

Consultation on the Household Energy Supplier Obligation from 2011



**Friends of
the Earth
Scotland**

A response from Friends of the Earth Scotland

17 September 2007

Introduction

Friends of the Earth Scotland is an independent member of the Friends of the Earth International network. We undertake research, advocacy and community development activities throughout Scotland in pursuit of environmental justice and sustainability. This response represents the views of Friends of the Earth Scotland.

Friends of the Earth Scotland welcomes the opportunity to respond to the call for evidence.

Summary of main points

- A step-change in levels of energy conservation and energy efficiency is required, and the supplier obligation can assist in this.
- We support a move towards a cap and trade scheme in the post-2011 supplier obligation.
- It is essential that carbon savings in each of the regions and nations of the UK are measured and capped.
- The Scottish cap should reflect the colder climate and higher incidence of fuel poverty north of the border.

Specific comments

To reach the UK carbon emission targets, the Government must make the wholesale commitment required to shift from relatively low-key energy efficiency schemes that are successful on a modest scale to high profile schemes that are hugely successful on a massive scale. In the face of a general trend of rising domestic energy demand, suppliers must work to reduce householders' demand through a mixture of information, behavioural change, technical measures and by offering more efficient appliances. This may only be achievable by a radical change in the rules of the supplier obligation. While it is comforting to continue with what is known, namely the present schemes, to achieve a "step-change", it may be required to go to a fundamentally different scheme, such as *cap and trade*.

For this reason, we have a long-term policy of supporting upstream cap and trade scheme for the post-2011 supplier obligation, and to this end we support the recommendation made by the Energy Efficiency Innovation Review's household report that EEC should move to a supplier cap and trade arrangement after 2011. In principle, we support a shift from schemes based on individual measures delivering theoretical energy savings, to one based on capped

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carbon emissions in the domestic sector which deliver actual savingsⁱ. The emphasis is on **capping** overall consumption (and emissions), not necessarily on the trading of measures, which may only need to happen on the margins.

Cap and trade implies a fundamental change in the business model of energy suppliers, from that primarily selling on units of energy, to one providing **energy services (ESCOs)**. More on the role of ESCOs below.

However, such residential ESCOs barely exist at present in the UK. While ESCOs are successful and thriving in the commercial world, in the domestic sector they are rare and usually centred round local monopolies of captive customers, for example, tenants in estates of blocks of flats with district heating. To make ESCOs more widely financially viable in the domestic sector, there needs to be a high price for carbon in any scheme.

The **price of carbon** will be dependent on the total cap the Government sets on total overall emissions for the sector, divided up amongst the registered suppliers. **The cap for each supplier should be based on the previous year's energy sales to the supplier's domestic customers.**

We support the weighting of carbon to use a **standard factor for all electricity** to reflect its higher carbon intensity per unit of energy compared to gas - the approach adopted by policies in other sectors such as the Climate Change Agreements and the Carbon Reduction Commitment.

In addition, we support the **measurement of carbon downstream** using standard factors. This encourages emission savings at the customer demand end, instead of the supply (generation and transmission). It also avoids overlap with the other schemes addressing upstream carbon emissions, such as the EU emissions trading scheme and the Renewables Obligation.

Once energy suppliers are required to offer energy services in order to meet their tradable carbon quotas, their fundamental relationship with their customers should improve from the present one of householder indifference or occasional downright hostility. Too many householders are suspicious of offers of low cost insulation measures, asking the reasonable question of *why is the gas or power company offering something that cuts its income by cutting my fuel use? What's the catch?* A recent poll by Ofgem showed that very few householders had heard of the Energy Efficiency Commitment or that suppliers (it could be said) made these offers because they were obliged to by the Government. This relationship, between customer and business, must be improved to one where it is perceived to be to the advantage of both parties to cut energy use in the homeⁱⁱ. Energy supply will become part of a range of home services – the British Gas “Three-Star Service” is a good example of an existing product which could be developed into an ESCO product. **The ESCOs would have an educative role to encourage behavioural change.** This could reduce emissions savings lost through comfort-taking. There would also be (at last) an incentive for suppliers to install smart displays, either standalone or as part of smart meters, to help customers monitor the effects of their actions.

Cap and trade implies a concentration of resources on existing customers, rather than a relentless (and costly to the suppliers) drive to acquire new customers through “switching”. Needless to say, it is the captive customer who pays for this - existing customers are paying higher tariffs to enable suppliers to offer attractive tariffs to attract the minority of potential customers willing to switch. While the aggressive marketing of tariffs by UK suppliers has occurred in the UK – and at the urging of the UK Government and its regulator, whom have made it a central part of their policy to reduce domestic energy prices, the truth is, **few customers really want to change supplier**, unless they have received a very poor service from their present supplier. In the USA, which also claims to have a liberalised market, but without

the political pressures, there is little evidence of widespread switching of domestic customers between suppliers.

The current supplier obligation, based on measures, does enable suppliers to provide measures to households which are not on their tariffs. **Cap and trade will restrict them largely to their own customers**, although they could in theory **buy in savings** made by other suppliers' customers as part of the trading arrangements.

There is some concern that technical measures which are dominant in present programmes, such as cavity wall (CWI) and loft insulation, where the cost of installation is up front but the emission savings accrue over many years, could be squeezed out by low-cost short-term projects such as changes to customer behaviour through media advertising and so on. We consider that the proven efficacy of **building insulation products in producing large carbon savings** for a relatively modest cost will still make them attractive for the suppliers to promote and the householder to install. These technical measures would still be paid jointly by the supplier (cross-subsidised from the wider customer base) and the householder, as at present under EEC. The advantage to the householder flowing from cap and trade is that the householder could pay over the longer term (possibly via a tariff), instead of upfront as largely happens at present. Obviously the liability for the repayment of the loan would remain with the householder if he/she switched supplier.

Currently measures such as CWI are credited for savings for 25 years. **The position of insulation could be protected** (at least in the transition and early years) in the programme accounting period **by creating a long programme (9 years or longer)** plus a tighter cap year on year. Also, an early declaration by Government that the programme would continue beyond 2020 would encourage suppliers to install measures that return emission savings over an even longer period of time.

Another argument is that under cap and trade, **district CHP** or **heat networks** will become financially more attractive. One is tempted to welcome anything that makes district CHP or heat networks more attractive in the UK, where they have hardly thrived when compared to similar European countries such as Denmark, which adopted legislation decades ago to make them viable. If the measurement of carbon is **downstream** using standard factors, as seems to be the favourite in the Defra consultation document, this may remove district CHP's carbon emission advantage over the grid, unless it is made a special case and effectively considered in the same way as microgeneration. This leaves heat as the main competitive product for householders. However, the marginal costs of connecting existing buildings to a heat network are high and it is hard to see how they can compete with CWI and 'A' rated GCH boilers in terms of financial savings to the domestic customer.

Moving on to **microgeneration**, we are concerned that it fits poorly, even with considerable uplift, within a carbon-saving programme largely driven by the installation of the lowest cost measures. Hopefully microgeneration will thrive under the present proposals for CERT: but we consider this unlikely, despite some good product offerings from the suppliers.

Microgeneration needs programmes centred on its own merits (such as Government grant programmes) to improve its economies of scale, rather than being shoe-horned into programmes when its higher cost per carbon saved (compared with, say insulation) is cruelly exposed.

The supply of energy efficient electrical appliances and 'A' rated-central heating boilers will be encouraged by cap and trade, as it will be in the direct interest of suppliers to promote them. This issue also shows the benefit in terms of the simplicity of control mechanisms set up and operated by the regulator. Instead of Ofgem having to estimate theoretical savings of different pieces of approved technology, the suppliers will be free to choose whatever they believe will cut energy demand and emissions in real termsⁱⁱⁱ.

Where **Ofgem** must adopt a stronger role is in **protection of residential customers**. By allowing the end of the 28 day rule, the Government has acknowledged that the days of large-scale switching, as a means of driving down prices, are effectively over. This also means the Government must accept the monopoly position of suppliers and that most customers are reluctant to switch. Ofgem and the successor to EnergyWatch must protect the consumer against any abuse of position. For example, we must avoid an energy company “paying old ladies to shiver in the dark” as a cheap method of cutting emissions. Another possible abuse would be in a supplier dropping low-income customers not able to cut their consumption through installation of measures, the obvious example being low-income tenants whose commercial landlord refuses to improve the property.

This issue neatly leads to the matter of the **priority group**. Details of any arrangements for the priority group in a cap and trade scheme has been left by Defra in this early consultation until later. We will also do so, although we must repeat the view - widely recognised - that a carbon saving programme such as the present EEC/CERT will not end **fuel poverty** – it can only make a limited contribution. This means that Government, and ultimately the taxpayer, cannot escape their fuel poverty obligations.

Assuming that a significant reduction in fuel bills to very low levels in the second decade of this century is unlikely, fuel poverty must therefore be tackled both by increases in the income of the fuel poor (most effectively by increasing the number of people claiming the full benefits to which they are entitled), and greater activity under Warm Front (the Warm Deal in Scotland) and other housing improvement schemes. The Government should consider diverting the Winter Fuel Payments (which are paid to any pensioner regardless of income and wealth whether they need them or not) into Warm Front / Warm Deal measures. It should also consider using the windfall of the £500m per year additional VAT income gained by the Government from the rise in fuel prices since 2003 for the same purpose.

When this matter is finally examined we consider that the issue of **scheme integration** must be taken more seriously. There are other players with an interest in cutting household emissions and reducing fuel poverty through installation of measures. Warm Front / Warm Deal is the obvious one. Warm Zones and local authority schemes are another. It is curious that the Defra consultation makes no cross-reference to the Defra proposed performance indicators for local authorities on household carbon emissions and increases in SAP for dwellings of people living in fuel poverty.

The Defra consultation mentions **personal carbon allowances**^{iv}. In line with Government’s thinking that it must ‘win hearts and minds’ to motivate consumers to use less energy^v, we believe that, with a view to 2020, some form of downstream, personal carbon trading scheme should be in place by this time. Indeed some energy suppliers have already commented upon the inevitability of such a scheme. Through this graduated approach, from upstream to downstream carbon trading, the public will become far more ‘carbon literate’ and will be financially motivated to take action to reduce emissions without too much comfort-taking. Such an arrangement is also bound to lead to a more competitive market for home services, which will in turn improve the accreditation of and trust in installers and energy suppliers, and reduce the ‘cost perception gap’^{vi}. Personal carbon trading has also been shown to be less regressive than other financial instruments and could provide a major step forward to realizing the legal commitment of the permanent elimination of fuel poverty.^{vii}

The consultation document does not raise any specific issues regarding the impact of the supplier obligation on the nations and regions of the UK. We would like to raise the issue of the monitoring of Scottish energy saving measures and the setting of a specific Scottish cap. According to Ofgem, around 7 percent of investment under EEC1 was in Scotland, yet Scotland has 9 percent of the UK’s dwellings^{viii}. We are not aware of any assessment for

EEC2, but would be surprised if it differed radically from EEC1. This proportion does not seem appropriate to us: since Scotland has a colder climate than the rest of the UK, we suggest it is appropriate that it receives more than 9 percent of the EEC investment. Post 2011, it is essential that the volume of savings delivered in Scotland is measured, and that Scotland has a separate cap which recognises both the colder climate and the higher incidence of fuel poverty.

We trust that you are able to take these comments into account.

For further information please contact:

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ⁱ As the consultation paper puts it (page 40): “A measures-based scheme delivers a target level of energy-saving measures, but the absolute level of energy use and carbon is not guaranteed. A cap and trade scheme delivers a more certain outcome in carbon/energy terms, but with more flexibility, and less certainty over what suppliers need to deliver on the ground.”

ⁱⁱ “A cap and trade approach would incentivise suppliers to engage principally with their own customers, but would give more flexibility over the measures deployed. Cap and trade gives more scope to include behavioural change”. *Defra Post 2011 consultation document*

ⁱⁱⁱ “Under a cap and trade obligation new measures would not require prior approval by the regulator, giving more flexibility... It is simpler to monitor total energy sales than a portfolio of installed measures”. *Defra Post 2011 consultation document*

^{iv} The consultation document says: “the concept of Personal Carbon Allowances – whereby individual citizens would have responsibility for their own carbon emissions, including their home energy use - would have significant interaction with the supplier obligation. Our initial thinking is that PCAs would be fully compatible with a supplier obligation, but there are complexities around issues such as ownership of any carbon saved through measures in the home, and further work is needed to explore this in detail.”

^v A comment frequently made by Energy Minister, Malcolm Wicks

^{vi} The *cost perception gap* occurs where consumers have poor knowledge of the costs and benefits of measures, and tend to over-estimate the costs and installation time, while underestimating the savings. The cost perception gap can also be addressed by better information *and marketing* by the agencies and by energy suppliers.

^{viii} Ofgem (2005) *A review of the Energy Efficiency Commitment 2002 – 2005*
<http://www.ofgem.gov.uk/Sustainability/Environmnt/EnergyEff/Documents1/11254-18105.pdf>