

15 September 2015

Demand Reduction Obligation

Energy Saving Trust paper

Further to the reports published by the Centre for Sustainable Energy (CSE) on introducing a demand reduction obligation the Energy Saving Trust is publishing this paper to look at what this would entail.

Introduction: Energy Saving Trust position on the Demand Reduction Obligation

As we explore below, we welcome the fact that DECC are looking at a range of options for ECO post 2017 and continues to explore new policy options for future energy efficiency programmes. We believe that a Demand Reduction Obligation – or something like it – could have a place in the policy mix. We would particularly welcome the incentive it would give for energy suppliers to innovate in approaches to achieving energy saving through behavioural change in the able to pay sector.

However, we do not believe a DRO is the most important part of the policy mix to tackle home energy efficiency. To meet Carbon Budgets and Fuel Poverty targets, our housing stock needs a major transformation involving significant upgrades to buildings and heating systems. And we need to prioritise fuel poor homes in making those transformations. A DRO – as it is proposed – will neither prioritise the fuel poor nor building level actions.

We suggest that a DRO would best be delivered by District Network Operators (DNOs) as they are best placed to deliver area-based schemes and building-wide improvements (for multiple residence buildings with different suppliers). These schemes would benefit from economies of scale and improved delivery. In addition demand reduction is aligned with DNOs' business models and objectives.

Context

DECC is currently looking at a number of different options for how to deliver the supplier obligation beyond the current phase of the energy company obligation - due to end in 2017.

A CSE report "[Beyond the Eco](#)" and its follow-up "[Beyond the ECO and beyond](#)" has proposed the concept of a demand reduction obligation, under which energy suppliers would be obliged by government to reduce the average demand of their consumer base by a set amount each year.

Demand Reduction Obligation

A demand reduction obligation (DRO) obligates energy suppliers to reduce the average demand of their consumer base by a set amount each year.

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Compliance of targets would be measured through smart meters by looking at total energy usage of a suppliers' customer base and dividing by the total number of customers. There would be very few – if any – restrictions on how suppliers are able to meet their obligations.

The energy saving target would be set by DECC and enforcement would fall upon an organisation such as Ofgem (though one of the attractions of this approach could be that the compliance requirements are lower than those of the current ECO).

Advantages

It is hoped that a DRO would incentivise suppliers to engage with their consumers and help them change their behaviour and save energy. This would ensure that the smart meter rollout is capitalised on and that the many low cost energy saving opportunities that are currently being missed out on are addressed. A DRO – it is hoped – would be a simple and effective policy instrument to get suppliers to engage with their customer base, drive behaviour change and reduce energy demand.

In addition:

- It avoids regressive effect that could come about from continuing ECO as is, whereby suppliers pay for few but expensive improvements funded through everyone's bills
- Incentivises low cost carbon saving measures that weren't delivered under ECO (lighting, draught proofing)
- Would encourage energy suppliers to introduce really effective behavioural programmes
- Contributes towards reducing peak demand and hence reduce needed investment in generation capacity
- Simplicity and flexibility
- Complements other DECC policies, mainly the smart meter rollout
- Places energy saving at the heart of the energy suppliers' business model

One of the most important advantages to a DRO is that it avoids the regressive effect a continuation of ECO would have: in focussing on the hard to treat properties "ECO3" would only be able to make improvements to a small number of properties. This would have a regressive effect as ECO is funded through everyone's bills and the majority of properties would not receive any measures. This creates a regressive effect as everyone contributes yet only very few people

Disadvantages

The disadvantages of a DRO include issues around target setting, suppliers' ability to influence demand, the level of energy saving measures actually introduced and the focus on low cost measures (which can be viewed as both an advantage and disadvantage), amongst others, as below:

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- Difficult to predict demand and therefore difficult to set targets – it may not be possible to set the requirement in a way that meets the additionality requirements of Article 7 of the EU Energy Efficiency Directive i.e. energy demand could be expected to decrease on its own over time therefore it may not be possible to argue that the action of the energy suppliers adds anything. This would go against the EU directive.
- Suppliers may not be able to influence consumer demand
- Does not incentivise the installation of measures in fuel poor households: fuel poor households are likely to take the benefit of efficiency improvements to keep their home warmer, not achieve lower bills savings.
- Energy consumption reduction not necessarily achieved through energy saving but through differential customer retention and capture (e.g. it will encourage suppliers to drop high use, low revenue customers)
- Goes against switching policies (because the model relies on suppliers having an ongoing relationship)
- Tends to incentivise low cost mass measures rather than the measures that are most needed to tackle the housing stock, especially solid wall insulation. This is because suppliers face a requirement to reduce average demand and they would look for the cheapest way to do so (mass changes in lighting, draught proofing and other low cost measures). Although when delivered on a mass scale low cost measures help reduce energy consumption they do not address the most pressing issue as identified by CCC: improving the fabric of the housing stock such as solid wall insulation or changing to renewable energy.
- Because suppliers' customers are dispersed it does not encourage building level, area based or community level action.

Possible solution to the barriers

To ensure that targets are: - appropriately set; correspond to additional energy saving; that suppliers are in fact able to deliver, extensive piloting could be performed.

To ensure that the targets are delivered through energy saving rather than simply differential customer retention and capture the scheme could be carried out over a long timeframe.

The main disadvantages of a demand reduction obligation lie in its omission of fuel poverty and solid wall insulation (SWI). This is explicitly recognised in the CSE report and the solution offered is for various organisations (local authorities, charities, energy suppliers, etc.) to bid for funding from a centrally funded “fuel-poverty” pot. However seeing as one of the advantages of a DRO is its simplicity, this is lost if a separate fuel poverty scheme needs to be set up administered alongside it.

To help stimulate the SWI market, CSE recommends first-adopters' grants, reforming stamp duty and incentivising best practice.

Concerns over a DRO

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On top of the disadvantages identified above, one of the main problems with the approach taken to look at the DRO is that it is an effective policy instrument, but it was not developed for the problem identified in the UK. The main issues in energy efficiency in the UK is how to effectively reach the “hard to treat” properties and how to tackle fuel poverty. This should be the starting point, from there we should be asking: what policy instruments (or what policy mix) best address these challenges? Although the DRO is undoubtedly a useful and effective policy instrument in its own right it is our view that it is being applied to a challenge that it is not well suited to.