

**NIAUR's  
NI Energy Efficiency Levy  
Strategic and Operational  
Review 2008**

NIE Energy Supply's  
Response

21 November 2008



## Background

The Utility Regulator has instigated a review of Northern Ireland's Energy Efficiency Levy (EEL), making various proposals on the future shape and direction of the programme. Of the licensed electricity suppliers, NIE Energy Supply (NIEES) has been particularly active in applying for and delivering programmes through the EEL, in partnership with a range of local organisations and has delivered significant benefits contributing to both carbon reduction and helping to alleviate fuel poverty. Some of the major achievements are summarised below.

### Summary of NIE Energy EEL achievements

- 732,043 tonnes of carbon saved (lifetime) – important in the fight against global climate change
- 3221 GWh energy savings
- £197million customer lifetime savings – particularly significant in contributing to the alleviation of fuel poverty
- Engaging with a multitude of partners from public, private, voluntary and community sectors to reach those in need of assistance to deliver genuine benefits to customers
- Piloting, in partnership with a range of organisations, innovative approaches which contribute to future public policy, eg whole house solutions, near benefits, working fuel poor, health linkages etc
- Transforming markets, particularly energy saving lighting and efficient appliances
- Building capacity and raising standards in the installer market.

NIAUR's consultants focus in detail on many operational issues. NIEES would be keen to see a debate on what the main objectives and priorities of the EEL should be, for example carbon reduction, alleviation of fuel poverty etc. These priorities should be established which would then inform many of the subsequent lower order issues.

### Issues raised by NIAUR

#### 1. Incentive payments are too high

The EEL was established as a regulatory mechanism in 1997 with an incentive structure to encourage a high level of energy savings within the framework rules.

The Regulator was keen to incentivise energy companies to invest their time and skills in the development of energy services, rather than purely sales of energy. An annual energy saving target is established by the Energy Saving Trust, who also oversaw the GB equivalent programmes. Each year, NIE Energy Supply has delivered energy savings for customers in excess of the targets and has earned incentives (the average over the life of the programme is equivalent to an 8% return against total project costs) – a win/win scenario for both customers and company.

NIE Energy Supply has invested considerable resources in achieving this positive outcome:

- Managing spend of approximately £10million each year, through 20-30 schemes, working with in excess of 50 partners and suppliers
- Driving down costs whilst ensuring that quality and customer service standards are maintained
- Encouraging 3<sup>rd</sup> party leverage that may not have otherwise been spent on energy efficiency by highlighting the positive benefits that NIEES's programmes deliver. Indeed, as a result of the success of NIEES's fuel poverty schemes, DSD applied for additional funds from DFP to direct towards these types of initiatives. It seems illogical and unfair to penalise such successes (requiring the investment of considerable time and effort from NIEES) which lead to better outcomes for customers.
- NIE Energy Supply also give due consideration to both stakeholder views and the indicative measure mix outlined in the Framework. This means that NIEES has not submitted just the most cost effective schemes which allows a broader range of measures and packages to be installed than would otherwise be the case (eg heating, energy efficient appliances, heating controls).

In the current Energy Efficiency Programme, the main fuel poverty packages of heating and insulation which are offered free to vulnerable customers fall below the cost effectiveness target established for that category (3.5p/kWh v 2.5p/kWh) and lead to no incentive earning. Indeed the position would be even worse if additional third party funding was discounted.

NIE Energy Supply would urge the Regulator to be cautious of potential unintended consequences that may result from a significant change in the current incentive arrangements.

## 2. There is little competition in the bidding process

NIEES understands that NIAUR writes to all licensed suppliers annually outlining the opportunities for suppliers to apply for EEL funds. Presumably, if suppliers had perceived the incentive arrangements to be lucrative, there would have been more active competition.

NIE Energy Supply goes to considerable lengths to open the EEL process to a broad range of possible partner organisations and holds an annual seminar to encourage potential partners to bring forward ideas for projects. NIEES generally partners with upwards of 50 organisations in any year in delivering programmes.

Increased competition will lead to only the most cost effective measures being installed ie insulation and lighting, to the detriment of other measures which, although less cost effective, should still be supported (as they help to alleviate fuel poverty or as part of a market transformation campaign).

In summary, whilst the inference of the review is that having little competition has led to inefficiencies in the use of levy funds, in reality, NIE Energy Supply has delivered energy saving schemes in accordance with the framework requirements and exceeded the target each year, suggesting a very efficient use of EEL funds. It has striven to provide a comprehensive range of measures and, in the priority sector, has provided fully funded packages of heating and insulation even though they do not contribute to incentive earning. Indeed, the programmes delivered by NIEES compare favourably when benchmarked against comparable GB schemes.

## 3. Ring-fencing of funds have led to less cost effective use of the EEL

NIE Energy Supply agrees that the extensive ring-fencing of funds does lead to less cost effective use of funds. However, we believe that some level of ring fencing is appropriate to encourage work across all sectors and to meet specific objectives (eg alleviating fuel poverty by providing whole house solutions, helping to transform markets, improving standards of installations). As all customers contribute, there should also be potential for all customers to have access to schemes funded through the EEL. NIEES would therefore recommend that optimum levels of ring-fencing be

retained. These are fundamental social policy issues which must recognise the fuel poverty situation in Northern Ireland.

## **Proposals for the future of the EEL**

NIAUR and their consultants have suggested 18 specific proposals.

### 1. Opening the Levy to other organisations:

NIE Energy Supply has a number of concerns with this recommendation:

- Potential customer confusion (similar schemes being approved) with no co-ordination and potential double funding eg a customer claiming more than one grant for the same measure.
- Loss of scale economies.
- Under current arrangements, participating suppliers are subject to tight regulatory frameworks and licence requirements. NIEES would ask if NIAUR will take responsibility if non-licensed organisations receive and use funds inappropriately.
- Potentially, an increase in costs of administering the EEL, so diverting funding from actual energy saving measures.

### 2. Opening the Levy to measure providers:

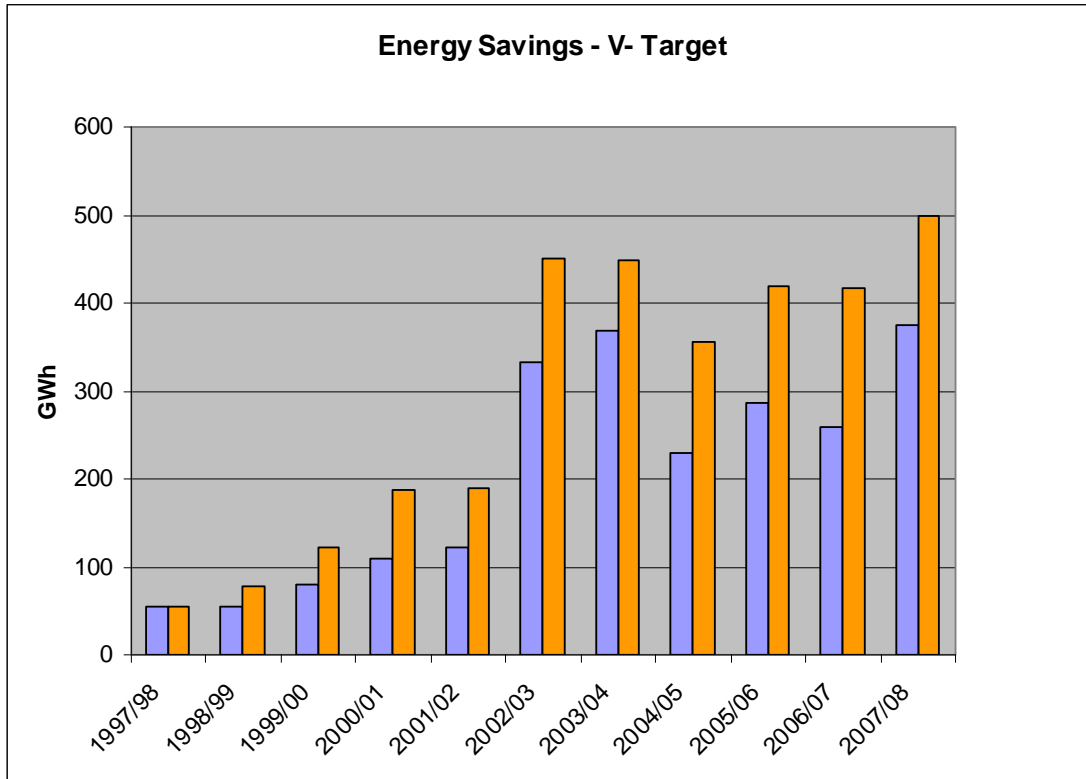
NIE Energy Supply (and presumably other suppliers) already works with a range of measure providers to drive down costs. NIE Energy Supply certainly does NOT take any margin on the costs obtained. Opening the EEL to measure providers is likely to result in an increase in costs, not a reduction.

### 3. Constraints on possible bidders:

If NIAUR choose to open the EEL, it is suggested that the minimum scheme size would be more realistically set at £100,000 (£10,000 could potentially lead to 600 small schemes). NIAUR's proposal is also likely to result in higher administration costs in general with less funding directed towards measures. NIE Energy Supply is also interested to know how the Authority will define and potentially accredit a 'reputable' contractor.

### 4. Retaining existing aspects:

- NIE Energy Supply strongly believes that the incentive structure works well. The graph below illustrates how the energy savings target has been exceeded in every year except the first.



NIEES has signed up to a voluntary agreement whereby it will use any incentives earned in excess of 8% of total project costs for fuel poverty and other energy efficiency initiatives. In the current year, NIEES has developed a Hard to Treat homes initiative using these funds.

- NIE Energy Supply is in favour of transparency, and, to this end reports on measure costs on an annual basis to the Energy Saving Trust
- The incentive structure encourages the efficient use of funds. NIE Energy Supply is always keen to minimise indirect costs however recognises that some costs are essential eg surveys, quality inspections. Many of the schemes also target vulnerable customers and it is vital that their needs are considered in delivering work in homes.

##### 5. Reduce incentive:

NIE Energy Supply can see no rationale in the report for reducing the incentive to £1000, especially when the report itself suggests the correct level should be £3460.

This seems contrary to the principle of ‘no surprises’ regulation espoused by NIAUR. Indeed, removing any meaningful incentive may also impact detrimentally on the overall energy savings delivered – surely an undesirable outcome when, now more than ever, customers can benefit greatly from energy efficiency.

6. Recalibrating targets:

NIE Energy Supply believes that NIAUR should decide on the objectives of the EEL eg energy savings, carbon savings, fuel poverty alleviation, priority sectors. Some of the objectives may be focused on the delivery of social policy objectives. The targets should then be set to achieve the desired outcomes. In addition, it would seem a perverse outcome if organisations were to be penalised for their efforts to secure 3<sup>rd</sup> party leverage.

7. Clarity:

Having a clear Framework which is set for a reasonable time period is welcomed. NIEES does not believe that the current framework lacks clarity however.

8. Arrangements for underperformance:

One of the major achievements of the EEL has been the ability to innovate both in terms of measures and approaches. Whilst generally this has been successful, if penalties were introduced, then bidders may adopt a higher degree of risk aversion and stifle innovation. Furthermore, when a scheme is submitted, a supplier has no way of knowing the house types and heating fuels which have such a dramatic impact on the actual outturn savings. This should be recognised in any new arrangements that are introduced.

9. The scale of the Levy (and proposal 15):

NIAUR are suggesting only minor changes. Considering the extremely serious issues of both fuel poverty and climate change, NIE Energy Supply would support an increase in the funds to be made available for energy efficiency. NIE Energy Supply proposes a number of options:

- It is suggested that NIAUR give serious consideration to levying heating fuels such as oil and gas (Economy 7 customers are already levied).
- The level of the GB CERT programme is thought to be in region of £18 per year per customer for each fuel (ie gas and electricity). NIEES would not suggest an

increase now, but consideration should be given to a review process for increasing the EEL as and when there is a sustainable easing of energy prices.

- Given the significant fuel poverty focus, and the success of the EEL in reaching those who fall outside the remit of the Warm Homes programme, NIEES suggests that government may contribute to an increased fund until such times as there is an opportunity to increase the EEL through the PSO tariff.

#### 10. Changing the focus from priority schemes:

With a major focus on alleviating fuel poverty, NIE Energy Supply suggest that at present, the focus remains on assisting vulnerable customers through the delivery of energy saving measures. This also has a carbon reduction benefit.

#### 11. Reduced focus on whole house solutions:

NIE Energy Supply appreciates that it is costly to deliver a whole house solution (ie heating and insulation) and that many more houses could receive insulation only. However, there has been considerable research carried out both locally and further afield into the health and well being impacts of comprehensive interventions which indicate that the social benefits arising from these packages provides value for money. NIE Energy Supply would therefore urge that NIAUR consider this research carefully before dropping whole house solutions (or structuring the framework in such a way that the same outcome results).

#### 12. EEL funds should be used for home heating oil:

NIE Energy Supply strongly disagrees with this proposal as it isn't sustainable in any way. Other mechanisms should be put in place to address issues with the oil heating industry to provide a 'pay as you go' solution.

#### 13. Ending segregation of non-priority categories:

NIE Energy Supply believes that there should be ring-fencing – energy efficiency in both the domestic and commercial sectors are equally important and there should be a continued focus on both areas. In addition, as fuel poverty schemes generally require a higher percentage of funding, this category should also be ring-fenced.

#### 14. Additionality:

No major issues although it should be recognised that ability to gain additional leverage should be welcomed and not deterred.



15. Review cap on indirect costs:

NIEES welcomes the review of indirect costs. It is important that a balance is struck between minimising costs and delivering high quality schemes and good customer service. The DEFRA formula appears to represent a sensible solution. It should be stressed that the current framework structure encourages costs to be minimised.

16. Levy on gas

See proposal 9

17. Obligations on suppliers:

It is difficult to understand how an obligation would operate in parallel with an open bidding structure.

18. Origin of funds:

The collection of the levy is relatively complex – ie the amount paid per customer depends on the number of units consumed. Customers do not have an option to not pay the levy, or indeed any of the other components that are included in the make up of electricity costs such as NFFO excess costs, the Renewables Obligation, legacy generation costs etc. Whilst NIEES favours transparency, it should be managed in a way which is not confusing. Furthermore, NIE Energy Supply understands that NIAUR is keen to encourage competition in the energy supply market. Supplier branding of EEL projects should be recognised as a positive contribution to encouraging greater competition therefore.

**Other issues for consideration**

- Heating upgrades

There is considerable demand for the upgrading of old inefficient oil heating to either oil or gas (where available). Whilst there is currently a category within the priority spend allocation, based on the current energy saving calculations, the work is not cost effective (due to high cost and low energy savings). NIEES believes that the savings recognised do not reflect the reality of the old oil systems installed in homes in NI and would request that the savings calculations are reviewed.

## **Conclusions**

To conclude, NIEES has a number of concerns about the proposals suggested. Not only does the fundamental change in the arrangements appear to be contrary to NIAUR's stated principle of 'no surprises' regulation, but the proposals could lead to unintended consequences with a focus on seeking efficiencies in an already demonstrably cost effective framework at the expense of the most vulnerable customers.

NIEES believes that the current arrangements which cap incentive earning allow suppliers a certain degree of flexibility to essentially cross subsidise between categories and schemes enabling fully funded packages to be offered to the fuel poor. In addition, it seems perverse to create a framework which discourages suppliers from leveraging in 3<sup>rd</sup> party support for schemes – does NIAUR really wish less support to be provided to low income customers?

The Framework which is developed as a result of the review process should set clear objectives and avoid excessive bureaucracies which result in unnecessary leaching from the fund into supplier, Energy Saving Trust and NIAUR indirect costs.

NIEES would also be keen to explore other ways of achieving positive energy efficiency outcomes which would continue to provide value for money to customers and operate effectively in competitive energy markets.