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24 November 2008

Dear Alison

**NI ENERGY EFFICIENCY LEVY – STRATEGIC AND OPERATIONAL REVIEW 2008**

Thank you for the opportunity to comment upon the Skyplex report and to contribute to the NIAUR workshop on 15 October.

The Energy Efficiency Levy (EEL) has proved to be highly effective, as noted by NIAUR and Skyplex Consulting (Skyplex), delivering savings of over 4000 GWh and an estimated £250m for customers. It has provided a strong platform and a market orientated based scheme that has been highly cost effective, encouraging innovative approaches and partnership led initiatives. It is against this backdrop that we comment on the proposals put forward by Skyplex.

The Skyplex report sets out a number specific reform proposals; as such, it provides a useful backdrop to the review and is helpful in flushing out new ideas. However, we also note the danger of making fundamental adjustments to the scheme that may potentially undo the good work and success achieved todate. For example, there is an underpinning presumption that targets may be set too low and the administration costs are too high. We do not share these views; first, because suppliers are reinvesting much of the incentive money back into energy efficiency initiatives and second, the report fails to really get to grip with the market differences that exist between the domestic and commercial sectors. As such, the report does not draw any distinction in its proposals, despite the sectoral differences that do exist.

However, we agree there are a number of key improvement areas that would be of benefit in meeting the scheme's objectives. The key changes we recommend are as follows:

- **Targeting:** a greater focus on energy efficiency measures that better support governmental targets to reduce carbon emissions. This would align thinking and outputs to the UK Climate Change Bill, which now puts into statute the UK's targets to reduce carbon dioxide emissions through domestic and international action by 60% by 2050[1] and 26-32% by 2020, against a 1990 baseline.

  One method of supporting this would be to allow a greater proportion of the Levy to be allocated irrespective whether they are priority or non-priority customers - thus allowing greater flexibility in how suppliers target customers with measures that deliver carbon emission savings. Striking the right balance between Fuel Poverty and Carbon emission objectives is a tough call; however, too heavy a reliance on Fuel Poverty under the EEL Scheme, whilst laudable, inevitably will mean Carbon savings will not be maximised.

- **Proportionate:** a more equitable basis for directing Levy moneys based on who pays; for example, business customers pay over 60% of the Levy funds but receive 5% of the benefits. We recommend a greater proportion of the Levy funds are directed at commercial businesses, i.e. where the maximum carbon abatement initiatives can be delivered. This could also be further supported by an increased Levy on commercial customers.

- **Administrative Costs:** an approach that recognises the inherent additional complexity and risk in placing and managing the commercial sector, especially against the present market recession backdrop. The commercial sector measures require tailored/engineered solutions, requiring careful management. In some cases (as much as 10%), difficulties can arise resulting in abnormally high levels of management time and cost. For example, these difficulties include having to extract the measures part way through implementation, multiple phone calls and site visits, and even dealing with legal representation.

  Inevitably, this can have a disproportionate effect on our administrative cost. We therefore recommend a move away from the straight 5% cap basis, and towards a two tier administrative charging structure that better reflects the high mass and high density domestic sector, versus the individual and specialised nature of the commercial sector. We would be happy to help develop this model further.

The next step is critical. To develop an EEL Scheme that is fit for purpose and so avoid a further fundamental review with the next few years, will require very careful scrutiny of all the ideas and issues raised by Skyplex and stakeholders.

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[1] Soon to be 80% under the UK Government's Climate Change Bill

Before moving to a draft decision, and in the interest of maintaining a fully transparent consultative process (the publication of the Skyplex report in its entirety is to be commended), we recommend NIAUR further consults, i.e. before moving to a draft decision, narrowing down its favoured reform options, distinguishing between domestic and non-domestic sectors, and so allowing further informed debate by consultees.

Please do not hesitate to contact if we can help further.

Yours sincerely

Mark Welsh

Energy Services Manager

## ANNEX

### Response to specific proposals

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

***Response:*** *we are very much for pro competitive market led approaches, providing the benefits can be demonstrated. In the case of the EEL, we have serious doubts whether opening this up to unlicensed companies is helpful for a number of reasons.*

- *NIAUR will not have the same level of control as it does over supply licencees, making future changes much more difficult.*
- *There will be less financial transparency and accountability, especially given that these are effectively 'public funds' and as such need to be handled sensitively.*
- *There will be difficulties with the concept of additionality. The Levy would in effect cross subsidise those organisations that are potentially already engaged in, or actively marketing to customers a particular energy efficiency measure.*
- *Fragmentation of the tending process will lead to less overall efficiency. The benefits of competitive tending will be offset by a plethora of smaller schemes, and a higher number of bidders resulting in less EEL coordination of measures for customers, and potentially greater overall administrative cost.*

**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.

***Response:*** *for the reasons noted above (see proposal 1), we believe direct control over funds is preferable and therefore bidders should be licensed.*

**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.

***Response:*** *we do not agree that schemes should be limited in size. Each scheme should be allowed to be judged on the benefits it will bring. As such, the tending process should choose the most efficient outcomes.*

**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.

a. **a.** Incentive payments to encourage schemes to maximise the energy savings measures obtained for Levy funding;

**b.** The requirement to provide transparency of the costs of measures;

**c.** Controls on the level of management and administrative expenses

**d.** 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.

***Response:*** *we agree with most of the recommendations above, with the exception of the incentive rate which we comment on below.*

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.

***Response:*** *the scheme has been highly successful giving rise to a total lifetime saving of over 4000GWh.*

*It would therefore be disappointing if the scheme's future success was effectively undermined by such a significant change, especially without taking account of the increasing difficulty in finding customers that can benefit from future EEL measures.*

*Nor are we persuaded by Skylink's suggestion these incentive monies so released could be put to better use or that potentially the targets have been set too low.*

*First, licensed suppliers (including Energia) have already made a commitment to NIAUR to apply incentive payments in excess of 8% of the total project cost back into additional energy efficiency measures. These monies do not therefore form a further revenue stream, but act as a driver for change (e,g, funding customer awareness forums). Reducing the incentive arrangement will therefore merely reduce the attractiveness of participation, and reduce other initiatives that fall outside of, but complement the EEL measures.*

*Without doubt, the scheme is pound for pound far better value and more cost effective than other similar energy efficiency schemes, and given that all the tenders are fully prejudged and audited by EST (providing a high level of assurance), we recommend the investment arrangements remain at £5120/GWh. Albeit, we fully support a firm commitment by participants to reinvest incentive payments in excess of 8% of the total project cost, back into energy efficiency initiatives.*

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

***Response:*** *given the wide diversity of schemes, it will be very difficult to achieve without having unintended consequences that might damage the viability of future measures. Indeed, it is acknowledged above that there will be cases where this is not possible.*

*The scheme benefits from a flexible approach allowing measures to be tailored according to a customer's circumstances. It should also be noted it is becoming increasing more difficult to find and develop energy efficiency measures for customers now that the 'low lying fruit' have more or less been picked.*

*We therefore recommend the present arrangements be maintained, albeit subject to further analysis being provided.*

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

***Response:*** *we agree this would be sensible, for example the Framework Document might include reference to the 8% incentive rule.*

**8.** No specific arrangements for underperformance should be introduced, other than the 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.

***Response:*** *in the event that EEL is opened up to unlicensed companies, it may be prudent to put in place arrangements for underperformance. How this underperformance may then be managed for unlicensed companies raises an important issue. For this reason, and those already stated above, it would be wise to ensure bidders are in fact licenced suppliers.*

**9.** Pending analysis if 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 the 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 fund in later years.

***Response:*** *there is already good grounds to increase the size of the levy, given the increasing thrust towards reducing carbon emissions. Providing commercial customers are* *attributed a greater percentage (currently 5%) of the Levy Funds, the Levy contribution could be increased from these customers. However, we accept the EEL may be better informed in light of the 2006 House Condition Survey for domestic customers.*

**10.** 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.

***Response:*** *in our view, there is a strong case for rebalancing the split such that an increased proportion of the available Levy is in future directed towards maximising carbon reduction measures. An immediate move towards a 70:30 split would not be unwarranted, and further analysis may help inform whether this should go further e.g. 60:40.*

**11.** 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.

***Response:*** *whilst this strictly falls outside our scope (we deal with commercial sites), it would seem sensible to at least free up measures thus allowing them to be directed at either 'whole house' solutions, or not as the case may be. The additional flexibility should enable bidders to maximise their deployment and minimise costs.*

**12.** 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.

***Response:*** *we agree with Skyplex that without oil, it would be difficult to justify gas inclusion. The fact that electricity is so common place provides a fair and equitable means of securing Levy funds.*

**13.** 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.

***Response:*** *in our view, there is a strong case for now rebalancing the split such that an increased proportion of the available Levy is in future directed towards maximising carbon* *reduction measures. An immediate move towards a 70:30 split would not be unwarranted, and further analysis may help inform whether this should go further e.g. 60:40.*

*The segregation funding principle between domestic and commercial should be maintained. There are a number of good reasons why this should be so. First, it ensures those that contribute to the Levy get a return. Second, the commercial segment is very different to domestic, requiring tailored and engineered solutions requiring a very different level of understanding. Third, any potential lessening of the emphasis towards the commercial sector could send out perverse messages to a sector that must surely continue to be a core contributor in helping to achieve Northern Ireland's contribution towards the UK's carbon emission objectives.*

*We therefore recommend maintaining the segregation of funds, and that these are rebalanced in line with the above recommended Levy split.*

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

***Response:*** *we have no difficulty with this proposal, albeit further guidance would be required to help bidders make successful submissions.*

**15.** 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.

***Response:*** *we make two observations. First, we do not believe the administrative costs are excessive. In our view, bidders have been very conservative when submitting costs. Second, Skyplex have presented insufficient data that helps inform whether the administrative costs submitted to-date are indeed unreasonable in all the circumstances.*

*In almost 10% of Energia's deployment of measures, significant difficulties can arise, resulting in disproportionate amount of management time and consequential expense within participation. For example, in one particular case the contractor refused to pay our partner lighting supplier. This resulted in numerous discussions with relevant parties including legal representation. In another example, the company decided to pull out mid way through implementation of the measures necessitating recovery of all installed equipment and funds.*

*Whilst we are not in a position to comment on the domestic difficulties and therefore costs, intuitively we believe that commercial business sites can pose in some cases a greater risk and therefore cost to manage.*

*If a more sophisticated criterion is adopted, it should remain simple to understand and apply and capable of accommodating the differences that exist between the domestic and commercial sectors.*

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

***Response:*** *we agree**.***

**17.** 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 on the light of experience of operation of the scheme.

***Response:*** *.the present arrangements have proved very successful, albeit more tendered schemes would be always welcomed. We do not agree it is necessary to place obligations on a supplier to submit a certain quantity of schemes, particularly as this will result in increased costs for suppliers and therefore EEL.*

**18.** 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.

***Response:*** *transparency is a good principle to adopt, albeit it may have unintended consequences. For example, we note that business customers pay proportionately more towards the Levy, but are entitled to less of the available funds. This may lead to adverse customer reaction.*

*That said, we have no objection to any supplier being required to explain to any customer from where the funds originate. However, it would be better to allow suppliers to be flexible in how this is managed. For example, to be available on a supplier's website, or via written communications, whichever is most efficient.*