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Department of the Environment, Food and Rural Affairs
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13 August 2004

The Energy Efficiency Commitment from April 2005 – Consultation Proposals

Dear Nurettin

I attach the Energy Retail Association's response to the consultation paper. This has been prepared on behalf of the UK's domestic energy suppliers and is the collective view of the sector.

Our main comments and concerns are reflected in the attached paper, but we would especially welcome further discussions on two aspects of the paper.

1. We have yet to see detailed projections from the insulation industry that sets out on a progressive basis the plans for expansion and the associated costs. We shall shortly be submitting an independent report on the current state of the insulation industry. The report will also include updated average costs to suppliers. Following our most recent meetings with Ministers and officials from DEFRA and the DTI we believe it will be mutually beneficial to discuss this report in a roundtable discussion with yourselves, suppliers and representatives from the insulation industry.

2. We very much welcome the proposal to establish a high level review group to monitor progress during the first phase of EEC2 to 2008. However, given our concerns about our ability to achieve the targets we are keen to understand the extent to which our work to achieve can be recorded and used to mitigate against penalties that would be imposed in the event that the energy savings targets are not reached.

We look forward to further discussions with DEFRA officials to develop a workable programme of energy efficiency targets.

Yours sincerely

Duncan Sedgwick
Chief Executive

The Energy Efficiency Commitment from April 2005 - Consultation proposals
Response from the Energy Retail Association

1. Introduction

This paper has been produced by energy suppliers forming the Energy Retail Association (ERA) and represents the collective views of its membership: Centrica, Scottish & Southern Energy, Npower, Powergen, EDF Energy and ScottishPower.

ERA members support the principle of extending the energy efficiency commitment from April 2005 and have played an active role in the work of DEFRA's High Level Advisory Committee and Target Setting Sub-Groups during the past year.

In addition, we have strongly supported the discussions that have taken place in the past 12 months and have contributed to the debate by producing various reports co-ordinated by the Energy Retail Association.

We have welcomed the approach taken by DEFRA to elicit widespread input from the various stakeholders having an interest in energy efficiency and acknowledge that DEFRA has already made some modifications to its views on some of the key issues.

However, we remain extremely concerned that some of the assumptions made by DEFRA have not been fully validated and that insufficient consideration has been given to future price trends and the impact on energy costs, particularly for our disadvantaged customers.

Whilst there has been considerable debate about consumer apathy and the commercial reality of a stagnant market, it is apparent that DEFRA believes that energy suppliers can solve the problem. This is not a view that ERA members share.

2. Key factors for success

ERA members believe that for EEC2 to be successful in delivering its environmental target other factors must be taken into account:

- Meeting the energy savings target
- Mitigating the effects of fuel poverty
- Developing an efficient manufacturer/installer infrastructure
- Delivering high quality & safety standards
- Transforming the market for energy efficiency products & services
- Delivering good customer experience & supplier branding
- Within the budget forecasts!

3. Key Concerns

ERA members have many concerns about the proposals, which even at this late stage in the statutory process are incomplete, but wish to highlight the following key concerns:

- Loss of flexibility
- Dependence on insulation products, particularly cavity wall insulation & the reliance on the insulation industry (manufacturers & installers) to invest and grow at the required rate
- Base cost assumptions and exposure to future cost increases
- Consumer appetite to buy products at the assumed costs and volumes required

3.1 Loss of flexibility

Why have suppliers always met previous energy efficiency targets?

Flexibility has been a key factor towards success and suppliers must continue to be able to innovate. At the time EEC was introduced the market conditions and policy environment were different. For example,

- Earlier programmes were significantly smaller, focussed initially on electrically heated homes and insulation represented a much smaller proportion of EESoP1 and EESoP2
- Emerging opportunities using energy efficient appliances and low energy lighting presented significant and viable alternatives to insulation products
- Earlier programmes included working with some business customers (up to 100kW i.e. not SME's) which widened the scope for products and customer targeting
- Timescales were more flexible allowing suppliers to take longer than the programme timescales if necessary and many suppliers needed to take advantage of this.
- Within a notional/assumed mix of measures suppliers had much greater flexibility to develop a wide range of schemes
- EESoP3 included gas customers for the first time widening the choice for suppliers to develop boiler schemes and more insulation work. Even greater interest was developed in appliance schemes and lower lamp costs meant greater volumes were delivered.
- In later programmes, Local Authorities became much more interested which has opened up opportunities for greater volumes through joint working

- Availability of social housing has been a key factor in ensuring targets were met.
- In all previous programmes, suppliers felt able to endorse the targets as realistic assumptions had been made.

In summary, earlier programmes gave plenty of choices for suppliers via an array of new product options, a growing commitment from appliance manufacturers, retailers and social housing providers, a wider audience after gas homes were included and suppliers felt able to endorse the targets.

Flexibility was key to success and this was verified at completion which showed that programmes were achieved but with a mix of measures that was very different to that envisaged in the original target models.

EEC II is also the first programme that is greater than the current capacity of the EE industry

Why EEC2 is a different case?

Apart from the obvious difference of scale between EEC2 and earlier programmes the loss of flexibility and over reliance on cavity wall insulation are the main concerns.

There appears little prospect that anything new will be added to the product portfolio and some of the previous measures are unlikely to feature in EEC2 despite being included in DEFRA's target model.

The following factors illustrate loss of flexibility and increased challenges imposed by changes in targeting and accreditation:
In particular,

- Some 82% of EEC2 target is anticipated to come from insulation products
- Some 2M appliances are expected to deliver about 1% of target but the removal of the uplift factor and the inclusion of the heat replacement effect will seriously affect this channel as a viable option to suppliers
- Lighting schemes have become less attractive through the imposition of the heat replacement effect and additional constraints on targeting and verification currently being considered by OFGEM make direct mail and charitable schemes unattractive.
- Boilers, whilst still included, are less attractive and at this stage the details of the 1M "exception boilers" is unknown. Additional monitoring requirements proposed by Ofgem (testing of boiler interlocks) are also likely to close this channel as a viable option due to the increased cost.
- Additional verification requirements and correction factors make DIY loft insulation less economic

- Heating controls are less likely to be delivered unless linked to boiler upgrades

In summary, there will be too strong a dependence on Cavity Wall Insulation and little flexibility to make a contribution from other products.

3.2 Dependence on insulation products, particularly cavity wall insulation & the reliance on the insulation industry (manufacturers & installers) to invest and grow at the required rate

There can be no doubt that the high dependence on cavity wall and loft insulation poses a serious risk to the delivery of the energy savings target and also to the programme cost.

We have valid concerns about the capability of the insulation industry to grow at the required rate and are not convinced that sufficient infrastructure exists, as claimed. The insulation industry's position that 1000 machines is enough, so long as the demand can be lifted for delivery evenly throughout the year is in our view an implausible argument.

We do not believe it will be possible to smear demand in the way we would all wish, at the national volumes required.

Equally, we do not believe that the industry would have previously invested in a capacity capable of delivering annual volumes of some 600,000 installations when historically the annual demand has never exceeded about 300,000.

The ERA has commissioned an independent study of the insulation industry. We understand that this is the only in depth assessment of the industry's ability to deliver at the rate anticipated by the targets. We expect to publish the findings in late August and would urge the Government to withhold judgment on this aspect of EEC2 until it has considered the report.

3.3 Price trends and risk to energy prices

As expressed previously, we are concerned that the base cost assumptions included in the EEC2 model prepared by DEFRA are vastly different from those experienced in the market place. Assumed future cost trends do not sufficiently take account of the investment that will be necessary in the insulation industry in particular.

The recent imposition of a 20% increase in the cost of loft insulation is a clear example of the volatility of the insulation sector and in our view this scale of increase is likely to be repeated on a frequent basis in the future. The ERA is currently collating further information about current costs and will be making this available as soon as practicable.

3.4 Consumer appetite to buy products at the assumed costs and volumes required

Since the commencement of energy saving programmes what has been confirmed time and time again is the lack of interest from consumers in energy saving products and services. Home owners' latent desire to improve energy saving has had to be targeted by a range of inducements that has seen the price of measures to consumers fall while the cost of delivery and installation has continued to rise. In our collective judgement, this trend will continue throughout EEC2. Additionally, the cost of lead generation will face significant upwards pressure as campaigns aimed at target group customers not only have to capture the interest and imagination of customers but also compete with an array of marketing messages that are increasingly sophisticated in order to elicit a positive response. It must be recognised that suppliers will find it increasingly difficult to absorb additional costs and this will need to be passed through to the customer.

We, therefore, strongly recommend that fiscal incentives are developed and introduced during the first phase of EEC2. We continue to support the proposal put forward by the Energy Savings Trust and Association for the Conservation of Energy for stamp duty rebates for households that install energy efficiency measures. This proposal should be incorporated into the Home Information Packs currently being developed by the Office of the Deputy Prime Minister.

4. Response to specific questions posed by DEFRA in the consultation document

Para 3.13 Disability Living Allowance and Attendance Allowance

We believe that customers in receipt of the DLA or AA should be included within the definition of the Priority Group. It is very difficult to define the factors that contribute to fuel poverty, but low income is not the only symptom. Any improvement for vulnerable customers must be welcomed and the current qualifying criteria should be sustained. The less attractive option would be to reduce the priority group share in line with the number of households no longer eligible because otherwise the 50% target is unrealistic.

Para 3.17 Interaction between EEC2 and Warm Front

ERA members are generally supportive of closer working so long as this is optional for individual companies and have contributed to recent discussions to establish suitable arrangements

Para 3.39 Energy Service Enhancements

ERA members support Governments proposal to provide an incentive for energy services for the first year of EEC2 but believe this should be extended for the whole of EEC2. It is not yet clear to what extent energy services will contribute towards achieving EEC2 targets. Energy service packages require

sustained investment by suppliers and any extension to the pilot allows time for the impact of the initiative to be properly assessed.

Para 3.43 Contributions from Consumers and Consumers Landlords

ERA members are very surprised at the change to accreditation rules for these schemes, as suggested by some stakeholders, as there has been no discussion on this issue throughout the past 12 months at the High Level Advisory or Target sub group meetings.

We strongly believe that this suggestion would represent a fundamental change in the design and focus of EEC2 which would have a serious impact on cost and volume assumptions.

Pressures on cost would come from;-

- a transition of focus from social to the private sector
- additional indirect costs needed for targeting the private sector priority group customer
- higher direct costs for insulation measures arising from lower productivity due to the need to insulate higher numbers of individual properties rather than blocks of properties .

Para 4.46 Trading options

ERA members welcome further options for trading. If EEC2 is to provide a stable platform for EEC3 in 2011, suppliers need maximum flexibility to operate in a highly competitive market.

Para 3.55 Micro-CHP and incentives

ERA members agree that the results of impending trials should be considered before deciding on incentives for micro-chp schemes.

5. Actions/recommendations

5.1 DEFRA should urgently review its target setting model in light of the comments noted above and in particular come forward with more reasonable target savings that can be met for the costs envisaged.

5.2 ERA members support the proposal to expand the initiative by energy suppliers to commission an independent review into the insulation industry with a view to provided DEFRA with more accurate information to inform its target setting.

5.3 Further consideration needs to be given to the proportion of savings targeted at the priority group. Indeed, we do not believe that the current proposals are realistic and may not represent the most effective means of targeting priority customers.

5.4 DEFRA and Ofgem should urgently review their proposals to ensure

consistency. In particular, Ofgem's proposals for additional monitoring, targeting and verification will, if implemented, effectively remove a number of measures from EEC2 that DEFRA have included in their target model. Clearly, this does not represent a coherent approach to setting reasonable targets on suppliers for EEC2.

5.5 We welcome the proposal for a high level advisory group to be established with the necessary powers to intervene and review EEC2 if necessary. ERA members look forward to playing a constructive part in defining the scope of the high level advisory group and setting realistic review implementation levels.