

## Joint ERA and UKBCSE submission to the Call for Evidence on the Supplier Obligation

### Executive Summary

Members of the Energy Retail Association (ERA)<sup>1</sup> and the UK Business Council for Sustainable Energy (UKBCSE)<sup>2</sup> are committed to the Government's goal of significantly reducing greenhouse gas emissions in the UK. While companies support the eventual convergence of policy instruments into a single 'price for carbon' they believe that additional policies are needed to address the range of barriers that prevent energy efficiency opportunities from being realised.

As part of the broader commitment to reducing greenhouse gas emissions, energy companies are keen to build on the important role they play in facilitating improvements in the efficiency of electricity and gas use in homes in the UK.

Companies agree that there is more that can and should be done through traditional approaches (such as the insulation measures supported by EEC and CERT) and believe that future policies should continue to encourage these opportunities. However, they also fully support increasing the scope for innovation and flexibility to allow for the development of new energy-saving products and energy services.

Energy companies are committed to continue to play their part alongside the Government, the housing industry and appliance manufacturers to deliver further energy efficiency improvements in UK homes. Energy companies are also keen to work with each other and with other stakeholders to facilitate changes in behaviour that will drive demand for these new products and services through the next decade.

The Supplier Obligation is a particularly important policy that has the potential to drive significant greenhouse gas abatement in the residential sector. The detailed design of the obligation will require considerable discussion and debate, and we all recognise the Call for Evidence as an important milestone along this process.

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<sup>1</sup> The ERA is the sole trade association for domestic energy suppliers in Great Britain with membership encompassing all the main electricity and gas retailers.

<sup>2</sup> The UKBCSE brings together the major energy companies in the UK aiming to facilitate a rapid transition to a sustainable energy economy, consistent with a secure, affordable and reliable infrastructure.

## **Introduction**

The ERA and UKBCSE have established a joint working group that brings together Centrica, EDF Energy, E.ON UK, National Grid, RWE npower, Scottish and Southern Energy, and Scottish Power with the aim of informing the development of the post-2011 policy.

This submission outlines the views shared by these organisations and highlights two of the more substantive areas which require further discussion and debate. Energy companies will present their own views in much more detail in individual responses to the consultation.

At the end of the document we have appended a set of general principles that energy companies agree should guide the development of this policy.

## **Joint energy company positions on the 'Post-2011' policy**

### Environmental Policy Framework

Energy companies recognise the critical challenge that climate change presents and all are active in addressing the challenge in different ways.

Companies agree that the long-term objective of greenhouse gas abatement policy should be to unify frameworks to reveal a price for carbon. However, they also believe that additional policy instruments are essential in order to address the barriers to energy efficiency, and to support specific sustainable energy outcomes in the transition to a fully carbon constrained economy.

There are some key actions that can be taken to better integrate the post-2011 policy with the broader environmental policy framework, including:

- considering the benefits of aligning the timescales of the 'post-2011' policy to the 5-year carbon budgets proposed within the climate change bill - while ensuring a smooth transition from the end of CERT to the commencement of the Supplier Obligation;
- aligning the drivers of regulation of gas and electricity networks with the aspirations of energy efficiency – this is being debated in the current 5<sup>th</sup> Electricity Distribution price review; and
- ensuring a coordinated approach to the development of policies targeting the commercial sector, including the Carbon Reduction Commitment, and policies affecting SMEs.

To fully realise the energy saving and greenhouse gas abatement potential in the residential sector, the Supplier Obligation will need to be supported by a suite of policies that target a range of key stakeholders, including tougher product standards, and widespread information and awareness campaigns.

### Clear objectives

Both the purpose and the direction of the post-2011 policy need to be clearly defined. This will focus the detailed design of the initiative, and enable the development of clear performance measures for energy supply companies.

The group continues to believe that the future policy should not attempt to address parallel issues, such as fuel poverty, which should be addressed through a separate set of actions.

### Ensuring a smooth transition from EEC

The Energy Efficiency Commitment (EEC) has delivered significant energy efficiency improvements across the residential sector and this is continuing today. When the successor to EEC, the Carbon Emissions Reduction Target (CERT), ends in 2011, some lower-cost energy saving opportunities will remain, including cavity wall and loft insulation.

It is important that there is a smooth transition to the post-2011 scheme that builds on the successes of EEC and CERT, and continues to deliver the least-cost energy saving opportunities. Hence, there is broad support for using aspects of EEC and CERT either as part of, or in parallel to, the Supplier Obligation to maintain the momentum for action in this area.

### Increasing flexibility and innovation within the policy

It is agreed that, to continue delivering on the UK's energy efficiency targets, the effort will have to move beyond traditional insulation measures to more innovative approaches which could include 'energy use reduction tariffs', micro-generation, energy services and even education/behavioural change. Currently little is known about the long-term effectiveness of these more innovative approaches, or the likely levels of consumer demand.

The increased focus on innovation that has been built into the CERT programme is welcomed by energy companies, and will help inform the design and implementation of the Supplier Obligation. Energy companies support increasing the scope for innovation in the policy governing domestic energy efficiency in a way that:

- builds on the development of awareness and behavioural change experience and expertise;
- is facilitated by technological advances such as smarter metering; and
- combines efforts in all aspects of the domestic energy chain including house design and appliance efficiency

### A future market for energy services

It is not yet clear whether a market for energy services will develop, and energy companies have different views on this point. However, all agree that both CERT and the post-2011 policy should facilitate the evolution of such a market BUT not prescribe it.

There has been some discussion about the role of DNOs in financing energy services. While there is merit in exploring this and other proposals, it is important that the unique relationship between energy companies and their customers is maintained, and that customer engagement with energy efficiency is not made unduly complicated, leading to increasing transaction costs.

### Engaging those who can influence

While energy companies have an important role to play in delivering energy efficiency improvements across the economy, they do not have all the levers necessary to drive a sustained reduction in energy demand in the UK.

To drive down energy demand, an integrated and coordinated approach from a number of key players is required including Government, local authorities, builders, and appliance retailers.

The level of any obligation beyond 2011 must reflect the scale of the energy saving opportunities that can be influenced by energy suppliers.

### Consumer engagement

Looking forward, energy consumers have a critical role to play in shaping energy demand in the UK. The post-2011 policy should have a greater focus on engaging consumers, and should support a long-term shift in consumer behaviour resulting in a decrease in energy demand. This should be complemented by Government initiatives, and the activities of relevant organisations such as the Energy Saving Trust.

### Electricity and gas

The measure should have a strong focus on heat and gas (which accounts for around 75% of average domestic energy use) as well as electricity.

### A targeted approach to increasing access to affordable energy

Energy companies support the development of a separate and targeted set of policies to increase access to affordable energy and help address fuel poverty through strong partnerships with local authorities and others.

Energy companies report that it is becoming increasingly difficult to identify and implement cost-effective priority group measures. An alternative approach for the Supplier Obligation is needed, and energy companies are keen to work with Government to develop an effective and equitable approach to increasing access to affordable energy outside of, and in parallel with discussions on the Supplier Obligation.

While energy companies support separate policies to address fuel poverty, it is acknowledged that in the design of the Supplier Obligation, consideration will need to be given to the impact of the price of the Supplier Obligation on vulnerable customers, and how vulnerable customers access energy efficiency measures.

### Role of technology and advanced metering

The precise design of the scheme (particularly the issue of input vs output measures described below) will have different impacts on the technology and information needed to deliver it. However, energy companies all agree that the introduction of smarter, more advanced metering is a critical enabler to measuring changes in energy demand, supporting new products and facilitating changes in consumer behaviour.

### **Moving forward**

While there is broad consensus on most issues, there are two key areas of contention. The details of these will be brought out by the individual responses to the Call for Evidence. Energy companies are keen to continue to explore these issues as a group to see if a broader consensus can be achieved.

### Input vs Output Measurement

It is clear that further work is needed to define how a new output based cap and trade scheme could work as an alternative to the existing input approach. Once this has been completed it will then be possible for energy companies to come to a clearer view on the merits of each approach.

There is much to debate and discuss on each approach, and we would encourage the Government to look at the individual proposals raised by energy companies in detail.

Some energy companies prefer an input-based approach, with the view that an output-based mechanism is complex to administer, places responsibility on suppliers for delivering outcomes outside of their control, and leads to a focus on measures that deliver short-term benefits.

Other energy companies believe that an output-based scheme will provide an investment framework that would enable innovation with minimal Government intervention. These companies believe that the output-based approach can be made to work, and is essential if 'measurable' improvements are to be made. Some energy companies are concerned that an input-based approach could constrain innovation, and would make it difficult to deliver challenging targets.

A number of companies are interested in exploring the potential for some form of hybrid approach.

One of a number of different approaches explored by the group is where individual companies are targeted and measured on the basis of inputs but the overall scheme is rewarded or penalised on the basis of UK-level domestic energy use reductions. This would have the benefit of encouraging joint action, but it could suffer from implementation difficulties and potentially 'free-riding'.

Energy companies are keen to engage with Defra on the detailed exploration of the different approaches, and we are committed as a group to work on this issue to see if greater consensus can be achieved as the debate unfolds.

#### Energy efficiency vs Low carbon

Although the call for evidence indicates that this policy is about demand reduction and efficiency improvements, a number of key players believe that the policy should focus more directly on carbon reduction.

The main arguments for a carbon-based mechanism are that: it would facilitate more innovative approaches and products; it would facilitate the 'zero carbon homes' policy commitment; and could assist the alignment of policy instruments around a single cost of carbon.

It has also been suggested that this could lead to double counting of carbon between upstream production and downstream consumption, which would make this approach difficult to administer. In addition, it is recognised that overcoming the barriers to increasing energy efficiency requires a targeted approach that may not be delivered through policies that are more broadly focused on carbon abatement.

A compromise might be to target the obligation so that it covers energy and carbon at a household level in a way that recognises and values on-site microgeneration, **and** community-scale activities as well.

## **Conclusion**

The Supplier Obligation will potentially be an important policy to help drive a sustained reduction in energy demand, and make the transition to a sustainable energy economy.

Any obligation on suppliers must be supported by a range of other policies, such as tougher product standards, and broad awareness campaigns.

The Energy Retail Association and the UK Business Council for Sustainable Energy welcome the opportunity to provide input into the development of the Supplier Obligation post-2011, and look forward to continuing a constructive dialogue with Government during the detailed design of the policy.

*The views expressed in this paper cannot be taken to represent the views of all parts of all the companies in the ERA and UKBCSE. However, they do reflect a general consensus.*

## **APPENDIX – Key principles of design and implementation**

### **Clear objectives**

- The purpose and direction of the post-2011 policy need to be clearly defined, e.g. it should be clear whether the aim is reducing energy demand, or reducing greenhouse gas emissions.
- The policy should not attempt to address parallel issues, such as fuel poverty, which should be addressed through a separate set of actions.

### **Sustainable business models**

- The supplier obligation should be designed in a way that supports the development of profitable business models for energy companies.
- The more prescriptive Government is about policy interventions (e.g. real time meters), the less scope there is for energy companies to innovate and compete.

### **Build on EEC**

- The scheme should build on the success of the EEC initiatives to date and those planned through the next period.
- EEC3 can play an important role to inform the design and implementation of a supplier obligation beyond 2011.
- The transition from CERT needs to be managed with care.

### **Long-term benefits**

- The scheme should focus on delivering long-term improvements at the lowest cost, and should be designed to avoid any short-term perverse outcomes.

### **Simplicity**

- The scheme should be simple to administer and cope with the issues arising due to the rapidly switching customer bases.

### **A fair start point**

- While we believe there should be scope in the scheme for suppliers to compete and innovate, at its launch there needs to be a level playing field for suppliers. All suppliers should have similar chances of meeting the obligation or targets.

### **Target those who can influence**

- The obligation should be placed on those that can best influence the outcomes~ hence delivering energy saving in this area will require an integrated and coordinated approach from a number of key players including suppliers, local authorities, builders, appliance retailers etc.

### **Electricity and Gas**

- The measure should have a strong focus on heat and gas (some 75% of average domestic energy use) as well as electricity.

### **Clarity about the broader context**

- There needs to be a clear picture of how the supplier obligation fits with other initiatives (e.g. ETS, RO etc), and how the Supplier Obligation will evolve over time.