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Utility Regulator
Queens House
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ESB Input to consultation by the Northern Ireland Authority for Utility Regulation (NIAUR) on the NI Energy Efficiency Levy

Dear Madam

ESB welcomes the opportunity to input to the above consultation. This consultation is significant and timely given the urgent need to accelerate the rate of implementation of energy efficiency improvements in order to meet UK climate change goals, and also recent developments at EU level relating to the Climate/Energy package.

ESB operates in the electricity sector in Northern Ireland and the Republic of Ireland, participating in the Single Electricity Market and also in GB. It is our intention to grow our business in the All Island market and in a future All Islands market context. Accordingly we have an interest in the approach to energy regulation on the part of NIAUR, including its compatibility with the approach to such matters adopted by the Commission for Energy Regulation and Ofgem. Our input is focussed on electricity issues, but addresses certain gas aspects where relevant.

In our view, the levy scheme must be seen in the context of a pressing need to accelerate the uptake of economic energy efficiency improvement measures, particularly in the domestic sector. The EU Energy/Climate package now under discussion is targeting a 20% efficiency improvement by 2020 and conditional on the outcome of international negotiations the 20% figure will likely be substantially increased.

It is clear from a cursory analysis of the scale of investment needed to meet such a target that cross-subsidising efficiency improvement measures via the levy can only impact a portion of the activity that is required to be stimulated in future years. Accordingly it is important that the levy complement other policy measures aimed at energy efficiency. Arguably a consultation on the levy in isolation is too narrow in scope and what is required is a focus on the overall stimulation of energy efficiency in NI and the role of the levy in that context.

We would suggest that given that the timescale for implementation of changes in the levy scheme extends to 2010 that a more fundamental review of the approach to regulation for energy efficiency be undertaken. This could anticipate the increased target for efficiency now under discussion at EU level.

In particular a fundamental review of the levy in the timescale that is available would provide an opportunity to clarify and redefine the policy objectives and principles underlying the levy scheme. At present the levy is largely focussed on the fuel poor, and in such a way which does not ensure that supported measures are the most cost effective available. This results in the levy not fully targeting the significant economic upgrading potential of the existing housing stock.

In addition the largest portion of levy revenue derives from the industrial and commercial sector which is only eligible for 10% of levy revenue. Yet it is clear from Appendix F of the consultant's report that levy schemes implemented in the industrial and commercial sectors were the most cost effective.

Also the levy does not apply to network delivered gas. We consider this anomalous as it distorts competition in the heat market, where the use of electricity driven heat pumps has clear environmental advantages (recognised in the draft EU RES Directive under development). In particular we consider that a fundamental review of the levy in the context of government support for energy efficiency promotion, using a transparent CO_2 metric, would clarify the implications of the current implicit support provided to gas.

We would suggest that consideration be given to the establishment of a social objectives/fuel poverty levy, separate from a general energy efficiency levy to be utilised without inefficient subdivision.

If it is decided to continue with a levy targeting both priority and non-priority sectors then its should be subject to a more equitable split between the priority and non-priority sectors (e.g. 60:40 or 50:50), reflecting the significant portion of levy funds deriving from the non-domestic sector. The development of a social tariff benefiting the fuel poor would support such a change in allocation.

In relation to section 6 of the consultants report dealing with other approaches and in particular 6.1 which addresses licence obligations on electricity suppliers and 6.3 dealing with a possible All- Island Approach, it is anticipated that our Department of Communications, Energy and Natural Resources may seek views on appropriate obligations on energy suppliers to promote energy efficiency. We expect that the topics discussed under section 6 will be fully explored in this process.

Responses to certain recommendations contained in section 7 are attached.

Yours sincerely

Fergal Egan
ESB

7 Specific Proposals

The EELP should continue past the current three year period approved by the Authority ending 2009/10 but should be subject to a number of reforms. Specific proposals are as follows.

1. Organisations other than licensed electricity suppliers should be permitted to compete for Levy funding.

1. Any proposals should respect the key role of Energy Supply companies and provide a means for integrating their commercial imperative with environmental and social obligations.

We consider that Energy Supply companies have a considerable advantage in terms of influencing customer behaviour and delivering energy efficiency measures due to their strong brands, direct linkage between saving and bill and their ongoing, regular, multi-dimensional customer contacts.

The Energy Efficiency Levy system should take advantage of the unique position of Energy Supply companies as is done by the Supplier Obligation models in the United Kingdom and Republic of Ireland.

It is important that the process is transparent. In particular standardised savings calculation for measures should be set in advance. If a new calculation method is proposed and accepted then this should be published immediately in the interests of transparency.

2. The Utility Regulator should seek views as to whether measures providers should be allowed to bid for Levy funding directly and as to whether controls and monitoring could compensate for the loss of transparency and prevent the inflation of measures costs.

2. It is not clear what this question means. *The process should be equitable and transparent*

3. Other constraints should be placed on the identity of bidders. For example in order to avoid excessive administration costs both of handling a high number of bidders and of monitoring bidders that may be submitting schemes purely in their own interests, schemes should be of a minimum size, say, £10,000 of Levy funding. Bidders should be or use reputable contractors.

3. We consider that the proposed minimum scheme size is too low to a significant extent. We would suggest that a range of £250,000 + be considered in order to achieve benefits of scale. Bidders could be required to submit a performance bond. It should be a requirement that measures are implemented by competent trained persons. Consideration should be given to as to what evidence of competence or training could be required of bidders.

4. A number of constraints under the existing scheme should be retained and kept under review, depending upon the success of the more competitive arrangements, i.e.
   - incentive payments to encourage schemes to maximise the energy savings measures obtained for Levy funding;
   - the requirement to provide transparency of the costs of measures
   - controls on the level of management and administrative expenses.

4. In our view the appropriate incentive payment should be the proposed reduced rate to a set maximum percentage e.g. 20% of the total amount
If the process is open and transparent we do not see any need for transparency of costs and the level of expenses incurred by bidders. This should remain commercially confidential.

5. The incentive rate should be reduced from the current £5120/GWh to £1000/GWh, whilst experience of the extent of competition for funds can be assessed;

5. We agree with the proposal to gain experience with a reduced default rate.

6. More realistic targets should be set by ensuring that the assumptions regarding the mix of measures, the fuel mix and third party funding are more realistic of actual outturns. For the first year, the contribution to the incentive target for each scheme should be based on an average of the marginal cost effectiveness of the group and the cost-effectiveness of the specific scheme.

6. In our view sub-targets impact the overall cost effectiveness of the scheme and should be avoided if possible.

7. To prevent any distortion to incentives, schemes with such outlying costs could be excluded from the group average calculation.

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8. Additional clarity should be introduced into the Framework Document, specifically for situations where, thus far, rules have not been needed.

8. No comment.

9. No specific arrangements for underperformance should be introduced, other than that funding will be pro-rated by the energy savings achieved. However, if underperformance becomes an issue, more onerous arrangements for under-performance should be introduced.

9. We agree.

10. Pending analysis of the 2006 House Condition Survey, the Utility Regulator should seek views as to the scope for further energy savings measures. In the absence of views to the contrary, the size of the Levy should remain broadly at current levels for the first year (with appropriate indexation). Taking the reduction in incentive payments into account, the funding for measures costs should be increased by £1m which would, except in the event of a very large increase in energy savings, not result in any increase in the total Levy funding including incentives. The size of the Levy should be kept under review, based on the nature and number of schemes submitted. If there is a high demand for funding whilst scheme costs remain acceptably low, consideration should be given to increasing the size of the fund in later years;

10. The impact of the levy on the wider energy efficiency industry requires to be monitored to ensure that expectations regarding possible future subsidy increases do not result in postponement of action on the part of homeowners. If there is a high demand for levy funding of cost effective schemes, exceeding the total funding available, this may have detrimental consequences on the uptake rate of efficiency measures and require to be addressed.

In general we consider that the size of the levy scheme should equate to circa 1 – 2% of total revenue.

11. The relative focus of the scheme on priority schemes - currently 80% - should be reviewed in light of: (i) the 2006 House Condition Survey; (ii) the Utility Regulator seeking views on the issue; (iii) further detail emerging of other initiatives to assist the fuel poor; and (iv) on an ongoing basis, depending upon the types of schemes that are submitted following changes to permit non-suppliers to bid for Levy funding.

11. See previous comments.

12. The emphasis of whole house solutions should be lessened with a view to enabling measures to be spread over a larger number of homes within the priority group with a view to levelling up the worst cases of fuel poverty or maximising energy efficiency gains alleviating fuel poverty. Whole house solutions should be selected on the grounds of their cost-effectiveness.

12. Bidders should be afforded the maximum flexibility to design and propose schemes, to be assessed on the basis of published standardised saving calculation methodologies. This will ensure that levy funding is used cost-effectively.

13. Views should be sought as to whether schemes should be permitted to assist with the purchase cost of heating oil and, if so, how this assistance should be prevented from going beyond that necessary to give effect to energy efficiency and becoming, instead, a pure subsidy of fuel purchase.

13. No. In our view assistance in the purchase of heating fuels is best carried out by Government Departments specialising in providing welfare assistance.

14. The Utility Regulator should seek views on ending the segregation of funds between non-priority domestic measures and non-priority commercial measures, in order to maximise energy efficiency gains.

14. Yes.

15. The 20% additionality criterion should be augmented by a requirement for scheme proposals to justify why measures are additional.

15. We agree.

16. The 5% cap on indirect costs should be replaced by a more sophisticated criterion. Views should be sought on the appropriate form and level of the cap to ensure that, whilst the allowance for indirect costs is realistic, the maximum funds are available to be spent on measures.

16. We consider that in a competitive and transparent process the level of indirect costs should not be of concern in the assessment of bids.

17. The raising of Levy funds should not be extended to gas unless it is also extended to oil.

17. We consider it anomalous that the levy applies only to electricity and not to gas. We note that in the UK CERT scheme applies to all domestic gas and electricity suppliers above a size threshold. This is a competitiveness issue. In order to achieve CO_2 targets it is apparent that, inter alia, domestic heat provision must be decarbonised and that the use of electrically driven heat pumps will have a key role to play in achieving this (Substituting a heat pump for a gas central heating boiler displaces the gas derived CO_2 at zero marginal CO_2 associated with the increased electricity use – as the EU ETS cap applies. In addition the use of heat pumps contributes to renewable targets). In our view the levy should apply to network delivered gas. The Authorities statutory duty to support gas should be tempered by competition and environmental considerations.

Current support gas must be bounded by other considerations

18. The option of placing obligations on suppliers to submit a certain quantity of schemes should not be introduced initially but this should be kept under review in light of experience of operation of the scheme.

18. See response to 1 above.

19. The Utility Regulator should seek views as to whether scheme sponsors should be required to explain to customers the origin of funds used to pay for measures or whether it might be appropriate to apply this requirement only to dominant suppliers.

19. We consider that all scheme sponsors should be obliged to inform customers of the origin of funding.