Email: priceprotectionpolicy@ofgem.gov.uk
Date: 25 September 2025

Dear Jess Skilbeck,

Ofgem's response to price cap aspects of DESNZ's consultation on extending the ECO4 end date

We welcome the opportunity to provide Ofgem's views on proposals for extending the ECO4 end date[1]. This response deals with price cap related aspects of the proposed extension and the interaction with our own Cost Allocation and Recovery Review[2]. We are particularly supportive of the potential inclusion of ECO4 cost recovery within the extension in a manner that does not lead to net bill increases to consumers. We consider it an important principle in protecting existing and future consumers that reasonable and efficiently incurred costs can be recovered by suppliers to facilitate a stable and investable market, while having regard to the need to support the UK's net zero targets.

Wider consideration of energy system cost allocation

The issue of ECO4 extension and cost-recovery links closely to our wider work exploring how energy system costs should be paid for by consumers. As part of our Cost Allocation and Recovery Review, we are considering the principles and options of how we allocate the evolving mix of costs in the system to test whether there are fairer and more efficient ways of doing it.

[1] DESNZ (2025) Extending the ECO4 end date - https://www.gov.uk/government/consultations/extending-the-eco4-end-date.
[2] Ofgem (2025) Energy system cost allocation and recovery review - https://www.ofgem.gov.uk/call-for-input/energy-system-cost-allocation-and-recovery-review.

Any continuation of the supplier obligation model for scheme cost pass through should be considered in the context of a price cap which must be applied universally across the market. This is because the price cap legislation requires that we only set one cap across the suppliers in the market. Therefore, unlike our powers which govern how we set allowed revenues for network companies (i.e. under RIIO), we may not set a price cap differentially for suppliers to account for variations in efficient costs. Instead, the cap reflects the underlying cost of supplying energy based on a notionally efficient supplier. As the price cap currently covers more than 60% of domestic customers it is therefore important when setting the level of the cap, that we are able to reflect the efficient costs of suppliers fulfilling regulatory obligations under government schemes.

To date, for ECO4 we have relied upon the Department's published impact assessment to make this judgement. However, such an approach, can cause challenges where the costs of the policy either depart from estimates or vary significantly across suppliers. Given the scale of policy costs on the bill relative to supplier margins these issues can have a material impact on financial performance. Where this is due to suppliers' own performance then that may be appropriate, but where it is not, then it may impact the investability of the sector.

We consider there is merit in exploring whether alternative mechanisms *may* improve the effectiveness of scheme cost allocation – ensuring funds can more accurately reflect efficiently incurred costs for those involved parties. This may include placing obligations on other parts of the energy system (such as network companies) or other reforms to cost allocation. Ensuring a stable and investable sector is paramount for a resilient energy system and for the protection of consumers overall.

Consideration of ECO4 costs within an extension

We strongly welcome DESNZ's consideration of cost recovery for ECO4 within the design of the scheme extension. As you are aware, over recent months we have been conducting a review of the allowances provided in the price cap for ECO4 against the reported costs incurred by obligated suppliers. The primary focus of this review is to assess whether the price cap allowances for ECO4 continue to reflect the efficient costs of suppliers delivering the scheme. Based on the information currently available to us, our assessment so far indicates that there has been a departure between ECO4 costs and cap allowances to date, but acknowledge that this has varied across suppliers and that there is also mounting evidence of widespread quality issues with installations, resulting in some uncertainty over compliance with the scheme and contributions to targets.

While we note that this divergence is largely a historic issue, since current year scheme costs have fallen to be broadly in line with allowances, and that regard must be given to a number of factors including the efficiency of costs incurred, we agree that some suppliers have incurred costs which exceed those forecast in the Department's original assessment of scheme costs. We believe that addressing this via an ECO4 extension balances the interests of current and future consumers through improving cost recovery without impacting consumer bills. We have encouraged interested parties to respond to your consultation, including views on an appropriate level of cost recovery to include in any extension to the scheme.

Once we have further detail on how the Department intends to proceed following the consultation, we will look to consult more widely on the methodological approach to reflecting it in the price cap. We look forward to further engagement with you on the work set out in this letter.

Yours sincerely,

Making a positive difference
for energy consumers

Charlie Friel

Director, Retail Pricing & Systems