

Decision



Making a positive difference
for energy consumers

Price cap – Decision on the planned ECO+ scheme

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We published a consultation on 6 January 2023 with proposals to reflect the government’s planned Energy Company Obligation (ECO)+ scheme in the default tariff cap (‘cap’) from cap period 10a (April 2023 – June 2023) onwards. This document sets out our decisions on how and when we will include an ECO+ allowance in the cap, and our considerations on removing the allowance if the scheme does not proceed as planned.

We have carefully considered all responses to our consultation and we have published responses stated to be non-confidential alongside this decision.

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Executive Summary

On 19 July 2018, the Domestic Gas and Electricity (Tariff Cap) Act 2018 (the 'Act') came into force.¹ This legislation required the Gas and Electricity Markets Authority (GEMA) to design and implement the default tariff cap. We introduced the default tariff cap (the 'cap') on 1 January 2019, which protects households on standard variable and default tariffs (which we refer to collectively as 'default tariffs'). The cap ensures that default tariff customers pay a fair price for their energy that reflects the efficient underlying cost to supply that energy.

The Energy Price Guarantee (EPG) is a scheme where the government will pay energy suppliers the difference between what can be charged to consumers through their bills, with the unit price of electricity and gas capped by the EPG, and what would otherwise be payable under the cap.² This means that the costs in this decision relating to year one of ECO+ will be covered by government if the cap level remains higher than the EPG. If the cap level falls below the EPG level at any time before March 2024, some of these costs would be borne by customers.

The cap includes a policy cost allowance through which suppliers are able to recover costs related to their obligations under certain government programmes. One of the existing policy costs relates to the latest iteration of the Energy Company Obligation (ECO) scheme, 'ECO4', which places obligations on eligible energy suppliers to generate notional bill savings by delivering energy efficiency measures in homes.

In November 2022, the government set out plans to legislate for an additional ECO scheme, ECO+, to begin in spring 2023 and run alongside ECO4 until 2026, at a value of £1bn over three years. ECO+ is intended to deliver rapid installation of predominantly lower-cost, single energy efficiency measures to a wider pool of households as well as those on a low-income.³

¹ Domestic Gas and Electricity (Tariff Cap) Act 2018.

<https://www.legislation.gov.uk/ukpga/2018/21>

² BEIS (2022), Further background on the EPG is available here:

<https://www.gov.uk/government/publications/energy-bills-support/energy-bills-support-factsheet-8-september-2022>

³ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026.

<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

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On 6 January 2023, we published our consultation on reflecting the ECO+ scheme in the cap from cap period 10a (April 2023 – June 2023) onwards.⁴ This document sets out our decisions following our consultation.

In summary we have decided to include an ECO+ allowance in the cap from cap period 10a (April 2023 – June 2023) onwards and to calculate this allowance using the same methodological approach used to calculate the existing ECO4 allowance.

The ECO+ allowance value for cap period 10a (April 2023 – June 2023) is therefore £5.00 per typical dual fuel customer. We anticipate the allowance value will remain around £5 for cap periods 10b – 11b (July 2023 – March 2024), the other cap periods corresponding with year one of ECO+. For cap periods corresponding with year two and year three of the scheme, we anticipate the allowance will be approximately £17 per typical dual fuel customer.⁵

We consider the inclusion of an allowance to be in customers' interest. The anticipated allowance values represent a modest increase in costs which is balanced against the intended benefits of the scheme, as set out in the government's consultation stage impact assessment, to improve energy efficiency for eligible households.⁶

To include an allowance in the cap ahead of the government's legislation for the scheme means setting the allowance based on anticipated costs. We consider this appropriate as it will help ensure the cap reflects the notional supplier's underlying efficient costs of supplying default tariff customers from the outset of the scheme. It will also help facilitate quick delivery of the scheme, ensuring consumers can benefit from it at the earliest possible opportunity, as well as spreading the costs over a longer period, thus limiting the impact to customers in any single cap period.

However, we also need to allow for scenarios where, having made this decision, the scheme does not proceed or there are significant changes to it. We have therefore decided to maintain our consultation position that if the ECO+ scheme does not proceed after this decision, we will not include an ECO+ allowance in subsequent cap periods. In

⁴ Ofgem (2023), Price cap: Consultation on reflecting the planned ECO+ scheme. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

⁵ All values are measured for the benchmark typical consumption values used to set the cap (12,000 kWh for gas and 3,100 kWh for electricity).

⁶ BEIS (2022), Design of the Energy Company Obligation ECO+ Consultation Stage Impact Assessment. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

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this scenario or if there are relevant fundamental changes to the scheme, we will also consult on how to correct for any difference that arises between the allowances provided in the cap for year one of the scheme and efficient costs.

1. Introduction

Chapter summary

This chapter provides background for this decision, highlights our key decisions and sets out the structure of the document.

Background

The default tariff cap

- 1.1 The default tariff cap ('the cap') protects approximately 27 million⁷ domestic customers on standard variable and default tariffs (which we refer to collectively as 'default tariffs'), ensuring that they pay a fair price for their energy that reflects the underlying costs to supply that energy.⁸ We set the cap by considering the different costs notional suppliers face. The cap is made up of a number of allowances which reflect these different costs.
- 1.2 One of these allowances covers policy costs relating to obligations on suppliers to deliver government schemes or initiatives. These are included in 'Annex 4 – Policy cost allowance methodology' of Standard Licence Condition (SLC) 28AD of the gas and electricity licences.⁹ One of the current policy costs reflected in Annex 4 of the cap methodology relates to delivering the government's current iteration of the Energy Company Obligation (ECO) scheme, ECO4.
- 1.3 The Energy Price Guarantee (EPG) is a government scheme where suppliers are paid the difference between what can be charged to consumers through their bills and the cost of supply.¹⁰ If the cap level falls below the EPG level (currently set at £3,000 per customer from April 2023) at any time before March 2024, our expectation is some of the costs resulting from this decision would be borne by customers.

⁷ This number is up to date as of December 2022.

⁸ The cap is one of the key activities which fall within the outcome "deliver fair prices for consumers" within our draft Forward Work Programme for 2023-24. Ofgem (2022), Consultation on Ofgem's draft Forward Work Programme for 2023/24. <https://www.ofgem.gov.uk/publications/consultation-ofgems-draft-forward-work-programme-202324>

⁹ Ofgem (2023), Default Tariff Cap level 1 April 2023 – 30 June 2023 - Annex 4 Policy cost allowance methodology v1.14 - <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2023-30-june-2023>

¹⁰ BEIS (2022), Further background on the EPG is available here: <https://www.gov.uk/government/publications/energy-bills-support/energy-bills-support-factsheet-8-september-2022>

The ECO+ scheme

- 1.4 The ECO scheme began in 2013 and is a government programme to deliver energy efficiency measures in homes across Great Britain (GB). The current iteration of the scheme, ECO4, runs from 2022 – 2026 and places obligations on eligible suppliers to deliver notional bill savings through the delivery of energy efficiency measures.¹¹
- 1.5 On 28 November 2022, the then Department for Business, Energy and Industrial Strategy (BEIS) published a consultation with proposals for an additional three-year scheme, ECO+, to run alongside ECO4 until 2026.¹² The BEIS consultation document and associated consultation stage impact assessment (IA) set out that the scheme’s value is intended to be £1 billion (in 2022 prices) over the three years.¹³ It proposed the overall obligation would be divided across three mandatory annual targets, aligned with the three-year spending profiles. The scheme is intended to be GB wide and under the government’s proposals, Ofgem would administer the scheme and ensure obligated suppliers’ compliance with their annual targets, set each year based on market share.¹⁴
- 1.6 The BEIS consultation noted that from April 2023, the cost of delivering ECO+ will be included in the EPG.¹⁵ It set out that through the EPG, the government will pay energy suppliers the difference between what can be charged to customers through their bills, with the unit price of electricity and gas capped by the EPG, and what would otherwise be payable.¹⁶

¹¹ BEIS (2022), Design of the Energy Company Obligation ECO4: 2022-2026. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco4-2022-2026>

¹² BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

¹³ BEIS (2022), Design of the Energy Company Obligation: ECO+ Consultation Stage Impact Assessment, page 12, para 19. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

¹⁴ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

¹⁵ BEIS (2022), Further background on the EPG is available here: <https://www.gov.uk/government/publications/energy-bills-support/energy-bills-support-factsheet-8-september-2022>

¹⁶ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026, page 47. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

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- 1.7 As things stand, this means the costs of year one of the ECO+ scheme will be covered by government if the cap level remains higher than the EPG. However, at the time of our decision, the government has not made provision to cover the costs of year one of ECO+ in a scenario where the cap level is lower than the EPG. In this decision document, we therefore assume that should the cap level fall below the EPG level, the costs for year one of the scheme will at that point be passed on to customers directly through energy bills.
- 1.8 The government said payment arrangements for ECO+ costs in year two (2024/25) and year three (2025/26) to meet ECO+ targets will be confirmed at a later stage, alongside those for other social and environmental obligations placed on energy suppliers.¹⁷
- 1.9 The government’s ECO+ consultation closed on 23 December 2022. The department now with policy responsibility for the ECO+ scheme, the Department for Energy Security and Net Zero, intends to publish the government consultation response in spring 2023 and is aiming to have the new ECO+ regulations laid by spring 2023.¹⁸¹⁹
- 1.10 We published a consultation on 6 January 2023 setting out our proposals to reflect the planned ECO+ scheme costs in the cap.²⁰ We proposed to include an ECO+ allowance from cap period 10a onwards and set out how we intend to calculate that allowance. In view of the legislation for the scheme not yet being in place, we also outlined our proposals for what we would do if the scheme did not ultimately proceed or there were significant changes to the scheme after including an allowance in the cap.

¹⁷ BEIS (2022), Design of the Energy Company Obligation ECO+ Consultation Stage Impact Assessment, page 13, para 21. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026> and BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026, page 48. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

¹⁸BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026, page 15. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

¹⁹ For the purposes of this decision document, we refer to BEIS in relation to past events or publications (eg BEIS November 2022 consultation) and to the Department for Energy Security and Net Zero on any forward or future references.

²⁰ Ofgem (2023), Price cap: Consultation on reflecting the planned ECO+ scheme. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

Our key decisions

- 1.11 We have decided to include an ECO+ allowance in the cap from cap period 10a onwards.
- 1.12 We have decided to make this adjustment using 'Annex 4 – Policy cost allowance methodology'²¹ of standard licence condition (SLC) 28AD of the electricity and gas supply licences.
- 1.13 We have decided to use the same methodological approach to calculate the ECO+ allowance as is used to calculate the ECO4 allowance in the cap. This takes the anticipated annualised cost of the ECO+ scheme, adjusts by the relevant GDP deflator, and divides by the latest obligated supplier volumes for each fuel type to provide a cost per MWh supplied for electricity and gas.²² This is consistent with our January 2023 consultation proposals.²³
- 1.14 We have decided to use the latest publicly available annualised cost estimate of the scheme from the Department for Energy Security and Net Zero as the input for the calculation. This is currently the BEIS consultation stage IA (the latest version is dated 14 December 2022) which sets out the proposed overall cost profile of the scheme and associated obligation targets.²⁴
- 1.15 The ECO+ allowance value for cap period 10a will therefore be £5.00 per typical dual fuel customer at benchmark consumption.
- 1.16 We have decided that if the ECO+ legislation does not come into force or the government decides not to proceed with the ECO+ scheme, we will not include an ECO+ allowance in subsequent cap periods. In such a scenario, or where there are relevant fundamental changes to the scheme in the final legislation compared

²¹ Ofgem (2023), Default Tariff Cap level 1 April 2023 – 30 June 2023 - Annex 4 Policy cost allowance methodology v1.14 -3e ECO - <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2023-30-june-2023>

²² Ofgem (2023), Default Tariff Cap level 1 April 2023 – 30 June 2023 - Annex 4 Policy cost allowance methodology v1.14 – 3e ECO - <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2023-30-june-2023>

²³ Ofgem (2023), Price cap: Consultation on reflecting the planned ECO+ scheme, page 18. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

²⁴ BEIS (2022), Design of the Energy Company Obligation ECO+ Consultation Stage Impact Assessment. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

to the BEIS November 2022 consultation, we would consult on correcting any under or over allowance relating to the costs of year one of the scheme.

Structure of this decision document

1.17 This decision document is structured as follows:

- This chapter (Chapter 1) introduces and sets out the context for our key decisions.
- Chapter 2 describes our decision-making process.
- Chapter 3 sets out our decisions and associated considerations on including an ECO+ allowance in the cap from cap period 10a onwards.
- Chapter 4 sets out our decisions and associated considerations on the methodology for calculating that allowance.
- Chapter 5 sets out our decisions and associated considerations on what we will do in a scenario where, after an allowance has been included in cap period 10a, the scheme does not proceed or there are significant changes to it.
- Chapter 6 covers our impact assessment (IA) on introducing an ECO+ allowance.

2. Decision-making process

Chapter summary

This chapter summarises our decision-making process and related publications.

January 2023 consultation

- 2.1 We published a consultation in January 2023 to seek stakeholder views on reflecting the planned ECO+ scheme in the cap from cap period 10a onwards. The consultation closed on 3 February 2023.²⁵ We did not ask specific questions but sought views on our proposals relating to reflecting the ECO+ scheme in the cap.
- 2.2 We received six responses to this consultation. Two responses were stated to be non-confidential. We have published non-confidential responses on our website.²⁶

Related publications

- 2.3 The main general documents relating to the cap are:
- Domestic Gas and Electricity (Tariff Cap) Act 2018:
<https://www.legislation.gov.uk/ukpga/2018/21>
 - 2018 decision on the cap methodology ('2018 decision'):
<https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview>
 - Energy Prices Act 2022:
<https://www.legislation.gov.uk/ukpga/2022/44>
- 2.4 The main documents relating to this decision are:
- January 2023 Consultation on reflecting the planned ECO+ scheme in the price cap: <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>
 - November 2022 (BEIS) Design of the Energy Company Obligation ECO+:2023-2026: <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

²⁵ Ofgem (2023), Price cap: Consultation on reflecting the planned ECO+ scheme, page 16, para 3.1. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

²⁶ Please refer to the following link for non-confidential responses.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

- November 2022 (BEIS) Design of the Energy Company Obligation ECO+ Consultation Stage Impact Assessment:
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>
- February 2022 decision on reflecting the planned ECO4 scheme in the price cap: <https://www.ofgem.gov.uk/publications/price-cap-decision-energy-company-obligation-scheme-and-warm-home-discount-scheme-allowance-methodologies-default-tariff-cap>

The default tariff cap

- 2.5 We set the cap with reference to the Domestic Gas and Electricity (Tariff Cap) Act 2018 ('the Act'). The Act requires us to put in place and maintain the licence conditions which give effect to the cap. The objective of the Act is to protect existing and future default tariff customers. We consider protecting customers to mean that prices reflect underlying efficient costs of a notional supplier.
- 2.6 Under the Act, we must have regard to five matters when setting the cap:
- 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;
 - the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence;
 - the need to set the cap at a level that takes account of the impact of the cap on public spending.²⁷
- 2.7 The requirement to have regard to the five 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 customers who pay standard variable and default rates. In reaching decisions on particular aspects of

²⁷ Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6)(e) as inserted by Schedule 3 to the Energy Prices Act 2022. In performing the duty under section 1(6)(e) we must have regard to any information provided by the Secretary of State, or any guidance given by the Secretary of State on this matter (section 1(6A)).

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.

- 2.8 Following the passing of the Energy Prices Act 2022, those specified considerations to be taken into account include ‘the need to set the cap at a level that takes account of the impact of the cap on public spending’.²⁸ This consideration reflects the fact that while the government’s EPG is in place and is lower than the price cap level, the cap level directly affects the levels of payments by government to energy suppliers.
- 2.9 In setting the cap, we may not make different provisions for different holders of supply licences. This means that we must set one cap level for all suppliers.

General feedback

- 2.10 We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this decision. We’d 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 stakeholders@ofgem.gov.uk

²⁸ Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6)(d) as inserted by Schedule 3 to the Energy Prices Act (2022).
<https://www.legislation.gov.uk/ukpga/2018/21/section/1>

3. Inclusion and timing of allowance

Chapter summary

This chapter sets out our decisions and associated considerations on including an ECO+ allowance in the cap from cap period 10a onwards.

Context

3.1 In our January 2023 consultation we said we considered the anticipated ECO+ costs to be material and systematic.²⁹ We proposed to include an ECO+ allowance from cap period 10a onwards, noting we considered this would support delivery of the scheme and help ensure consumers start benefiting from the scheme at the earliest possible stage.³⁰

Decisions

3.2 We have decided to maintain our consultation position to include an ECO+ allowance in the cap from cap period 10a onwards.

Overview of responses

3.3 Four respondents explicitly agreed with or expressed support for our proposal to include an allowance from cap period 10a onwards, with two respondents not commenting directly on this point.

3.4 One respondent outlined their view of the importance of there being an ECO+ allowance in the cap period before the ECO+ scheme legislation is in place to ensure suppliers can recover any efficient costs incurred as a result of delivering measures early.

3.5 Another respondent commented additionally that in future it would be helpful if Ofgem collaborate with BEIS (now the Department for Energy Security and Net Zero) to better coordinate ECO+ publications around key cap updates.

Considerations

Inclusion of an allowance

²⁹ Ofgem (2023), Price cap: Consultation on reflecting the planned ECO+ scheme, page 17, para 3.6. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

³⁰ Ofgem (2023), Price cap: Consultation on reflecting the planned ECO+ scheme, page 17, para 3.8. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

- 3.6 In our 2018 decision on the design and implementation of the cap, we said: "if in the future we consider there are material systematic issues that require correction, we might modify the licence. The Act includes specific provision for us to make supplemental modifications to the licence conditions. This would allow us to make any changes required to correct how the cap was updated, if it systematically and materially departed from an efficient level of costs". We also said: "The type of specific systematic errors for which we would adjust the cap would need to be unforeseen, clear, material, and necessitate changes".³¹
- 3.7 We have applied this test when considering changes to the cap. As set out in our November 2021 wholesale consultation: "We broadly consider the case for amending the cap methodology against the test of whether a change in the costs facing suppliers is material and systematic, considering the market as a whole".³²
- 3.8 Applying that test in relation to ECO+, we consider the anticipated ECO+ costs are material and systematic, and therefore have decided they should be reflected in the cap. This is consistent with our January 2023 consultation position.

Timing of allowance

- 3.9 The government intends the ECO+ scheme to commence in spring 2023.³³ It is not known precisely when the legislation for the scheme will be brought forward or when obligated suppliers will begin delivering measures under the scheme. However, we consider including an allowance from cap period 10a onwards will ensure the cap reflects the costs we would expect an obligated supplier to incur from the outset of the scheme. We also consider it could support early delivery of the scheme, which we consider to be in consumers' interests given the scheme's intended energy efficiency benefits. It will also, we consider, help ensure eligible households can benefit from the scheme at the earliest possible stage, and provides clarity and simplicity for suppliers and consumers.

³¹ Ofgem (2018), Default Tariff Cap decision – Overview, paragraphs 3.14 and 3.16.
<https://www.ofgem.gov.uk/publications/default-tariff-cap-decision-overview>

³² Ofgem (2021), Price Cap: Consultation on the potential impact of increased wholesale volatility on the default tariff cap, page 34, para 4.16.
<https://www.ofgem.gov.uk/publications/price-cap-consultation-potential-impact-increased-wholesale-volatility-default-tariff-cap>

³³ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026, page 10.
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

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- 3.10 Additionally, including an allowance from cap period 10a is in alignment with the scheme cost profile proposed in the BEIS November 2022 consultation,³⁴ and is consistent with our approach to the ECO4 scheme.³⁵ It also ensures the costs of year one of the scheme are spread over four cap periods (cap period 10a – 11b), rather than concentrated in fewer, thus limiting the impact to customers in any single cap period.
- 3.11 While no respondents objected to our proposal, for completeness we have carefully considered the alternative option of waiting until a later cap period, after the legislation is in place, before including an allowance.
- 3.12 The next routine opportunity to add an allowance to the policy costs methodology in Annex 4 would be cap period 11a (October 2023 – December 2023). Given the legislation for the scheme may be in force for several months by this point, waiting until cap period 11a could, we consider, have an impact on obligated suppliers' willingness and ability to deliver the scheme from its outset. This would, in turn, impact how quickly consumers may see benefits from it. Given the benefits of this scheme for consumers, and the material and systematic nature of the costs, we therefore consider it to be appropriate and in consumers' interests to reflect the relevant efficient costs of a notional supplier from cap period 10a onwards.
- 3.13 Furthermore, the allowance in the cap would be misaligned with our current understanding of the cost profile for the scheme and the year one allowance would be concentrated into fewer cap periods. This could lead to a less accurate cost recovery if suppliers' customer bases changed materially between April 2023 – March 2024. On balance, we therefore do not consider this would be a preferable approach.
- 3.14 The inclusion of an ECO+ allowance in the cap ahead of the government's legislation for the scheme does, however, necessitate setting an allowance based

³⁴ BEIS (2022), Design of the Energy Company Obligation ECO+ Consultation Stage Impact Assessment page 12, para 19

<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

³⁵ Ofgem (2022) Decision on the Energy Company Obligation scheme and Warm Home Discount scheme allowance methodologies in the default tariff cap

<https://www.ofgem.gov.uk/publications/price-cap-decision-energy-company-obligation-scheme-and-warm-home-discount-scheme-allowance-methodologies-default-tariff-cap>

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on anticipated costs rather than finalised values. The associated considerations around this in relation to the cap period 10a allowance value are set out in further detail in the following chapter (Chapter 4) on the methodology.

4. Methodology

Chapter summary

This chapter sets out our decisions and associated considerations on our methodology for calculating the ECO+ allowance in the cap.

Context

4.1 In our January 2023 consultation, we proposed to use the same overarching methodology to calculate the ECO+ allowance as is used to calculate the ECO4 allowance. We proposed to use the latest publicly available annualised cost estimate of the scheme from BEIS as the scheme cost input for the calculation, and to adjust to account for inflation using a GDP deflator. For cap periods after 10a, we also proposed to take into account any changes to costs for periods where we had already set an allowance.³⁶

Decisions

4.2 We have decided to make the adjustment to include an ECO+ allowance in the cap using 'Annex 4 – Policy cost allowance methodology' of standard licence condition (SLC) 28AD of the electricity and gas supply licences. We published the changes we proposed making to Annex 4 as part of our January 2023 consultation.³⁷ These are unchanged in the Annex 4 model published in parallel to this decision as part of the cap 10a announcement and included at Appendix 2 of this document.³⁸

4.3 To calculate the ECO+ allowance, we have decided to take the anticipated annualised cost of the ECO+ scheme, adjust by the relevant GDP deflator,³⁹ and divide by the latest obligated supplier volumes for each fuel type to provide a cost

³⁶ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 18, para 3.1 – 3.3 and 3.15. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

³⁷ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme – Appendix 2 "Annex 4 Policy cost allowance methodology v1.131". <https://www.ofgem.gov.uk/sites/default/files/2023-01/Annex%20-%20policy%20cost%20allowance%20methodology.xlsx>

³⁸ Ofgem (2023), Default Tariff Cap level 1 April 2023 – 30 June 2023 - Annex 4 Policy cost allowance methodology v1.14 – 3e ECO- <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2023-30-june-2023>

³⁹ Most recent OBR Economic and Fiscal Outlook, Table 1.7, Supplementary economy tables, calendar years – currently: <https://obr.uk/efo/economic-and-fiscal-outlook-november-2022/>

per MWh supplied for electricity and gas.⁴⁰ This is consistent with the methodology used for the ECO4 allowance in the cap and consistent with our January 2023 consultation proposals.

- 4.4 We have decided to use the latest publicly available annualised cost estimate of the scheme from the Department for Energy Security and Net Zero as the input for the calculation. This is currently the BEIS consultation stage IA (the latest version is dated 14 December 2022), which sets out the proposed overall cost profile of the scheme and associated obligation targets.⁴¹
- 4.5 We have decided to maintain our consultation position that in calculating each cap period allowance after cap period 10a, we will take into account any changes to costs for periods where we had already set an allowance.⁴²
- 4.6 The ECO+ allowance value for cap period 10a will therefore be £5.00 per typical dual fuel customer.⁴³ Thereafter, we anticipate the allowance will remain around £5 for cap periods 10b – 11b (the other cap periods which correspond with year 1 of the scheme). For cap periods which align with year two (April 2024 – March 2025) and year three (April 2025 – March 2026) of the scheme we estimate this allowance will increase to approximately £17 per typical dual fuel customer.⁴⁴

Overview of responses

- 4.7 Subject to comments on adjusting for inflation, five respondents expressed broad support for our proposal to use the same overarching methodology to calculate

⁴⁰ Ofgem (2023), Default Tariff Cap level 1 April 2023 – 30 June 2023 - Annex 4 Policy cost allowance methodology v1.14 – 3e ECO - <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2023-30-june-2023>

⁴¹ BEIS (2022), Design of the Energy Company Obligation: ECO+ Consultation Stage Impact Assessment. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

⁴² Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 19, para 3.15. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

⁴³ The annualised cost in cap period 10a (under ECO+) is approximately £0.21 per MWh supplied for gas, and approximately £0.79 per MWh supplied for electricity. To reach the allowance value, we multiply the per MWh supplied by the benchmark typical consumption values used to set the cap (12,000 kWh for gas and 3,100 kWh for electricity)/1000. Consistent with our methodology in Annex 4 and approach to ECO4, the ECO+ allowance is not allocated to the standing charge.

⁴⁴ As with the cap period 10a allowance value, all values are measured for the benchmark typical consumption values used to set the cap (12,000 kWh for gas and 3,100 kWh for electricity). Anticipated allowance values for cap period 10b onwards are estimates and will take account of obligated supplier volumes at the time of setting the allowances and the appropriate GDP deflator.

the ECO+ cap allowance as is currently used for the ECO4 cap allowance. One respondent did not comment directly on this point.

- 4.8 One respondent expressed support for using the latest publicly available estimates from BEIS for the cost scheme input and for our proposal to take into account any changes to costs for periods where we had already set an allowance. Another respondent said they are supportive of each cap period taking into account any changes to BEIS's estimates on costs for the scheme.
- 4.9 Five respondents disagreed with our proposal to adjust for inflation using a GDP deflator. Three of those respondents explicitly suggested using CPIH (Consumer Prices Index including owner occupiers' housing costs) instead of the GDP deflator, broadly on the basis that they believe CPIH would be more reflective of costs faced by suppliers to deliver ECO obligations. Two respondents said Ofgem should review/conduct further analysis on its approach to adjusting to account for inflation. One respondent said Ofgem had provided no rationale for using a GDP deflator for ECO+ other than it being consistent with ECO4. One respondent did not comment on inflation adjustment proposals.
- 4.10 While no respondents commented directly on our proposed anticipated allowance value set out in our consultation, there were several comments about aspects of the government's proposed funding, budget and design of the ECO+ scheme.
- 4.11 One respondent said both ECO4 and ECO+ impact assessments significantly undervalue installation costs incurred by suppliers and coupled with concerns around using a GDP deflator to adjust for inflation, the respondent considered this is likely to result in an underfunded allowance in the cap and risks the success of the scheme's rollout. The respondent provided associated information sent in response to the BEIS November 2022 consultation.⁴⁵
- 4.12 Two respondents commented on the government's proposed 10% consumer contribution for the scheme, outlining there is a risk suppliers will be unable to obtain this contribution, particularly in view of the current cost of living pressures.

⁴⁵ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

One respondent expressed concern that cost recovery for this is not provided for in the funding mechanism for the scheme.

- 4.13 One respondent proposed including an explicit mechanism for adjusting future caps based on the efficiency of suppliers' delivery of their obligations. They outlined that any efficiency savings should be shared between the public purse and suppliers, to allow the scheme to avoid wastage and retain the incentive for suppliers to deliver more under the existing scheme budget.
- 4.14 One respondent said they were concerned about the lack of clarity provided by BEIS to Ofgem and industry on key aspects of the final policy design, noting the potential impact this could have on scheme delivery. Another respondent said in view of the risk the scheme is not in place by April 2023, Ofgem should work with BEIS to calculate how individual targets will be affected by a delayed launch of the scheme.
- 4.15 Two respondents commented on the scheme's funding. One respondent said it is essential suppliers have clarity on government's approach to year one costs in the scenario where the cap level is lower than the EPG, and that government must bring forward their consultation response. They also said clarity was required on funding for years two and three of the scheme and that they support potential for a centrally-funded scheme supported by general taxation in place of the current model of support.
- 4.16 Another respondent said they believe if 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. The respondent said clarity on any funding approach should be provided as early as possible. This respondent said Ofgem should work with government on the approach to funding green levies, and that government funding offers opportunities for better promoting heat decarbonisation by, in the respondent's view, addressing the current distortion whereby such policy costs fall heavily and disproportionately on electricity bills, and not on gas bills.

Considerations

Overarching methodology

- 4.17 We have decided to maintain the position from our January 2023 consultation and use the same overarching methodology to calculate the ECO+ allowance as is

used for the ECO4 allowance.⁴⁶ This takes the anticipated annualised cost of the ECO+ scheme and divides by the latest obligated supplier volumes for each fuel type to provide a cost per MWh supplied. Subject to comments on how we adjust for inflation as part of it, there was broad support for this overarching methodology in response to our consultation and we have not identified any other viable methodologies.

- 4.18 The approach to the cost scheme input and how we adjust for inflation as part of the methodology is discussed further below.

Scheme cost input

- 4.19 In our January 2023 consultation, we proposed to use the latest publicly available figure from BEIS at the time of determining each cap update as our scheme cost input. We have decided to maintain this position and therefore for cap period 10a, we use the annualised cost figures in the latest publicly available BEIS consultation stage IA (version dated 14 December 2022).⁴⁷
- 4.20 We have also decided to maintain our consultation position that in calculating each cap period allowance after cap period 10a, we will take into account any changes to costs for periods where we had already set an allowance.⁴⁸ This will enable us to reflect, for example, changes by government in the estimated cumulative cost of the scheme during course of the scheme's implementation (2023 – 2026).
- 4.21 In line with our January 2023 consultation, we consider this approach will help ensure the cap reflects the notional supplier's efficient costs of supplying default tariff customers for the duration of the scheme.⁴⁹ We do not anticipate that reflecting intertemporal cost changes in this way would amount to a change to the cap methodology.

⁴⁶ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 18, para 3.12. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

⁴⁷ BEIS (2022), Design of the Energy Company Obligation: ECO+ Consultation Stage Impact Assessment, page 12, para 19. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

⁴⁸ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 19, para 3.15. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

⁴⁹ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 19, para 3.15. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

Adjusting for inflation

- 4.22 The BEIS November 2022 consultation stage IA said the proposed annual budgets for the scheme (£130m, £435m and £435m) “are increased in line with inflation so that total scheme spend over the three years equates to £1 billion in today’s prices. The inflation adjustment has used the HM Treasury’s GDP deflator series: [50]”.⁵¹
- 4.23 The GDP deflator is a measure of general inflation in the domestic economy. The GDP deflator is a broader price index than the Consumer Prices Index (CPI), CPIH, the Retail Price Index (RPI) or the Producer Price Index (PPI) as it reflects the prices of all domestically produced goods and services in the economy. The GDP deflator also includes the prices of investment goods, government services and exports, and excludes the price of UK imports. This wider coverage of the GDP deflator makes it more appropriate for deflating public expenditure series. The GDP deflator is currently used for specific cap allowances, for example where we need to forecast future inflation or where the allowance is subject to specific scheme rules (eg the existing ECO4 scheme).
- 4.24 As outlined in para 4.9, five respondents to our consultation disagreed with our proposal to use a GDP deflator to adjust to account for inflation in our ECO+ allowance calculation. CPIH was commonly suggested as more appropriate inflation measure to use, broadly on the basis that respondents believed CPIH is more reflective of the cost rises relevant to ECO+, such as the cost of materials.
- 4.25 We have carefully considered the arguments advanced in each response received. We consider that for us to adjust the annualised scheme costs using a different inflation measure to the measure used by government, the allowance in the cap could become materially misaligned with the intended overall annual value of the scheme and the associated notional bill savings targets. Given the proposed payment arrangements for the scheme, this could have the effect of the cap allowance unilaterally determining the value of the scheme.

⁵⁰ Link in quote is - <https://www.gov.uk/government/collections/gdp-deflators-at-market-prices-and-money-gdp>

⁵¹ BEIS (2022), Design of the Energy Company Obligation: ECO+ Consultation Stage Impact Assessment, page 12, para 19, footnote 19.
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

- 4.26 Additionally, while we note the evidence presented in response to our consultation, we consider the best estimate of scheme costs and design, including the approach to adjusting the overall budget for inflation, remains the BEIS November 2022 consultation and associated consultation stage IA.⁵² We do not consider it feasible or appropriate to seek to develop our own estimates on proposed scheme costs and inflation impacts.
- 4.27 For these reasons, we have decided to maintain our consultation position to use the GDP deflator to adjust the annualised cost of the scheme (the cost scheme input) for inflation in our ECO+ allowance methodology.⁵³ For cap period 10a, the relevant deflator to be used is the latest forecasted FY 2023/2024 deflator (3.2%) given the base year for the scheme is 2022/2023.⁵⁴ This is consistent with how the government intends to apply the GDP deflator.
- 4.28 The Department for Energy Security and Net Zero will have the opportunity to respond to any similar points on inflation adjustment and scheme costs made in response to the BEIS November 2022 consultation.
- 4.29 Finally, one respondent to our consultation said it was unclear why we considered 2.8% deflator to be an accurate and sufficient measure by which to uplift costs, referring to Annex 4 model v1.131.⁵⁵ The 2.8% deflator value was used in the ECO4 allowance calculation for cap periods 9a and 9b. For clarity, the relevant GDP deflator value for ECO4 and ECO+ are determined separately given the different base years for each scheme.

Scheme design, implementation, and funding

- 4.30 There were several comments from respondents expressing concern about aspects of the government's proposed scheme costs, design, implementation and

⁵² BEIS (2022), Design of the Energy Company Obligation: ECO+ Consultation Stage Impact Assessment. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

⁵³ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 18, para 3.13. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

⁵⁴ Most recent OBR Economic and Fiscal Outlook, Table 1.7, Supplementary economy tables, calendar years – currently: <https://obr.uk/efo/economic-and-fiscal-outlook-november-2022/>

⁵⁵ Ofgem (2023), Annex 4 Policy cost allowance methodology v1.131. <https://www.ofgem.gov.uk/sites/default/files/2023-01/Annex%20%20-%20policy%20cost%20allowance%20methodology.xlsx>

funding, and the consequential impact that would have on suppliers' ability to meet the proposed obligation targets.

- 4.31 From responses to our consultation, we know many of the same or similar points about the government's proposals were made in response to the BEIS November 2022 consultation.⁵⁶ The Department for Energy Security and Net Zero will have the opportunity to consider and substantively respond to these points in their consultation response. We consider it is appropriate that that response is the primary mechanism for doing so rather than this decision about the cap allowance.
- 4.32 Furthermore, as with our consideration on adjusting for inflation, we do not consider it is feasible or appropriate for us to seek to develop our own estimates on proposed scheme costs or the proposed obligations targets. We consider the best estimate of scheme costs and design and associated proposed obligation targets remains the BEIS November 2022 consultation and associated consultation stage IA.⁵⁷
- 4.33 There were also comments from two respondents about the funding source of the scheme, and specifically the interaction between the costs of the scheme and the EPG. Decisions on the EPG and scheme funding lie with the Department for Energy Security and Net Zero and HM Treasury. We do not consider this interaction precludes inclusion of an ECO+ allowance from cap period 10a onwards as regardless of whether the costs are covered by the EPG or by customers, the allowance calculation would remain the same.

Cap allowance value for cap period 10a

- 4.34 To calculate the cap period 10a allowance, we have taken the anticipated annualised scheme cost (£130m⁵⁸) from the latest publicly available BEIS consultation stage IA, adjusted by the relevant GDP deflator in line with the

⁵⁶ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

⁵⁷ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026 and Consultation stage IA <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

⁵⁸ BEIS (2022), Design of the Energy Company Obligation: ECO+ Consultation Stage Impact Assessment, page 12, para 19. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

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government’s intention for how the scheme costs will account for inflation, and divided by the latest obligated supplier volumes for each fuel type to provide a cost per MWh supplied for electricity and gas.⁵⁹

- 4.35 The cap period 10a allowance value is therefore £5.00 per typical dual fuel customer.⁶⁰ A breakdown of the ECO+ cost allowance for electricity (single-rate and multi-register rate) and gas customers in cap period 10a is shown in Table A1 in Appendix 1.
- 4.36 We anticipate the allowance value will remain around £5 for cap periods 10b – 11b (the other cap periods which correspond with year one of the scheme). For cap periods corresponding with year two (2024/2025) and year three (2025/2026) of the ECO+ scheme, we anticipate the allowance value will be approximately £17 per typical dual fuel customer.⁶¹

Annex 4

- 4.37 We are making this adjustment using ‘Annex 4 – Policy cost allowance methodology’ of standard licence condition (SLC) 28AD of the electricity and gas supply licences. We published the changes we proposed making to the annex alongside our January 2023 consultation.⁶² These are unchanged in the Annex 4 model published in parallel with this decision as part of the price cap 10a announcement.⁶³

⁵⁹Ofgem (2023), Default Tariff Cap level 1 April 2023 – 30 June 2023 - Annex 4 Policy cost allowance methodology v1.14 – 3e ECO- <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2023-30-june-2023>

⁶⁰ The annualised cost in cap period 10a (under ECO+) is approximately £0.21 per MWh supplied for gas, and approximately £0.79 per MWh supplied for electricity. To reach the allowance value, we multiply the per MWh supplied by the benchmark typical consumption values used to set the cap (12,000 kWh for gas and 3,100 kWh for electricity)/1000. Consistent with our methodology in Annex 4 and approach to ECO4, the ECO+ allowance is not allocated to the standing charge to the standing charge.

⁶¹ As with the cap period 10a allowance value, all values are measured for the benchmark typical consumption values used to set the cap (3,100 kWh for electricity and 12,000 kWh for gas). Anticipated allowance values for cap period 10b onwards are estimates and will take account of obligated supplier volumes at the time of setting the allowances, and the appropriate GDP deflator.

⁶² Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme – Appendix 2 “Annex 4 Policy cost allowance methodology v1.131”.
<https://www.ofgem.gov.uk/sites/default/files/2023-01/Annex%20%20-%20policy%20cost%20allowance%20methodology.xlsx>

⁶³ Ofgem (2023), Default Tariff Cap level 1 April 2023 – 30 June 2023 - Annex 4 policy cost allowance methodology v1.14 – 3e ECO - <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-april-2023-30-june-2023>

ECO4

4.38 Our January 2023 consultation was explicitly about reflecting the ECO+ scheme only in the cap. We said that we did not propose to make any changes to our approach for setting the ECO4 costs as we consider the current methodology is appropriate and sufficient. We therefore consider comments relating to ECO4 to be out of scope of this decision.

5. Exceptional allowance correction

Chapter summary

Having decided to include an allowance from cap period 10a onwards, this chapter sets out our decisions for our approach in scenarios where there are significant changes to the scheme in year one eg the scheme does not proceed.

Context

- 5.1 In our January 2023 consultation we proposed that if the ECO+ draft legislation does not come into force, or the government decides not to proceed with the ECO+ scheme after an allowance is included in the cap, we would not include an ECO+ allowance in subsequent cap periods.⁶⁴
- 5.2 We also said that if the anticipated costs for year one of the ECO+ scheme change, either because the scheme does not proceed or because there are material non-budget changes to the structure of the scheme, there would be a difference between the allowances provided in the cap and efficient costs. In this scenario, we said we would consult on how to correct for this difference and that the consultation would set out the precise nature of how we would seek to correct the allowance and the proposed level of correction, with a view to including the correction allowance as soon as is feasible.⁶⁵

Decisions

- 5.3 We have decided to maintain our consultation position that if, after including an ECO+ allowance in the cap, the ECO+ legislation does not come into force or the government decides not to proceed with the ECO+ scheme, we will not include an ECO+ allowance in subsequent cap periods.
- 5.4 We have also decided that if a material difference between the year one allowances provided in the cap and efficient costs arises, either because the scheme does not proceed (eg because the legislation does not come into force) or there are relevant fundamental changes to the scheme in the final legislation compared to the BEIS November 2022 consultation proposals, we would consult

⁶⁴ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 22, para 4.1. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

⁶⁵ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 22, para 4.2. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

on how to correct for this difference. That consultation would outline the precise nature of how we would seek to correct the allowance and the proposed level of correction, with a view to including the correction allowance as soon as is feasible.

Overview of responses

5.5 Four respondents to our January 2023 consultation commented directly on our allowance correction proposals.⁶⁶ Three respondents expressed support or agreement with our proposal to consult with suppliers when correcting any under or over allowance. One of those respondents said it is important to also ensure, in the event the legislation is delayed or fails, that any costs incurred by suppliers from April 2023 are recoverable.

5.6 One respondent said their reading of the proposal was that if the notionally efficient cost of delivering obligations reduced, the allowance would later be corrected downwards via this exceptional allowance correction. The respondent instead proposed including an explicit mechanism in the cap to incentivise efficiency improvements, whereby suppliers could keep 50% of any efficiency savings relative to the current expected costs of delivering obligations.

Considerations

5.7 While we consider it appropriate to include an allowance from cap period 10a onwards, ahead of legislation for the scheme, we equally need to ensure the cap does not materially depart from a notionally efficient level of costs.

5.8 Therefore, as a first step, if the ECO+ legislation does not come into force, or the government decides not to proceed with the ECO+ scheme after this decision, we would not include an ECO+ allowance in subsequent cap periods. The timing of this exclusion would be determined by having sufficient certainty and notice of the scheme not proceeding ahead of the relevant cap update announcement date.

5.9 We also consider it is necessary to have provision to correct any under or over allowance in the event the ECO+ scheme does not proceed or there are relevant

⁶⁶ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme, page 22. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

fundamental changes to the scheme in the final legislation compared to the BEIS November 2022 consultation.

- 5.10 We consider, as set out in our January 2023 consultation, that we cannot pre-emptively state the amount of the correction allowance required for a scenario where the scheme does not proceed.⁶⁷ Instead, we would work with stakeholders to gather and analyse the relevant data on the ECO+ costs suppliers had incurred to inform the proposed scale of correction. This would allow us to take account of, for example, any reasonably incurred costs by a notionally efficient supplier given the government’s statements on early delivery of the ECO+ scheme.⁶⁸ We consider this reflects the point made in response to our consultation about incurred costs in case there is a delay to the scheme.
- 5.11 Similarly, we consider we cannot pre-emptively define all of what would be considered a relevant fundamental change to the scheme, or the proposed amount of the correction in such a scenario. However, this could relate to, for example, a change in the government’s intention for the scheme’s payment arrangements which impacts on the cap allowance. We would consider these on a case-by-case basis and as set out above, we would work with stakeholders to gather and analyse the relevant costs data to inform the scale of any correction.
- 5.12 There are, however, key principles which would inform our consideration around any exceptional allowance correction. These are:
- As we must set a single cap level across suppliers, any correction would seek to reflect the average position of a typical, notionally efficient supplier. Therefore, any correction would not necessarily match individual suppliers’ costs.
 - We would seek to make the correction in the earliest possible cap period subject to the required information being available and having sufficient time to enable us to make the amendment. We consider a prompt

⁶⁷ Ofgem (2023), Price Cap: Consultation on reflecting the planned ECO+ scheme page 23, para 4.6. <https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-planned-eco-scheme>

⁶⁸ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026 page 15. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

correction would provide certainty for suppliers and customers, without significant drawbacks.

- 5.13 This exceptional allowance correction provision is intended to only apply to year one scheme costs in scenarios where the legislation does not come in to force as anticipated, or where there are relevant fundamental changes to the scheme in the final legislation relative to the BEIS November 2022 consultation.
- 5.14 With regards to the proposal to include an explicit mechanism to share efficiency savings between the public sector and suppliers, as noted in para 2.5, we consider protecting customers to mean that prices reflect underlying efficient costs of a notional supplier. As set out in the BEIS November 2022 consultation, the ECO+ scheme will be designed to incentivise obligated energy suppliers to negotiate the best value for money deals with supply chain installers, in order to maximise their own profitability.⁶⁹ We therefore consider that suppliers are already incentivised to improve their efficiency relative to the benchmark of a notional supplier when delivering ECO+, and therefore introducing an explicit efficiency adjustment mechanism is neither necessary nor appropriate.

⁶⁹ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026, page 47. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

6. Impact assessment

Chapter summary

In this chapter, we summarise how we assess the impact of introducing an ECO+ allowance from cap period 10a onwards.

Context

- 6.1 As outlined in Chapter 2, we act with a view to protect existing and future consumers who pay standard variable and default rates. In doing so we must have regard to the five matters identified in section 1(6) of the Act in our decision-making process.
- 6.2 In reaching our decisions, we have been mindful of the trade-offs between customers' interests in minimising the immediate impact on energy bills, and their interests in ensuring resilient suppliers who can efficiently manage risks. As part of our decision-making, we conducted an impact and equalities assessment.
- 6.3 We carried out three assessments of the impacts of introducing an ECO+ allowance in the cap from cap period 10a onwards:
- High-level qualitative analysis: we assess the potential impact of including an ECO+ allowance in the cap on default tariff customers and suppliers.
 - Bill impact analysis: we assess the potential impact on bills for a number of different representative domestic users in relation to year one of the scheme.
 - Potential impact on public spending duty.

High level qualitative assessment

Overview of policy rationale

- 6.4 If we did not include an ECO+ allowance in the cap, then there would be no alternative mechanism for suppliers to recover their costs in meeting the proposed obligations relevant to default tariff customers. We consider obligated suppliers would therefore be unlikely to begin to seek to meet the proposed obligations, and consequently consumers would not see the intended benefits of the scheme quickly, if at all. We therefore consider it is appropriate to reflect the proposed costs of the ECO+ scheme in the cap.

Assessment

- 6.5 We focus this assessment on the customer and supplier impacts of the factual scenario of introducing the ECO+ allowance in the cap, against the main counterfactual scenario of not introducing one.
- 6.6 In the factual scenario, suppliers will be able to fully recover the efficient costs of a notional supplier. We consider this would allow obligated suppliers to meet the costs of delivering their obligations under the scheme, manage financial risk, and in extreme circumstances reduce the risk of exits.
- 6.7 Customers will experience a modest increase in their energy bills (ie an increase in the cap level), although the impacts might be partly mitigated by the EPG. However, we consider that the cost impact of including an allowance in the cap should be balanced against the expected benefit of energy efficiency measures delivered through the ECO+ scheme for eligible households, including those on lower incomes. We have had regard to the BEIS November 2022 consultation and consultation stage IA which note the intention for the scheme to deliver rapid installation of energy efficiency measures to a wider pool of households, including those on the lowest incomes and those in the least energy efficient homes in the lower council tax bands.⁷⁰
- 6.8 The main counterfactual scenario has lower immediate costs for customers than the factual scenario. However, if we do not include an allowance in the cap, there would be no mechanism for obligated suppliers to recover their efficient costs. This either will increase suppliers' financing risk, or they will not deliver the anticipated customer benefits from the scheme related to improved energy efficiency for eligible households. In light of the above qualitative assessment, we therefore consider the net benefits of an allowance to outweigh the costs.

Bill impact analysis

- 6.9 We have carried out a distributional analysis of the ECO+ cap allowance for the cap periods corresponding with year one of the scheme (cap periods 10a – 11b) on customer energy bills. We have limited this analysis to year one costs of the scheme, given the government's position that payment arrangements for ECO+

⁷⁰ BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026.
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

costs in year two and year three will be confirmed at a later stage, alongside those for other social and environmental obligations placed on energy suppliers.⁷¹

6.10 It is difficult to determine precisely how much customers would pay due to the uncertainty around the price cap level (resulting from wholesale price volatility) and its interaction with the EPG level (currently set at £3,000 between April 2023 and March 2024). We have therefore assumed two scenarios to assess the range of potential impacts:

- Scenario 1: The year one allowance is covered by the EPG in cap period 10a, but not in cap periods 10b – 11b.
- Scenario 2: The year one allowance is fully covered by the EPG.

Scenario 1

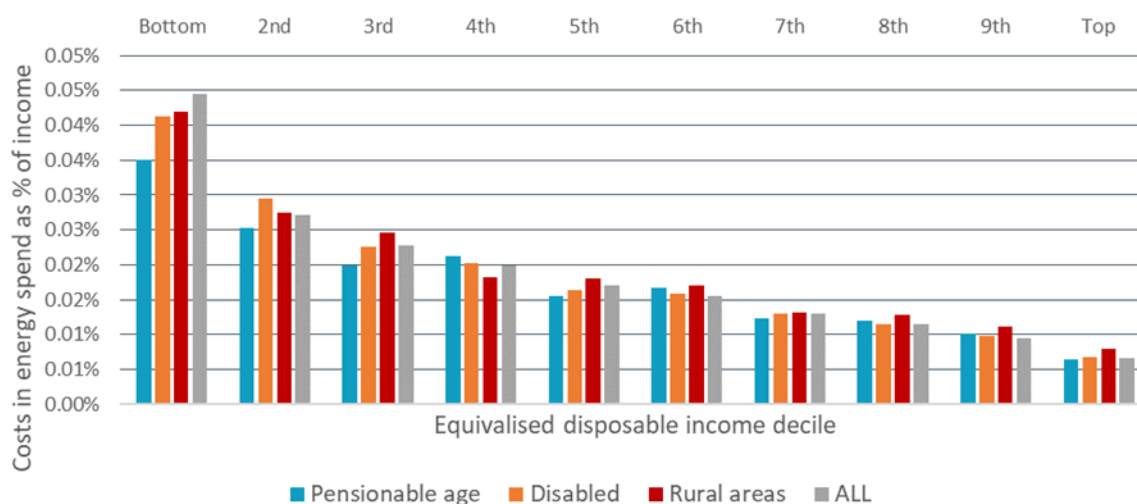
6.11 In this scenario, the ECO+ allowance corresponding with year one of the scheme would be recovered over a 12-month period. We have assumed only the scheme year one allowance in cap period 10a would be covered by the EPG, with the costs borne by consumers through their bills in the remaining cap periods corresponding with year one of the scheme (cap period 10b – 11b - July 2023 – March 2024). Figure 2 shows the distributional analysis based on current estimates of the ECO+ cap period 10b – 11b (July 2023 – March 2024) allowance value.

6.12 We have had particular regard to the interest of individuals who are disabled or chronically sick; pensionable age; of low incomes; and residing in rural areas.

⁷¹ BEIS (2022), Design of the Energy Company Obligation ECO+ Consultation Stage Impact Assessment, page 13, para 21. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026> and BEIS (2022), Design of the Energy Company Obligation (ECO): 2023-2026, page 48. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

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Figure 2: Estimated impact of the ECO+ allowance being borne by customers in cap periods 10b – 11b, by categorical group.



The bar graph shows the change in energy expenditures as a percentage of income following the introduction of an ECO+ allowance for pensionable age, rural area, disabled, and all customers. It indicates that those in the equivalised bottom income decile will incur the highest costs.

- 6.13 The inclusion of an allowance costs customers at the lower end of the income distribution more on a relative income basis (approximately 0.05% of average incomes in the bottom income decile), while it costs customers at the top of the income distribution less. There is variance in which categorical group is impacted most within each decile.
- 6.14 Under the Equality Act 2010 we are required to have regard to the public sector equality duty and consider how our policies or decisions affect people who are protected under that Act.⁷² The allowance would be an increased immediate cost for customers, including those with protected characteristics. However, this needs to be balanced against the potential benefit to be derived by eligible households from the scheme, such as improved energy efficiency and ultimately bill savings in the longer term. In this regard, we have noted Chapter 7 of the BEIS consultation stage IA in particular which sets out the government’s equality and distributional analysis for the proposed scheme.⁷³
- 6.15 Furthermore, if the costs of the scheme are not recovered or recoverable by suppliers, it could increase the risk of supplier failure and could lead to a later

⁷² Equality Act 2010 - <https://www.legislation.gov.uk/ukpga/2010/15/contents>

⁷³ BEIS (2022), Design of the Energy Company Obligation: ECO+ Consultation Stage Impact Assessment, page 25, Chapter 7. <https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

adjustment, to be borne by future customers, including those with protected characteristics.

Scenario 2

- 6.16 This scenario assumes the cap level remains above the EPG level for the duration of year one of the scheme. Since the EPG has been extended until the end of March 2024, all of year one costs for ECO+ would therefore fall within the period in which the EPG is in place.
- 6.17 If the price cap remains above the current expected EPG levels (currently set at £3,000 per customer from April 2023), we consider the direct impact of the allowance on customers' energy bills would likely be neutral until April 2024, since the recovery of ECO+ costs would not directly affect how much the customer would pay. In these circumstances, we do not expect the allowance reflecting the costs of year one of the ECO+ scheme to have a substantial impact on customers, including those with protected characteristics.
- 6.18 We recognise, however, that while this scenario will have a relatively small impact on energy bills, any costs absorbed by the EPG will ultimately impact taxpayers who are also domestic energy customers as well.

Impact on public spending

- 6.19 We are required to exercise our functions under the Act with a primary focus on protecting customers on default rates, while having regard to specified considerations (see s. 1(6) of that Act). Following the coming into force of the Energy Prices Act 2022, those specified considerations include "the need to set the cap at a level that takes account of the impact of the cap on public spending".⁷⁴
- 6.20 This consideration reflects the fact that, while the government's EPG is in force, the cap level affects the levels of payments by government to energy suppliers. For example, if the cap level remains above the EPG, the cost of the ECO+ allowance would be covered by the government. As a scheme proposed by government, at a value set by government and with a consultation stage IA

⁷⁴ Domestic Gas and Electricity (Tariff Cap) Act 2018, section 1(6)(d) as inserted by Schedule 3 to the Energy Prices Act (2022).
<https://www.legislation.gov.uk/ukpga/2018/21/section/1>

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setting out the government’s view on associated benefits, we consider including an ECO+ allowance in the cap is consistent with the government’s expectation of public spending.

6.21 We have provided the opportunity for the Department for Energy Security and Net Zero and HM Treasury to provide representations on the impact of any aspect of our proposed decision on public spending, having regard to the new consideration in the Act. We did not receive any representations from the Department for Energy Security and Net Zero or HM Treasury. We therefore sought confirmation from both that they did not have any representations. The Department for Energy Security and Net Zero has confirmed that they do not have any representations to make. The Treasury has not provided such confirmation, but we consider that they have been provided with appropriate opportunity to make representations.

6.22 Table 6.1 shows our estimate⁷⁵ of the potential impact of this decision on government spending for each cap period where the EPG level remains below the price cap level. We do, however, note that even if this cost is paid for by the exchequer, then it will ultimately impact taxpayers who are also domestic energy customers as well.

Table 6.1: Estimated impact on public spending for cap periods where the cap level is above the EPG level.

Cap period	Cost per individual cap period
10a (April 23 – June 23)	£22m
10b (July 23 – September 23)	£16m
11a (October 23 – December 23)	£34m
11b (January 24 – March 24)	£39m

6.23 If the price cap level were to fall below the EPG level in any cap period between April 2023 – March 2024, then the cost to the exchequer would be £0 in each of the relevant cap periods. The costs set out in table 6.1 would instead be borne by default tariff customers only.⁷⁶

⁷⁵ We have calculated this by weighting the allowance with quarterly gas and electricity demand shares from Annex 2. We have also assumed that the number of default tariff credit customers is constant throughout the recovery period of our allowance using numbers from the October 2022 customer account and tariff RFI. Ofgem (2022), Annex 2 – Wholesale cost allowance methodology v1.13, tab 3b. <https://www.ofgem.gov.uk/publications/default-tariff-cap-level-1-october-2022-31-december-2022>

⁷⁶ We have only included default tariff customers in our calculation of the estimated impact on public spending since they are the customer base affected by this decision.

6.24 We consider this decision appropriately takes into account the impact the proposed changes may have on public spending. Overall, the adjustment being made is no more than reasonably justified having regard to the consideration of enabling suppliers to recover efficient costs of supplying energy. Furthermore, enabling suppliers to recover the efficient costs of their supply activities reduces the risk of suppliers failing and becoming insolvent, which can impact public spending (such as through the cost to the taxpayer of a special administration regime).

Appendices

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Appendix 1 – ECO+ allowance value - cap period 10a

Table A1 sets out the ECO+ allowance value in cap period 10a.

Table A1: Annualised ECO+ scheme costs (GB average) in cap period 10a

	Electricity (single rate) (£) Nil	Electricity (single rate) (£) TDCV	Electricity (multi- register rate) (£) Nil	Electricity (multi- register rate) (£) TDCV	Gas (£) Nil	Gas (£) TDCV
Cap period 10a	N/A	2.44	N/A	3.30	N/A	2.56

Source: Ofgem calculations based on data from BEIS' consultation stage impact assessment.⁷⁷

Notes: Benchmark 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. To reach the values in table A1, we multiply the per MWh supplied values by the relevant TDVC/1000.

⁷⁷ BEIS (2022), Design of the Energy Company Obligation: ECO+ Consultation Stage Impact Assessment, page 12, para 19.
<https://www.gov.uk/government/consultations/design-of-the-energy-company-obligation-eco-2023-2026>

Appendix 2 – Annex 4 policy cost allowance methodology v1.14

Attached separately