Pixie Energy
2 Millennium Plain
Bethel Street
Norwich
NR2 1TF

beisecoteam@beis.gov.uk
BEIS
Level 6, Orchard 1
1 Victoria Street
London
SW1H 0ET

27 April 2018

Dear Sirs

# ECO3 consultation – ECO Switch proposal

Thank you for this chance to respond to your ideas on how to take forward domestic energy efficiency in the GB market. The Energy Company Obligation will be an important tool in continuing to meet social policy objectives, especially fuel poverty mitigation and affordable warmth.

Pixie Energy is an energy market specialist, established by Nigel Cornwall with the aim of transforming regional markets and accelerating their decentralisation and democratisation. We believe that, with the addition of a new, more flexible, trading mechanism to replace or at least supplement the existing BEIS brokerage, a more cost-effective result could be achieved enabling more focussed local markets. This could allow the same spend to go further and benefit more consumers.

In this context we propose a local pilot scheme initially based on part of East Anglia, but which could be replicated or scaled.

## BEIS brokerage

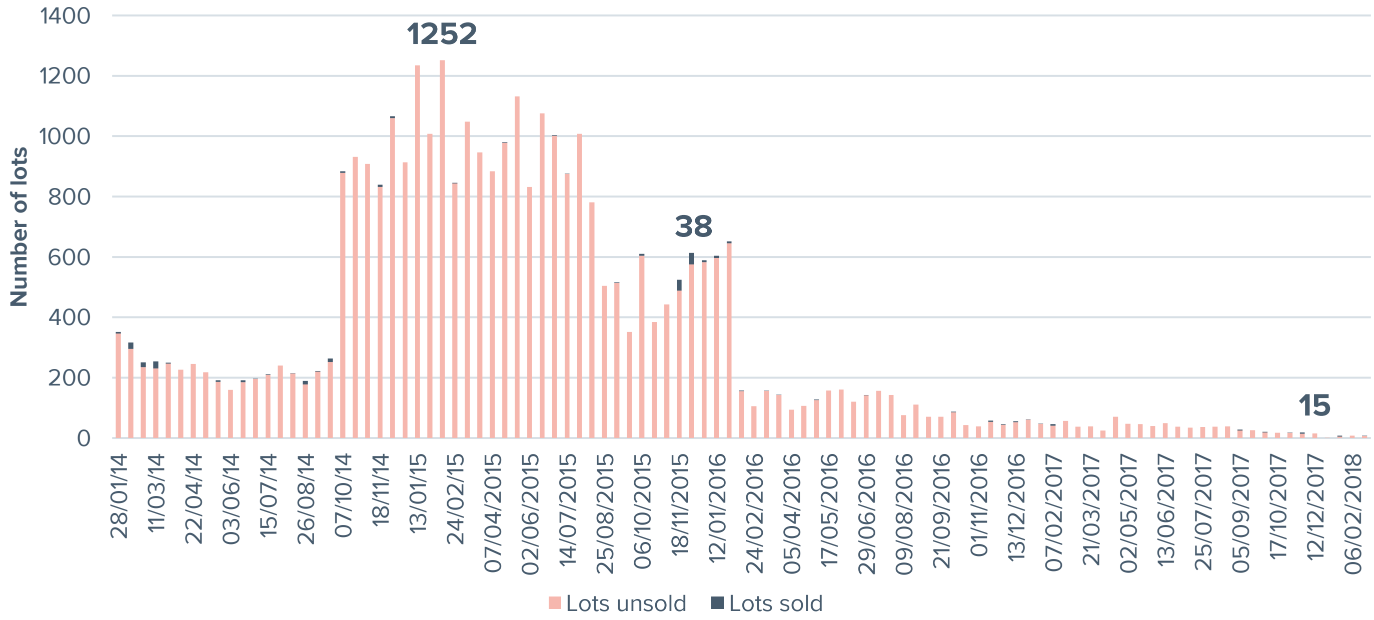
While well-intentioned, the existing brokerage system managed by Crown Commercial Services has never proven popular among suppliers, even the large energy suppliers who bear most of the burden for ECO.

We believe that this is due to several issues with the system:

- Overly large lot sizes
- Lack of clarity on actual delivery volumes
- Lack of clarity on delivery and payment timescales,
- Lack of trust in the anonymised process and who is being contracted with.

This has resulted in only a small number of trades being carried out, and general lack of liquidity in terms of lots being added to the system at all, especially recently. Figure 1 shows volumes of lots added to the brokerage, and whether these were sold or unsold. Peak of sales was in November 2015, when around 6% of lots were sold. More recently, for the March 2-18 auctions (held 6 and 20 March), no lots were submitted at all.

**Figure 1: BEIS brokerage lots added, divided into sold and unsold**




*Source: [BEIS]* *1,252 is the highest number of lots submitted, 38 the highest number of lots sold and 15 is the recent level of lot submitted to any of the bi-weekly auctions on the platform*

We can trace the lack of success of the platform to a mismatch between its ambition – to assist suppliers to identify and implement measures to deliver ECO obligations – and its format. Minimum lot sizes of 1-3ktCO2e or £100,000 to £300,000 lifetime bill savings only make sense for large suppliers, who have other existing routes to fulfil their obligations, and these are usually foreclosed to their competitors. Small and medium obligated suppliers have not engaged with the brokerage, as indicated by the fact that only the six large suppliers are registered to it, and some small suppliers are not even aware of it.

Furthermore, the scheme rules allow installers to provide these measures at any time over a range of timescales, up to 12 months. However, the supplier must pay for the measure within 30 days of delivery. This introduces a level of uncertainty into a small suppliers cost-stack, which it may not have the resources to deal with.

Finally, due to the illiquidity of the scheme, and the anonymous contracting nature, few installers will have been able to build up the good reputations necessary to reassure suppliers that they were working with good partners who would deliver on time and on quantity. It is not possible either to deliver a local or regional strategy to align with a supplier's commercial strategies.

The wider environment in which the platform would be rolled out is of course changing. We estimate that for the current compliance year, 17 suppliers are or will become obligated. Experience to date suggests newly obligated suppliers struggle to identify properties and in effect contract compliance by buying in measures paid for by their larger competitors. With independent supply now accounting for over 20% of the domestic dual fuel market, the number of obligated suppliers is set to increase.

**Figure 2: Process for ECO Switch trading platform**


In a competitive market, there are real issues surrounding distortions that clearly exist by purchasing compliance from competitors. Over time there will also be questions surrounding the ability of large players to foreclose the ECO compliance market, especially as over time the cost of new measures increases as cheaper options are exhausted.

We conclude from the foregoing commentary that a different approach is needed to facilitating trade. We address this in the next section.

Our assessment also suggests that consideration should be given to establishing a buy-out mechanism, which we consider in the section after that.

## ECO Switch

The changes in ECO rules to underpin version three of the scheme, give rise to the potential to deliver more efficiently for a wider range of suppliers, which should also deliver commensurate benefits for consumers. A key objective should be to increase the locationality of delivery, especially given the problems around properly targeting measures on the fuel poor.

Local authorities (LAs) have discretion under ECO2t to allocate additional eligible targets for 7% ECO measures. Under ECO3, there is a proposal – which we support – to extend this to 25%. Given that assessed search costs are £125 for on-gas-grid customers, and levels of deprivation are higher in the off-gas-grid sector where search costs are £400, better utilising LA knowledge and experience to identify targets could save significant amounts of money in scheme delivery.

This may also achieve better targeting of measures, to allow the most-in-need, not the cheapest-to-treat, to benefit from energy efficiency support, saving them money and improving their outcomes.

We propose a new form of tri-partite trading platform, allowing LAs, private tenure landlords as well as social housing associations (SHAs) to identify target properties to deliver measures, local installers to bid to deliver these at best-cost, and then suppliers to bid to pay to acquire these measures to notify to Ofgem. The process is shown at Figure 2.

LAs, private landlords and SHAs would be the target for listing measures to bid, due to their existing knowledge of housing stock (including EPC status), customer vulnerability and/or fuel poverty levels, and resource to engage with the public. They also often have a trusted brand with local residents and have a vested interest in increasing energy efficiency to reduce carbon emissions and fuel poverty levels. In addition, LAs would be able to engage with multiple suppliers simultaneously to attract energy efficiency funding to their region, maximising the value of the limited resource many LAs have in the energy sphere.

However, if the platform was successful, other parties and potentially even installers looking for funding for innovation projects could list measures on the platform. This would allow suppliers to access a wider range of potential projects and support the penetration of ECO into the private rental sector, which is presently underserved by energy efficiency in general. Allowing innovative solutions to be listed could make it easier to secure funding, and drive awareness out to a wide user-base.

Our initial engagement with suppliers and LAs on the topic has revealed a high level of support for a different trading approach, with a more local focus. We are also in discussion with EnTrade, a Wessex Water subsidiary that operates a regional trading service for environmental compliance in the water sector. The way they operate their existing trading platform could be modified for a new ECO compliance market.

## Buy-out fund

ECO, of course, does not have a buy-out option. We suspect a reason for this is that until 2011 only the six incumbent suppliers had an obligation, all of whom also had mass market coverage and therefore access to eligible households.

One lesson learnt from CERT and CESP is that suppliers have varying ability to achieve the targets given their different customer bases. In addition the competencies needed to deliver ECO are very different to those needed by a good quality supplier and as a result ECO can cause operational stress in such businesses. But even for large diversified suppliers, we are hearing concerns that the cost of meeting elements of the targets is escalating, and search costs are increasing. It is likely that this recognition that led BEIS's precursor to establish the brokerage services to enable suppliers to buy into lower cost solutions offered by the market and avoid the need to develop the in-house capability and the fixed costs that go with that.

A possible different approach that we believe BEIS should consider might be:

- calculating an average compliance cost under ECO by dividing the total obligations in any one year across all customers all suppliers are expected to have above the 250,000-account threshold
- translating this volume obligation per customer into an assessed benchmark cost. This would establish in effect a market-based cost per customer of meeting the obligation and give a signal to participating suppliers regarding the most effective way to meet it. As such it would take into account the different costs of individual suppliers of meeting the obligation
- supplementing the brokerage with a new buy-out option based on the benchmark cost per customer (which could include a small non-participation premium to incentivise action perhaps reflecting the 10% headroom mechanism adopted on the Renewables Obligation), which would in effect cap the costs a supplier would have to pay and make it transparent and stable at the same time
- recycle the monies received in respect of buy-out payments by purchasing services through the existing brokerage or other permitted trading avenues, and

- combining the two ideas (local trading platform and buy-out option for suppliers), LAs, private landlords and SHAs might be able to bid awards in much the same way as they compete for supplier funding.

## What we need

Pixie Energy is, as we have noted, in discussions with possible IT and trading services partners to begin scoping this work and hopes to deliver a trial project to run in a limited geographical scope (probably Suffolk and Norfolk, possibly extending into the wider East Anglian region) for the first phase of ECO3, October 2018 to April 2019. We have had a number of preliminary conversations with newly obligated suppliers, some of who tell us they wish to work with us on the pilot project.

We would like to attract BEIS attention to this project as a stakeholder, both to provide input into key decisions – such as the answers to the questions proposed above – and to take away learnings. We also would like to discuss whether any innovation support might be available to support this initiative.

All being well, we would then hope to roll the project out over the remaining years of ECO3, but retaining a specific regional focus (for instance, allowing regional suppliers to better connect with regional customer bases and the relevant local stakeholders).

**Nigel Cornwall**

**Director**

T: 07900092524