppliers.

4. Implications of ECO+ funding arrangements for price cap allowance

We agree that the inputs for the ECO+ price cap allowance should be determined from the latest publicly available information from BEIS. We note that following the Government's commitment to cover the first year's costs of the scheme via the EPG, there are different scenarios which could necessitate a significant change to the way in which ECO+ costs are reflected in the price cap.

First, suppliers must know how ECO+ costs will be covered in the event that wholesale prices fall towards or below the EPG level, ie will costs be recovered via customer bills as for ECO4, or will the Government step in with some alternative funding mechanism? This is an issue even if the price cap is at or slightly above the EPG. We note that these scenarios are looking ever more likely given the recent fall in wholesale prices.

We believe that, where the EPG no longer covers ECO+ costs, the Government should continue to cover the costs of the scheme in a progressive manner and avoid placing the burden on customer bills. If this cannot be done with direct payments between the Government and suppliers, a mechanism could be adopted to directly reimburse customers for their ECO+ costs in the price cap. (In the event that a new funding mechanism is introduced, it will be important to minimise the administrative burden for suppliers - in particular, avoiding the need for secondary administrative accounting such as is currently required for EPG or EBSS).

5. Inflation adjustment

We agree with Ofgem's proposal to apply an inflation adjustment to supplier ECO+ costs, noting that inflationary effects on costs remain significant in the current market environment. However, we disagree with the proposal to apply this adjustment using a GDP deflator. Compared to other indices, the GDP deflator tool suffers from a number of known issues related to its measurement of government output during the COVID-19 pandemic.

Indeed, the latest forecasts from the OBR demonstrate a significant divergence between the deflator and other tools.¹ It would be more appropriate for Ofgem to align the ECO+ model with other allowances in the default tariff cap and apply the CPIH index of inflation to costs, which as a market-based measure is free from the issues that affect the deflator and would prove more robust. Further, using CPIH is more likely to capture market-based inflationary pressure that corresponds to ECO+ cost rises, eg material costs.

6. Allowance Correction

Ofgem is proposing (paragraph 3.15) to "take into account any changes to costs for periods where we had already set an allowance." Under this proposal, price cap allowances could be altered to consider discrepancies in previous cap periods. There is no indication what changes this refers to, but we assume it refers to smaller discrepancies between price cap allowances and latest cost estimates, and we agree that Ofgem should alter allowances to take this into account.

¹ [Most recent OBR Economic and Fiscal Outlook, Table 1.7, Supplementary economy tables, calendar years](#)

Ofgem discusses the need for further consultation if the planned ECO+ scheme does not proceed or there is a non-budget material change in the structure of the scheme such that the price cap does not allow for efficiently incurred costs to be recovered. We agree with this proposal.

ScottishPower
February 2023