REA Response to Energy Efficiency Scheme for Small & Medium Sized Businesses – Call for Evidence, March 2019

The Renewable Energy Association (REA) are pleased to submit this response to the above consultation. The REA represents a wide variety of organisations, including generators, project developers, fuel and power suppliers, investors, equipment producers and service providers. Members range in size from major multinationals to sole traders. There are over 550 corporate members of the REA, making it the largest renewable energy trade association in the UK. The Wood heat Association is also a completely owned subsidiary of the REA and is the UK trade association for the modern wood heating and related biomass heating industry including wood fuel suppliers, biomass boiler and stove installers and distributors, and anyone involved in the supply chain

Introduction

Overall, the REA welcomes the recent suite of commitments from Government as part of the 2019 Spring Statement, including this Call for Evidence on an energy efficiency scheme for Small and Medium Sized Businesses (SMEs). As highlighted in the Call for Evidence document, SMEs are not only central to the UK economy, comprising 99.9% of UK businesses in 2018, but accountable for around 50% of business energy use. As such, incentivising energy efficiency for this tranche of the economy presents significant opportunities for the reduction of overall UK emissions.

These savings can be provided through a wide range of measures such as solid wall, cavity wall, underfloor and loft insulation; glazing and lighting efficiency upgrades. Importantly, however, significant reductions in the carbon intensity of properties can also be delivered by micro-generation from on-site renewables, the replacement of fossil- for low-carbon heating and the installation of smart control technologies (e.g. smart meters). This Call for Evidence highlights three possible options for incentivising such improvements. Our responses are detailed below.

Q1: To what extent do you think that competitive tendering could be an effective mechanism to achieve energy savings through energy efficiency? What do you see as the pros and cons?

Competitive tendering under auction, as propounded by the Capacity Market (CM) and Contracts for Difference (CfD) model, is a proven method for the delivery of a

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desired outcome (MWh/£, for example) at the lowest possible cost. The clear advantage here is that the mechanism and market themselves act as a sorting house, meaning Government policy can remain technology agnostic and focus instead on the maximum utility afforded against some primary metric (in this case, energy efficiency).

This being said, a potential negative attribute of this option is that, as in the CfD, a mechanism which focuses exclusively on securing maximum efficiency savings per £ may struggle to simultaneously promote less-established technologies/measures without some secondary instrument. This is relevant because we may also want to expedite the installation of slightly more expensive energy-demand-reducing technologies, such as on-site battery storage.

Q2: What are the different ways of designing an auction, and which would be the most appropriate for energy efficiency measures targeted at SMEs?

The details of any such auction would be best determined by a subsequent consultation, assuming a competitive tender mechanism is considered the best option moving forward by the respondents of this Call for Evidence. However, the highlighted examples of Switzerland and Germany provide potentially analogous cases from which to adopt an overall framework and learn important lessons. The Swiss example, in particular, has run efficiency auctions since 2010 and therefore boasts a wealth of data on how such mechanisms operate in practice. This resource should not be neglected in informing any future, similar mechanism in the UK.

Furthermore, the UK Government has considerable experience running the CfD mechanism and CM auctions, both of which provide valuable insights into effective auction design.

Q3: What approach should Government consider for funding a business energy auction scheme?

Whilst it is the case that all businesses captured by this proposal should see tangible improvements in energy efficiency and therefore, decreases in overall energy bills, it is not the case that the scale of these savings will be equivalent across the board. This consultation notes the diversity of commercial properties and business models captured by the category 'SME', and should therefore also consider the expected differences in energy demand for each individual business. Figure 3.1, pg. 48 of the Building Energy Efficiency Survey (2015) notes the range in energy consumption across SMEs. Given this is the case, a tenable option could be co-funding efficiency measures with businesses but tiering the level of co-support available based on annual company turnover. This would have the effect of ensuring available budget is directed to those companies that most require it, whilst preventing competitive distortions between businesses.

Q4: What level of co-funding would maximise the value for money from the auctions and minimise competitive distortions, while providing a sufficient incentive for SMEs to take up the measures?

The REA does not feel best positioned to respond to this question. If this option were to be selected, we would suggest further consultation with the full spectrum of SMEs.

Q5: What are the pros and cons of implementing a new business EEO?

Perhaps the most obvious benefit associated with developing a business EEO is that the domestic EEO (ECO scheme) provides a proven and effective analogue. In its simplest possible form, a new business EEO would place an obligation onto energy suppliers to deliver a set amount of energy savings per year for their business customers. The range of eligible measures would be clearly outlined, as is currently the case under ECO3 (here), and costs would then be borne, over time by a business (the beneficiary) through its energy bills. Clearly, the savings provided by the obliged energy supplier would need to be greater than the cost of repaying the implemented efficiency measures.

Another positive attribute of a new business EEO stems from the transferability of measures currently deemed eligible under ECO3. These include micro-generation (Solar PV only); Air Source Heat Pumps (ASHPs); Ground Source Heat Pumps (GSHPs); biomass boilers; and connection to a district heating system. The promotion of renewable energy and clean technologies in businesses will deliver significant carbon savings overall. The latest BEIS household energy efficiency statistics indicate that 12,500 energy efficiency measures were installed in February under ECO3, an increase of 4000 measures installed in January. These numbers show that, based on the first five months of data for ECO3, 28% of installations were for cavity wall insulation, 21% were for loft insulation and **25% were for boiler upgrades**. **Other heating accounted for 17%**. The government has a target to upgrade around 1 million homes between May 2015 and April 2020. Given the continued success of the ECO3 scheme, building a new business EEO on this basis will likely be at least as beneficial for the commercial sector.

Q6: What are the relative merits of placing the obligation on suppliers, network operators, generators or other bodies?

The REA does not feel best positioned to respond to this question. If this option were to be selected, we would suggest further consultation with each of the proposed obligated parties and an assessment of European examples and their transferability to the UK case.

Q7: What models of EEOs would minimise costs while delivering efficiencies?

Whilst the REA does not feel best suited to answer this question in full, it seems intuitive that placing the obligation on suppliers, as with the current ECO scheme, would reduce costs as well as administrative friction. This may be more time efficient relative to designing a drastically different EEO framework, and thereby deliver more immediate carbon savings.

Q8: A number of countries operate EEOs, what can we learn from their experiences?

One of the most important lessons that can be learnt from international comparators is a general one: the UK is unusual in having an EEO for domestic properties only. This means that the ~58TWh/annum energy demand from businesses is not being suitably managed. At this stage, we cannot afford to delay securing the 'low hanging fruit' of energy demand reductions in the business sector.

Q9: What level of co-funding would maximise the value for money from an EEO and minimise competition distortions, while ensuring a sufficient incentive remains for SMEs to take up the measures?

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Q10: How could the ESCO 'pay as you save' model be adapted for SMEs?

Q11: Do ESCOs and banks see additional risks operating in the SME market?

As a trade association, the REA is not well placed to answer this question.

Q12: Do you believe a scheme encouraging and helping lenders develop more innovative and attractive finance products will help generate interest amongst SMEs?

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Q13: What types of innovative finance products or banking initiatives would attract SMEs into taking action on energy efficiency? Please provide examples.

Q14: Do you have an alternative model for the business energy efficiency scheme that we should consider?

One suggestion here is that, rather than/as well as considering the creation of a new, separate scheme, an existing UK scheme could be modified to reduce the energy demand and carbon intensity of businesses. Specifically, we suggest a modification of the Energy Savings Opportunity Scheme (ESOS):

Administered by the Environment Agency, the ESOS is a mandatory energy assessment, carried out every four years, for organisations that fall within the qualification criteria. Our proposal is that the focus of the scheme could be changed from energy savings to CO_2 reduction, incentivising the deployment of on-site low carbon heating or power generation in the commercial sector. The existing scheme has been successful in reducing energy usage through the adoption of measures including LED lighting and insulation. Here, we suggest that by shifting the scheme to focus on reducing the carbon intensity of business properties, we will promote the installation of on-site renewables, such as low-carbon heating and power solutions.

This option directly addresses emissions from the commercial sector, which are considerable, and would work well in tandem with a grant or soft loan mechanism. It is especially suited to ensuring that quality, rather than quantity, is the focus for installed systems by encouraging the continued use and improvement of low-carbon heating systems/efficiency measures.

REA, May 2019