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12 August 2013

Energy Markets and Programs Division
GPO Box 1264
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By email: DMITRE.REESReview@sa.gov.au

Review of the South Australian Residential Energy Efficiency Scheme (REES)
Directions Paper July 2013

Thank you for the opportunity to respond to the Department for Manufacturing, Innovation, Trade, Resources and Energy's (DMITRE) Directions Paper (Directions Paper) for the Residential Energy Efficiency Scheme (REES).

Simply Energy is a leading electricity and gas retailer in South Australia, and has been an obliged retailer under the REES since its commencement in 2009. We are also liable entities under the Victorian Energy Efficiency Target (VEET), New South Wales Energy Savings Scheme (ESS), and the Commonwealth Government Renewable Energy Target (RET) schemes. Our submission to the REES Review draws on our experiences across these environmental obligation schemes.

As stated in our submission (dated 12 November 2012) to the Issues Paper for this review, we do not support the continuation of the REES beyond 2014.

REES is contributing to cost of living concerns and is not assisting hardship

Customer concern about the rising cost of energy and the contribution that energy is making to cost of living concerns has become intense in recent years. Along with network costs, a primary contributor to increasing energy prices has been the increasing number of green energy schemes and the rising costs of meeting the obligations imposed by these schemes.

South Australian customers currently bear the costs of a price on carbon, two Renewable Energy Target schemes, increasingly complex solar feed-in tariff arrangements and the REES. In addition, there are various directly government funded green schemes that South Australian customers fund through their taxes.

The REES may be a smaller contributor but it still adds to the cumulative cost of the regulations applying to the industry and thus impacts upon the affordability of an essential service.

The number of customers falling into hardship has continued to grow in South Australia since the inception of REES. This fact contradicts suggestions that REES is assisting customers manage their bills. We suggest that the opposite is in fact the case and that the incremental cost of REES will cause the next individual on the verge of hardship to fall into hardship.

We query the logic of trying to assist low income customers manage their bills by increasing the cost of energy.

Hardship customers, including those who are on the verge of falling into hardship, require more effective assistance than changing a few light bulbs or replacing a power board here and there. What they require is government sponsored industry wide help that provides them with genuine, effective

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and where necessary, long term support to get them out of hardship or support them in paying for an essential service over the long term.

We suggest that government and industry resources would be better spent on developing more effective approaches to addressing or managing customer hardship than on the REES.

Continuation of REES is not justified on a cost-benefit or emission reduction basis

We do not believe that the extension of REES can be justified on a cost-benefit or emissions reduction basis. The ratio of historical benefits to costs was significantly overstated by ESCOSA and Pitt and Sherry, and the opportunities identified were only described at a high level, with no credible, costed examples provided.

In particular, Pitt and Sherry have used historical costs to assess the merits of the scheme continuing. We believe that the proposed changes to the scheme, such as expansion of priority group membership, expansion to small business, tighter regulation of audits, will increase the cost of REES and these future cost impacts must be considered in assessing the costs and benefits of the scheme.

We have addressed the major directions listed in the paper with the aim of reducing the scheme's overall costs and therefore the additional burden on South Australian consumers. Our comments against the Directions Paper are in the attachment.

Please contact James Barton on (03) 8807 1171, or at James.Barton@SimplyEnergy.com.au, if you wish to discuss this submission further.

Yours sincerely

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Our responses to the major directions proposed for the REES in the Directions Paper:

Direction 1: Continue the scheme

We do not agree that the Directions Paper has demonstrated without doubt that the REES should be continued.

- The scheme objectives are not relevant going forward. However, instead of recognising this, the Directions Paper changes the objective to ensure the scheme continues. This is not consistent with the principles of best practice regulation.

- The Directions Paper does not attempt to demonstrate the need to continue the scheme so that it can meet its objectives into the future. Instead, the Directions Paper justifies its proposal to continue, and expand, the REES as follows:

  > *The cost-benefit analysis undertaken by ESCOSA* (Essential Services Commission of South Australia) *and the Independent Evaluation* (by Pitt and Sherry) *demonstrated that the scheme delivers significant net benefits to South Australians. The Independent Evaluation also found that opportunities exist for the scheme to be continued and expanded*[1].

- Continuing the scheme on this basis is flawed because the ratio of historical benefits to costs was significantly overstated by ESCOSA and Pitt and Sherry, and the opportunities identified were only described at a high level, with no credible, costed examples provided.

- It is generally accepted that the activities with the highest benefit to cost ratio will be undertaken first, as retailers seek to meet their targets most efficiently. Therefore future activities will provide fewer benefits, at higher cost, than historical activities.

- The historical benefit to cost ratio of approximately 3.5, as calculated by ESCOSA and Pitt and Sherry, may suggest that the costs of meeting REES targets can increase significantly, and still provide a positive cost-benefit outcome. This may suggest that it is reasonable to take the risk of continuing the scheme in the absence of well-costed future activity estimates.

- However, the historical benefit to cost ratio has been overstated, and a correct figure is approximately 1.7. With historical benefits exceeding costs by a much lower margin than thought, the risk that the cost of future activities exceeds their benefits is much higher. To continue the scheme on this basis, without well-costed future activity estimates, poses a significant risk that future activity costs will exceed benefits.

- The use of historical costs alone is misguided. The DMITRE are proposing changes to the scheme which we believe will increase the delivery and compliance costs going forward. The purported benefits of the scheme need to take into account these additional costs in evaluating the merits of continuing the scheme.

The Directions Paper responds to our previously-stated concerns about the continuing relevance of the original scheme objectives by giving the scheme a new objective. Additionally, the independent evaluation confirmed our estimates that showed that the costs of CO2-e abatement under the REES

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[1] DMITRE 2013, *Review of the South Australian Residential Energy Efficiency Scheme (REES) Directions Paper*, Adelaide, page 5.

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(approximately $44 per tonne) were significantly higher than the $23 per tonne Commonwealth Government's fixed price of carbon, for 2012–13. This finding supports our belief that the REES should not continue, as there are more cost-effective ways of meeting this objective. Instead the proposed response to this finding is to remove this objective, but continue the scheme.

Assessment of the benefits and costs of any scheme requires consideration of only those benefits and costs that are attributable to the scheme. Costs which would have been incurred anyway cannot be attributed to the scheme and benefits that would have been obtained anyway cannot be used to support the scheme.

Estimating the benefits from a particular energy efficiency scheme has some challenges because there are a range of government schemes and requirements that address energy efficiency, as well as the observed trend towards greater energy efficiency. The 'business-as-usual' against which changes are measured is not a flat level of efficiency – there is an increasing trend towards greater energy efficiency as prices rise and community attitudes towards energy change.

The Australian Energy Market Operator (AEMO), in its forecasts of electricity consumption for the NEM, excludes REES and other state-level schemes from its forecasts. It states:

> *Only savings from Commonwealth Government level measures are included, to reduce the risk of double counting, as regional* (AEMO's term for state level) *programs tend to target similar savings and bring their impact forward*[2].

This supports our position that state-level schemes should be discontinued, as they impose significant costs on consumers for little incremental benefit – merely changing the timing of benefits that would have been obtained anyway.

This is further supported by AEMO's statement that ignoring state-level schemes poses little risk of understating future savings:

> *Any risk of understating potential savings is low because state government level measures tend to be comparatively small*[3].

ESCOSA's 2009 REES Annual Report acknowledged the overlap of State and Commonwealth Government schemes:

> *There is, of course, a degree of overlap between the activities on the approved REES energy efficiency activity list and the activities which may be otherwise subsidised or encouraged under other government (State and Federal) policy initiatives*[4].

ESCOSA does not consider that this is a relevant consideration for its annual report:

> *For the REES administrative purposes, the key concern is not whether an activity has been performed solely for purposes of the REES but, rather, whether or not that activity has been performed in accordance with the specification*[5].

While the overlap may not be a valid consideration for ESCOSA's administrative purposes, it is a crucial consideration for estimating the costs and benefits of the REES. Unfortunately neither ESCOSA's report nor the Pitt and Sherry evaluation take sufficient account of this when estimating the costs and benefits of the REES.

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[2] AEMO 2013, *Forecasting Methodology Information Paper*, Melbourne, page 5-45.
[3] AEMO 2013, page 5-45.
[4] ESCOSA 2010, *Residential Energy Efficiency Scheme Administration of the Scheme in 2009*, Adelaide, page 21.
[5] ESCOSA 2010, page 22.

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The costs incurred by retailers (which are then passed on to all customers in higher prices) generally relate to scheme administration costs and the costs of staff visiting customers to undertake REES activities, rather than the cost of the hardware (shower heads, compact fluorescent lamps (CFLs), and stand-by power controllers (SPCs)), and so the scheme costs can generally be attributed to the scheme.

In contrast, much of the benefit attributed by ESCOSA and Pitt and Sherry to the REES is not due to the REES scheme, as many activities would have occurred anyway. Once REES benefits are correctly calculated to exclude these amounts, what appeared at first to be a strong case for continuing the scheme on cost-benefit grounds is found to be much weaker.

ESCOSA has published data on REES scheme activities for 2009, 2010, and 2011. Data has not been published for 2012.

The published data shows that approximately 30% of the CO2-e benefits attributed by ESCOSA to the REES in 2009, 2010, and 2011 come from ceiling insulation installed under the Commonwealth Government scheme (which has now finished). Householders and energy retailers were generally not charged for this insulation, and these installations would have taken place in the absence of the REES, as they did in other states. As a result, it is not appropriate to attribute these activities to the REES for cost-benefit analysis purposes.

Additionally, the approach used to calculate the CO2-e saving from installation of the CFL that represents the largest share (50%) of benefits attributed to the REES by ESCOSA, significantly overstates the benefits attributable to the REES.

The analysis uses the original deemed value of this CFL (non-reflective 15W–22W CFL with a life of 10,000 hours or more), which is 0.29 tonnes CO2-e. EnergyConsult's report[6] to ESCOSA revises the deemed value from 0.29 to 0.18 tonnes CO2-e.

EnergyConsult states that their revision takes account of the Commonwealth Government decision to phase out inefficient lighting, and research that shows that business as usual (the baseline for the calculation of the deemed value savings) is for 50% of light bulbs to be replaced by CFLs and 50% by halogens (in the absence of the REES and similar schemes).

The reduction in deemed value from 0.29 to 0.18 reduces the benefits from this activity by 40%.

This reduction, and deducting the benefits inappropriately attributed to the REES for ceiling insulation, reduces the benefits of the scheme for 2009 to 2011 to approximately 50% of those reported by ESCOSA and Pitt and Sherry. This in turn reduces the historical ratio of benefits to costs from approximately 3.5[7] to approximately 1.7.

The reduction in the estimate of the historical benefit to cost ratio from 3.5 to 1.7 is crucial when considering continuing the scheme. It is generally accepted that future REES activities will give a lower benefit to cost ratio than historical activities, as the most efficient ways of meeting the targets will be exhausted by the market first.

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[6] EnergyConsult 2011, *Residential Energy Efficiency Scheme Review of Energy Efficiency Activities – Phase 3*, Jindivick, page 59.
[7] Pitt and Sherry 2013, page xii.

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A historical benefit to cost ratio of 3.5 may suggest that the risk of future costs exceeding benefits should be low, because future costs will have to increase significantly before they exceed benefits. This position is no longer justified when the correct historical benefit to cost ratio of 1.7 is used. The risk that future costs will exceed benefits is seen to be much higher, given the much lower net benefits obtained by the historical activities.

Concern about this risk is supported by the Pitt and Sherry report, which states:

> *Generally, the focus of the REES so far, as in Victoria and now in the ACT, has been on simple, easy to carry and install, and low-cost, technology-based solutions. This is both an understandable and appropriate response…We find that a continuation of the current approach would increasingly run into saturation constraints, as search costs associated with identifying and providing services to those households that have not already received the preferred technology treatments (CFLs, SPCs, shower heads) rise.*[8]
>
> *Saturation of current activities will require REES to facilitate the uptake of a wider range of energy efficiency activities – a smaller number of larger and more expensive activities*[9].

The risk that costs exceed benefits could be mitigated by well-costed, credible plans for future REES activities. The Pitt and Sherry report bases its recommendation to expand the REES on three scenarios, but provides little detail about the activities that they represent. The additional activities it lists are ceiling insulation, hot water system replacements, and air-conditioning replacements and substitution for electric space heating. The scenarios envisage a voucher system (based on \$50/tCO2-e) that incentivises consumers to choose to upgrade these very expensive household systems.

The report provides no detail about how the voucher approach could be made to work in South Australia, no examples of similar schemes working elsewhere, and no data to support their estimates of the level of uptake of these vouchers.

Additionally, the Pitt and Sherry report shows the annual costs per household of the REES doubling from approximately \$14 to \$27 or \$33 under the scenarios that include these additional activities.

The REES should not be continued, as continuing it under these circumstances presents a significant risk to consumers that the costs of the REES will exceed its benefits. Pitt and Sherry, the consultant to DMITRE, does not consider that the REES can continue as it is, but fails to provide well-costed, credible plans for the scheme to continue.

Direction 2: Re-focus the objectives of the scheme

The Directions Paper proposes that the scheme objective is changed to 'reducing energy use, with a particular focus on low-income households'[10]. This would replace the objectives that were used to justify the scheme initially and against which it has operated since its start in 2009.

We consider that the proposal to change the scheme objective reflects a misplaced approach to regulation. Regulation, such as the REES, should be put in place to address substantiated market failures and have clear objectives that address these failures. The opposite is being proposed - the objective is being changed to justify the continuation of existing regulation.

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[8] Pitt and Sherry 2013, pages 71 and 72.
[9] Pitt and Sherry 2013, page 73.
[10] DMITRE 2013, page 5.

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The current objectives of the REES scheme are the following:

- Improve energy efficiency and reduce greenhouse gas emissions within the residential sector.
- Assist households prepare for likely price increases resulting from carbon emissions trading.
- Reduce total energy costs for households, particularly low income households.

It is likely that REES has contributed to these objectives, if only in a small way.

In our submission (dated 12 November 2012) to the Issues Paper for this review we questioned the relevance of these objectives going forward.

DMITRE acknowledges ESCOSA's cost-benefit analysis published in the REES 2012 Annual Report, which found that the REES could not be justified on the basis of emission abatement alone[11]. Simply Energy agrees that with the introduction of the Commonwealth Government Carbon Pricing Mechanism (CPM) and the continuation of other environmental schemes, this objective is not a valid reason for the REES' continued operation.

Prior to CPM commencement on 1 July 2012, the REES played a small role in providing SA households with products which may assist in reducing energy consumption, so that the impact of any CPM-related price increases would be reduced. Now that the CPM is operational the objective of assisting households' preparation for this price increase is no longer relevant. We do not believe there is an ongoing role for the REES in regards to this.

Historically, REES has been effective in delivering the lowest-cost energy efficiency activities to households. These activities have generally been provided to consumers free of charge, they are quick and simple to undertake, and suit a wide variety of households.

However, these activities are rapidly approaching market saturation. In order to continue meeting the obliged retailers' obligations, more expensive activities will need to be undertaken. This means increased costs for all South Australian consumers through higher REES subsidy. Further, since this subsidy is levied on all customers, low-income households would be disproportionately impacted. This is inconsistent with the stated objective.

We are disappointed that the proposed response to the evidence that the current scheme objectives are losing relevance is not to close or reduce the scope of the scheme, but to replace the objectives with a new, more general objective.

[11] ESCOSA 2012, *Residential Energy Efficiency Scheme Annual Report - Administration of the Scheme for Stage 1 2009 – 2011*, Adelaide, page 22

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Priority group

The Directions Paper proposes the retention of the priority group target and the possible expansion of priority group membership.

The priority group targets under REES require 35% of all energy efficiency activities to be performed for low-income households. Simply Energy does not support ring-fenced targets, which increase the complexity and cost of compliance. Ring-fenced targets have not been shown to be more effective in assisting low-income households than single-target schemes. Simply Energy has continued to experience an increase in the number of South Australian customers falling into hardship as South Australian energy prices have increased.

The inclusion of ring-fenced targets effectively creates additional commodities in the market. The REES requires the acquisition of three commodities – energy audits, energy efficiency activities and energy efficiency activities for priority-group households. The result of splitting the total supply of energy efficiency credits into separate markets is reduced liquidity, and therefore higher costs. As these commodity prices fluctuate independently, liable entities are not able to restrict contracting options to those available at least cost.

As lowest-cost activities reach saturation, and households will be required to contribute to the upfront cost of more expensive energy efficient products, uptake from low-income households will fall. To reduce this effect, and enable obliged retailers to meet their targets, it is likely that the contracted price for priority-group REES activities will increase. This increases the compliance costs of obliged retailers, and therefore the REES component of energy prices to consumers. Because of the cross-subsidisation inherent in the REES funding model, the most vulnerable customers - who are unable to access REES activities requiring upfront cost - are likely to be most severely impacted.

The Directions Paper proposes expanding the eligibility for the priority group. Should a priority target be retained, Simply Energy supports reviewing eligibility to target consumers who will benefit the most. Eligibility changes should not be used as a justification for expanding any priority group target or percentage, as this will again increase the costs of the scheme for no clear benefit.

The Directions Paper proposes processes that enable community and welfare groups to refer households directly to retailers or service providers. This is justified as a way of reducing search costs, improving the efficiency of the scheme.

Voluntary bilateral arrangements between welfare and community groups and retailers or service providers can be established without any further regulation. These arrangements would be expected to develop if retailers and service providers consider that their search costs will be reduced.

Further regulation is not required and we do not support any measures that compel retailers or service providers to take referrals or engage with community or welfare groups on REES audits or activities.

Compulsion would increase the cost of the scheme, because retailers and service providers would be required to develop new processes, and spend time engaging with community and welfare groups, in circumstances where this engagement incurred higher costs than other ways of meeting REES targets.

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Direction 3: Consider expansion to small and medium enterprises

Simply Energy does not support the expansion of REES beyond the residential sector. The CPM was implemented to provide a price signal to encourage investment in emissions abatement and energy efficiency activities across the economy. The REES cannot be justified where it does not lead to energy efficiency improvements over and above what would have otherwise occurred.

Obliged retailers' management of REES service providers is already an onerous, time-consuming and costly responsibility, despite household energy efficiency activities being relatively straightforward. Energy efficiency improvements for commercial and industrial consumers can be highly complex, and must often be tailored to individual business needs. Should the REES be expanded beyond the residential sector, the cost of compliance would be substantially increased.

How the increased costs of an expanded scheme would be recovered from customers will depend on the market conditions in the residential and commercial energy markets. Nevertheless, recovering all the increased costs from small and medium businesses, who are already under significant rising cost and competitive pressures, may be impossible, further increasing the burden on residential consumers.

If the scheme is expanded beyond the residential sector, we would support obligation threshold changes that would include retailers with a small number of customers, but a high level of energy sales, in the scheme. Similar changes have been made to the VEET during 2013.

Direction 4: Improve the quality of energy audits

The Directions Paper proposes further regulation of energy audits, including revising the minimum specification and raising the qualifications required for auditors. We do not agree that further regulation is required, given the REES Review survey findings that show a majority of audit recipient households were satisfied with the quality of the audits provided, and that over 70% had adopted some of the suggested actions.

Further regulation that increases the costs of audits will increase the scheme costs for all consumers, for no demonstrated additional benefit. The REES Review survey found that the time taken for audits had a wide range, but did not correlate the time spent with householder satisfaction, or the adoption of recommendations. Similarly, the qualifications of the auditors were not correlated with outcomes.

In the absence of evidence of a correlation between qualifications, time spent, and outcomes, further regulation of these matters is not justified.

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Direction 5: Pursue greater harmonisation with other schemes

Simply Energy supports the introduction of a National Energy Savings Initiative (NESI), conditional on the closure of all state-based energy-efficiency schemes.

Should a NESI be implemented, industry must be consulted on appropriate transitional measures. In particular, if a participant has a REES activity or audit credit at the scheme's closure, it is imperative that these may be banked towards future liability under the NESI, so that the value may be recognised.

The Directions Paper proposes creating South Australian certificates for commercial activities in either the VEET or ESS registries. Simply Energy does not support expansion of the REES to the commercial sector, but if this happens anyway, we support it being done as efficiently as possible. A certificate scheme meets the targets at lower risk and cost to participants than a directed scheme (such as the current REES scheme), and so is preferred.

We would also support use of an existing registry, to avoid the costs of developing a South Australian registry.

We would also support the transition of the residential REES from a directed scheme to a certificate-based scheme, using an existing registry. This would reduce participant risk and compliance costs, and would reduce the impact of the scheme's costs on customer prices.

Direction 6: Improve participation in regional areas

The Directions Paper proposes consideration of a multiplier to encourage the servicing of households in remote or regional areas.

The data does not support further regulatory intervention of this sort, as regional areas are being appropriately serviced by the REES.

For example, ESCOSA's REES Annual Report for 2012 shows that 76.8% of emissions abatements in 2011 were for the Adelaide metropolitan area, with the remainder relating to regional and remote areas. This is consistent with the population shares, with the Adelaide metropolitan area making up 74% of the South Australian population.

It has been informally suggested that the 2012 data (which has not been published) shows an increase in the Adelaide metropolitan share. We consider that this does not represent a pervasive shift in the distribution of activities, but instead reflects the 'wave' effect as new types of REES activity are rolled out. The wave effect sees new activities roll out first in the metropolitan area, before moving to regional areas. This was seen from 2009 to 2011 with CFLs and shower heads, and is now being seen with SPCs. As metropolitan SPC opportunities become exhausted, the regional share of activities will increase again.

Additionally, Simply Energy does not support a multiplier or any approach designed to distort the market.

Where a customer values a particular product or service, they will be willing to pay what it is worth. By artificially valuing the efficiency of one activity over another, normal market signals are distorted.

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Customers are encouraged to purchase products that they do not actually value, reducing the likelihood of longer-term changes in purchasing decisions.

Bonuses and multipliers also make quantifying scheme outcomes very difficult. A multiplier applied to REES activities would mean that the number of tonnes of CO_2-e (or energy saved) reported to ESCOSA would no longer represent the emissions abatement which was deemed to have occurred as a result of that activity. Tonnes of emissions abatement or energy savings will no longer be relevant metrics for assessing scheme achievements.

While multipliers overstate the actual response to the scheme, they significantly add to overall costs. The use of the Solar Credits multiplier for solar installations under the RET led to a boom-bust cycle, triggering substantial regulatory intervention in a bid to minimise market impact. ESCOSA should avoid making the same mistake in relation to the REES.

Direction 7: Increase flexibility in activity approval processes

Simply Energy supports maximum flexibility in delivering the REES, as this will minimise the costs to consumers of delivering the activities. Allowing behaviour change strategies and technologies, for example, will increase the range of opportunities to achieve energy savings.

We also support the proposal in favour of accepting all activities that are approved by other Australian schemes. This will be a step forward in reducing compliance costs, as activities will only need to be assessed once.

Direction 8: Improve timeliness of activity reporting

Simply Energy does not support the proposal to change the date of an activity (for REES obligation purposes) to the date the activity is reported to ESCOSA.

The proposal is justified as a measure to reduce duplication, as it will encourage early reporting of activities. The costs of early reporting have not been considered. Additionally, other measures that can address the issue of duplication, if duplication is found to have a significant cost, have not been considered.

REES compliance is a complicated process because activities are carried out by the agents of service providers. The agents report to the service provider, who checks the activities. The service provider then reports to the retailer, who checks the activities. Finally, the retailer reports to ESCOSA, who checks the activities.

This is a cumbersome and expensive process, which will become more cumbersome and expensive under the proposal, because the batch sizes of activities will be reduced, to facilitate early reporting. Reporting smaller batches of activities, to get the earliest possible activity dates for them, will increase the number of batches reported, increasing reporting costs.

An alternative approach, which addresses duplication risk more efficiently than the proposal, is to move the REES from a directed scheme to a certificate-based scheme. This could be done at reasonable cost if existing registries can be used.

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Direction 9: Change the metric of the scheme to energy reduction

We do not support the change of the scheme metric from emissions reduction to energy reduction, as this obscures the costs of the abatement obtained by the REES, compared with other measures.

Direction 10: Improve the quality assurance for service providers

Simply Energy recommends that DMITRE introduces service provider accreditation, as currently occurs under the VEET, ESS and RET schemes. Any energy efficiency business could apply to ESCOSA for accreditation by demonstrating its capacity to meet REES Code requirements. A service provider would not be allowed to offer REES activities or audits without ESCOSA accreditation.

Once accredited, these businesses would undertake energy audits and activities and contract these volumes to obliged retailers (as many do currently). Providers would report on their REES activities and audits directly to ESCOSA, rather than through the contracting retailer. ESCOSA would assess the compliance of these activities and audits by working directly with providers.

ESCOSA would maintain a register of accredited service providers on its website, as a reference for consumers and obliged retailers wishing to access their services.