



Department for
Business, Energy
& Industrial Strategy

Energy Security Bill Policy Statement

Energy Company Obligation Buyout
Mechanism

August 2022



© Crown copyright 2022

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Where we have identified any third-party copyright information you will need to obtain permission from the copyright holders concerned.

Any enquiries regarding this publication should be sent to us at: energybill2021@beis.gov.uk

Contents

Summary	4
Buy-Out Mechanism	5
Background	5
Policy Design	5

Summary

The Energy Security Bill was introduced into Parliament on 6 July 2022. This Bill will deliver a cleaner, more affordable and more secure energy system for the long term. It builds on the ambitious commitments in the Prime Minister's Ten Point Plan and the British Energy Security Strategy to invest in homegrown energy and maintain the diversity and resilience of the UK's energy supply.

The Energy Security Bill makes provisions to create a more equal and fair energy market by enabling the Government to establish a buy-out mechanism under the Energy Company Obligation (ECO) scheme for suppliers.

Buy-Out Mechanism

This statement describes the objectives of the ECO buy-out mechanism. This measure will provide powers to the Secretary of State to introduce a buy-out mechanism through secondary legislation under the ECO scheme. We intend to consult on the details to be covered in secondary legislation in autumn.

Background

The Energy Company Obligation (ECO) scheme is an obligation that the Government has placed on larger energy suppliers to install energy efficiency and heating measures to people's homes in England, Scotland and Wales. Obligated suppliers recoup these costs from customer bills.

Currently, energy suppliers with over 150,000 domestic customer accounts are obligated under the ECO scheme. This creates a cost distortion between obligated and non-obligated suppliers and their customers, as suppliers who are not obligated under ECO are able to offer lower prices, while obligated suppliers need to charge higher prices to cover their ECO costs.

In the Energy White Paper, Government committed to reducing or removing this threshold subject to not disproportionately increasing costs for smaller suppliers.

However, simply obligating smaller suppliers in the same way as larger ones would increase their costs disproportionately, as they do not have the same administrative economies of scale as larger suppliers. The solution we are proposing is to give energy suppliers the option to meet their ECO obligations by making a payment to an approved third party for an approved purpose which will be stipulated in regulations.

The public consultation on ECO4 in Summer 2021 included initial proposals for a buy-out mechanism and committed to a further consultation on secondary legislation details before its introduction, with supportive feedback.

Policy Design

A detailed consultation will be published in autumn, covering which suppliers can use the buy-out mechanism, what activities can be funded, and how the buy-out price will be set. There have been some changes to policy proposals since the ECO4 consultation, however the underlying policy intentions remain the same.

The ECO4 consultation initially proposed the use of a buy-out 'pot'; however, collecting a levy that would be held by Government would have led to complexity in how the funds were

collected, held and used. The Government Response therefore introduced the new proposal of allowing energy suppliers to meet their ECO obligations simply by making a payment to an approved third party – similar to the Industry Initiatives element of the Warm Home Discount scheme. Criteria for approving third parties and purposes would be set out in legislation and approved by Ofgem.

The introduction of this mechanism would allow smaller suppliers to participate in the ECO scheme without disproportionate costs. We are therefore proposing to reduce participation thresholds once a buy-out is introduced. Aligning with the approach taken under the Warm Home Discount scheme, we are proposing to exempt suppliers with up to 1,000 domestic customer accounts as, even with a buy-out mechanism, they would face disproportionately high fixed costs.

We are proposing that optional access to the buy-out mechanism be set using a sliding scale approach based on size. The fundamental intention behind introducing a buy-out mechanism is to enable small suppliers to participate in ECO without facing disproportionate costs, rather than to create a secondary delivery route. Therefore, we want to limit the use of the mechanism by larger suppliers further than previously consulted on.

The table below illustrates that we are proposing to allow suppliers that are not currently obligated under ECO (those with between 1,001 and 150,000 customer accounts) the option of using buy-out to deliver their entire obligation. To avoid a cliff-edge situation, we are proposing that as the supplier grows, their option to buy-out declines. The main change from our earlier proposals is that suppliers with over 500,000 customer accounts will not be permitted to use the buy-out mechanism. Initial modelling on the potential buy-out spend per year indicated that allowing the largest suppliers to even buy-out 1% of their obligation would divert significant funding away from core ECO delivery.

Customer Base	New mechanism cap
1,001 - 150,000	Up to 100%
150,001 – 250,000	Up to 10%
250,001 – 500,000	Up to 2%
500,001 or above	0%

As expressed in the ECO4 Government Response, we are proposing to use Impact Assessment prices to set the buy-out price, with the flexibility to adjust using reported supplier costs and market price data in response to any significant price fluctuations. This is a stable and fair way of setting the buy-out price. The flexibility to adjust prices is necessary to ensure

that the amount of money going towards energy efficiency improvements through buy-out is not misaligned with the main scheme costs.

We are proposing that suppliers must declare their intentions to use the buy-out mechanism during an annual 'decision window' between the confirmation of obligations by Ofgem and the beginning of the next annual obligation phase. This declaration would be binding, so they could not revert to standard ECO delivery for that phase. However, suppliers would not be restricted to deliver buy-out projects within that phase.

We are proposing that the buy-out mechanism should be used to deliver energy efficiency projects. However, there is an opportunity to offer a broader range of assistance to low-income households by going beyond the current remit of ECO in a limited capacity through buy-out. We are therefore proposing that a range of advice, services and goods would be eligible, covering ECO4 insulation measures, provision of advice services, wider energy efficiency measures including hot water efficiency measures.

Each of these proposals are expanded upon in our upcoming consultation in Autumn 2022 which will inform secondary legislation.

This publication is available from: www.gov.uk/beis

If you need a version of this document in a more accessible format, please email enquiries@beis.gov.uk. Please tell us what format you need. It will help us if you say what assistive technology you use.