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Dear Fiona,

Energy Efficiency Commitment 2005 – 2008 Administration Procedures

Thank you for the opportunity to comment on the above. We have set out our detailed comments in the attached paper. However, we have three fundamental concerns about the proposed administration procedures and we have outlined these in turn below.

Multiple Supply Licences

We note in paragraph 3.3 that Ofgem state that where a supply business holds a number of licences, the intention is that the minimum 15,000 domestic customers threshold would apply to the supply business as a whole and not to each licensee individually. Accordingly, a licensee within the supply business that does not reach the 15,000 consumer minimum individually may still be subject to a target. Ofgem state that they are currently clarifying this matter with Defra and that if this is the case, Article 4(1) of the Order will need to be redrafted (paragraph 3.12).

We wrote to Defra in October 2001 seeking clarification of this issue as a matter of urgency. We outlined our concerns about any possibility that the aggregate industry target would be allocated to individual suppliers on the basis of the customer numbers under each licence rather than the total for the group as a whole. Such an approach would clearly discriminate against companies with one supply licence in favour of those with more than one licence even in circumstances where the two companies have the same number of customers in total. In effect, suppliers with the same total number of customers would receive vastly different targets simply because of the way that they have legally structured their business following implementation of the Utilities Act.

This approach would therefore undermine the competitive position of one supplier compared to another. We would consider such an approach completely unacceptable, in a competitive market. There is also a danger that such an approach could lead to gaming amongst suppliers.

Defra subsequently responded to our concerns and confirmed that for the purposes of ascertaining the number of domestic customers supplied - for determining whether a supplier is subject to an energy efficiency obligation or for determining a suppliers energy efficiency target – any customer supplied by a holding company or a subsidiary or by a subsidiary of a holding company, will be treated as being supplied by the supplier in question. Defra therefore supports Ofgem's understanding of the policy intent of the draft Order.

In paragraph 3.15 Ofgem states that it is proposing to apply the relevant adjustment factor to the total customer numbers within the suppliers business group. The resultant figure will then be apportioned between each licensee in the business. While we clearly support applying the adjustment factor to a supplier's total domestic customer numbers, we do not believe that it is necessary (or indeed appropriate) to then apportion the obligation between each licensee in the business. Article 1(2) of the draft Order provides for all licensees to be viewed as one supplier.

We would welcome clarification on this matter and in particular our interpretation of the draft Order as soon as possible.

Refinement of the Criteria in Relation to Averaging the Number of Domestic Customers over the Period of the Order

Paragraph 3.16 states that Ofgem and Defra are currently considering refinement of the criteria contained within Article 4(2) in relation to the averaging of the number of domestic customers over the period of the Order for target setting purposes and the calculation of the relevant adjustment factor. No further details are provided on what form the refinements might take. We would therefore consider it essential that we are afforded an opportunity to comment on any proposals to change the existing criteria before a decision is made whether to implement the changes or not. If we are not afforded such an opportunity, we would question whether the process for amending the draft Order could be viewed as fair and reasonable.

Proposed Correction Factor for DIY Loft Insulation

Ofgem outline their views on a proposed correction factor for DIY loft insulation in paragraphs 7.27, 7.28 and 7.29. We have a number of serious concerns about this proposal and we have detailed them below.

First, customers who return unwanted rolls of loft insulation will expect to obtain a refund from the retailer. The retailers with whom SSE are working with administer any refunds through their electronic point of sales (EPOS) system. This means that any returned rolls are automatically included in the returns provided by the retailer to SSE. This has been confirmed in the weekly data provided to SSE which sometimes shows a negative figure for sales of loft insulation for a particular store. We can therefore confirm that no claims are made for loft insulation which is subsequently returned.

Second, for part rolls of product which cannot be refunded we agree that householders will try to use it where possible. It should be recognised that loft insulation can to

some extent be stretched or squeezed to cover an area and that surplus insulation could be used in this way. Therefore the insulation will be made to fit the loft area and excess will be reduced. There is also evidence of customers purchasing insulation to insulate part of the loft, i.e. over a room, which is used more than others, in which case there may be no excess insulation. We do not therefore agree with Ofgem's conclusion that a reduction factor should be applied to account for this.

Third, while some householders purchase loft insulation to insulate structures other than their loft it should not be assumed that these are unheated spaces. The fact that householders are prepared to go to the trouble of insulating them suggest that they are in-fact heated. There is a growing trend for householders to build substantial garden sheds to be used as offices and to heat then electrically in which case the energy savings could be substantial. As a consequence, we do not believe that householders are insulating unheated spaces, as this will not significantly improve the comfort conditions within the space. We therefore strongly object to the proposed 10% correction factor being applied to take account of such instances.

Fourth, where householders are purchasing insulation to insulate other miscellaneous parts of a dwelling or structure, then these are likely to represent very small areas of insulation. It is hard to envisage where significant amounts of material could be used other than for insulating lofts, walls or floors.

In view of the above, we firmly believe that the proposed correction factor of 12.5% cannot be substantiated and should not therefore be applied. We also note that Defra is currently considering amending the target setting model to account for Ofgem's proposed correction factor. As an absolute minimum, Ofgem cannot apply any correction factor unless Defra's model is amended to reflect this position.

If you have any queries on the above or on our detailed comments attached overleaf, please call.

Yours sincerely,

Rob McDonald
Director of Regulation

Energy Efficiency Commitment 2005 – 2008 Administration Procedures

Target setting

We are concerned that Ofgem has asked Defra to consider changes to the definition of a domestic customer within the Order to reflect the definition in the supply licence. We do not understand the reason for this change. While very similar, the definition contained in the supply licence appears to include customers who require to be supplied with electric or gas but who are not yet actually supplied by the licensee in question. We firmly believe that it would not be appropriate to include such customers within the calculation of a supplier's target. Moreover, to attempt to do so would significantly increase the complexity and administrative burden on suppliers in terms of reporting customer numbers. This is particularly the case given the high number gains and losses experienced by each supplier. We would therefore request clarification on this issue as soon as possible.

Supplier's Proposals

Paragraph 4.7 states that " any changes made to an action which has been approved as a qualifying action may mean that that action can no longer be considered qualifying". This statement should be qualified to refer only to changes resulting in material changes in the predicted energy savings of a scheme. If this is not the case, suppliers would be required to notify Ofgem of all inconsequential changes to a scheme which would lead to a significant administrative burden on both suppliers and Ofgem.

Paragraph 4.10 states that if all the relevant information has not been provided by suppliers then the notification will not be considered to be complete and Ofgem will be unable to assess whether the proposed action can be considered as qualifying or not. While suppliers will undertake all reasonable endeavours to complete the necessary monitoring proformas correctly and on time, we do not believe that the provision of monitoring data should ultimately determine whether or not energy savings can be claimed under a scheme. This is clearly not the intention of the draft Order and a degree of flexibility should be allowed for by Ofgem.

Ofgem state that we can begin to provide notifications of proposed actions under Article 5(1) from the 3rd January 2005. However, we do not yet have copies of the proforma and spreadsheet to be used and we would welcome notification of when these will be made available to suppliers.

In relation to transferring energy efficiency targets, it would be useful to be able to transfer part of the target i.e. part priority or part non-priority. This would allow suppliers to trade their priority or non-priority obligations accordingly.

Compliance

Paragraphs 5.3 and 5.7 – see comments above in relation to paragraph 4.10.

In paragraph 5.8 Ofgem state that suppliers must provide notifications of the draft Order in writing and ideally in electronic format. We note that this is the preferred method but highlight that in some cases this is not possible, for example where information is prepared by third parties it may be necessary to send this information in hard copy.

Ofgem ask whether it would be appropriate to conduct monitoring additional to the proposed audits, such as mystery shopping. In our view, such additional monitoring is not necessary as the audits (combined with the information regularly submitted to Ofgem under EEC) is more than sufficient to allow Ofgem to audit the delivery of measures for which improvements in energy efficiency are claimed.

Qualifying action

Paragraph 6.9 vi) b) states that a supplier's action must result in improvements in energy efficiency additional to mandatory requirements and those achieved by voluntary industry agreements. However, in our view, neither suppliers nor Ofgem have sufficient knowledge of voluntary industry agreements or mandatory requirements for consumer electronics and advice should therefore be taken from an independent advisor.

Paragraph 6.9 vii) a) - we do not believe that it is appropriate or necessary for suppliers to demonstrate an uplift in sales for retailer schemes. The EEC2 targets are very large and challenging. As a consequence, if a suppliers' retail scheme does not result in an uplift in sales then the shortfall will need to be met by delivering some other type of measure or scheme. In addition, there are many different factors that can significantly affect retail sales not directly related to the scheme e.g. opening and closing of new stores, offers being made available by competitors and the overall availability of products.

Paragraph 6.19 states that "any energy service activity proposed by suppliers will be assessed separately for the purposes of the draft Order and for the trial suspension of the 28 day rule". We are not clear what is meant by this statement, but our understanding is that measures installed as part of the trial suspension of the 28 day rule can be claimed against our target under EEC2. We would welcome urgent clarification if this is not the case.

Determining improvements in energy efficiency

We would welcome clarification under paragraph 7.4 of exactly what Ofgem would consider a deviation from the action. If for example we state we will fund cavity wall insulation in a pre 1976 gas heated home, but then claim for a measure in a post 1976 oil heated home, will we have deviated? Also would the mix of properties need to be close to our original predictions?

Paragraph 7.10 deals with cavity wall insulation and in particular states that Ofgem will determine the energy savings for cavity wall insulation using an average cavity width. We do not consider this to be a reasonable or appropriate stance, particularly given that for other measures very detailed, specific information is used to calculate the savings e.g. in the case of CFLs Ofgem propose to take account of the heat replacement effect.

More importantly, however, wider insulation cavities deliver significantly higher energy savings than an average width cavity at a considerably higher cost to the installer. Also, in certain areas of the country wider cavities are much more predominant and, as such, some suppliers will be seriously disadvantaged compared to others by Ofgem adopting an average cavity width across the UK. We would regard such an approach to be unacceptable in a competitive market. We therefore firmly believe that Ofgem should take into account varying widths of cavity wall insulation in order to accurately predict energy savings realised under EEC and to avoid discrimination against certain suppliers. We would be happy to provide detailed information on varying cavity widths across the UK if required.

In relation to the proposal in paragraph 7.14, we believe that suppliers should be able to claim energy savings for loft insulation where the U value achieved is higher than 0.16 w/m2K. For example, some social landlords only want to install loft insulation to a depth of 200mm. Alternatively, where measures have been traded with the Scottish Executive Warmdeal programme, the standard depth of loft insulation is 200mm.

Again, in paragraph 7.66 Ofgem state that they intend to calculate an *average* energy saving for set top boxes in line with Defra's target setting model. Energy savings for set top boxes should be based on a model's actual consumption rather than an average. The actual consumption of a particular model should then be compared with the average for new set top boxes in the market.

Paragraph 7.72 – at present savings for TRVs can be claimed by suppliers when installed in a domestic premise. We would urge Ofgem not to introduce even greater complexity to the EEC process by excluding TRVs installed in certain rooms within the property.

Monitoring

Under paragraph 8.8, Ofgem state that a suitably qualified independent contractor should monitor a minimum of 5% of the dwellings of recipients of an action to ensure that the installation meets the correct standards. We propose to use an SSE employee who is suitably qualified and independent of the insulation installer.

Ofgem also state that ideally the monitoring should be conducted within 2 months of installation. This is not always possible, particularly in remote areas where only a few jobs are being completed each month. In such cases, we would normally wait until enough jobs have been completed to make a survey visit worthwhile.

In paragraph 8.26, Ofgem state that the 5% technical monitoring will be in addition to the process of the boilers being fitted by a Corgi registered installer. We would question whether this additional monitoring is really necessary given that it is a legal requirement for boilers to be installed in accordance with technical standards.