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

**Review of the South Australian Residential Energy Efficiency Scheme (REES)
Issues Paper October 2012**

Thank you for the opportunity to respond to the Department for Manufacturing, Innovation, Trade, Resources and Energy's (DMITRE) Issues Paper (Issues 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), Energy Savings Scheme (ESS), and the Renewable Energy Target (RET) schemes. Our submission to the REES Review draws on our experiences across these environmental obligation schemes.

We do not support the continuation of the REES beyond 2014. In the context of customers bearing the combined costs of a price on carbon, the two Renewable Energy Target schemes, solar feed-in tariffs as well as the increasing cost of the REES to consumers, its extension cannot be justified either on a cost-benefit or emissions reduction basis.

Should DMITRE decide that despite evidence to the contrary that the extension of the scheme is in the best interests of consumers we have listed a number of recommendations for changes to the design of the REES with the aim of reducing its overall costs and therefore the additional burden on South Australian consumers.

Our submission is structured in three parts:

1. Continuation of the REES beyond 2014
2. Key recommendations for REES amendment, should DMITRE decide the scheme should continue beyond 2014
3. Other matters raised in the Issues Paper

Through this approach, we have addressed most of the questions posed by the Issues Paper.

Please contact Jenna Polson on 03 8807 1171 or Jenna.Polson@SimplyEnergy.com.au should you wish to discuss further.

Kind regards,

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1. The Continuation of the REES Beyond 2014

Simply Energy does not support the continuation of the REES beyond 2014. The cost of regulated obligation schemes can only be justified where they are shown to be the most cost-effective approach to addressing clear objectives related to real market failures. We do not believe the REES should continue as, compared to other market based mechanisms, it does not provide the most cost-effective solution nor meet the stated objectives of the REES.

We are concerned that the Department should suggest a revision of the REES objectives without clearly specifying and consulting on the market failure that the Department believes it is trying to address through the continuation of the REES scheme. Further, where a new market failure is identified, it should not be assumed that continuing an existing scheme is the best solution. For example, the Issues Paper highlights the issue of peak demand in SA as a contributor to increasing energy prices. While we agree that peak demand should be addressed, we expect the REES would be an expensive and ineffective approach. Separate consultation should investigate the most effective, least-cost approach to directly target any new failures identified.

Objective 1: Improve energy efficiency and reduce greenhouse gas emissions within the residential sector.

The Carbon Pricing Mechanism (CPM) was introduced via the Clean Energy Future legislation with the key objective of reducing greenhouse gas emissions. It is inefficient to duplicate the role of the CPM through additional regulatory obligations.

DMITRE acknowledge ESCOSA's cost-benefit analysis published in the REES Annual Report, which found that the REES could not be justified on the basis of emission abatement alone[1]. Simply Energy agrees that with the introduction of the CPM and the continuation of other environmental schemes, this objective is not a valid reason for the REES' continued operation.

Objective 2: Assist households prepare for likely energy price increases resulting from carbon emissions trading.

The introduction of carbon pricing has increased the wholesale cost of energy, and in turn, retail energy rates. Prior to CPM commencement on 1 July 2012, the REES played a 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.

Objective 3: Reduce total energy costs for households, particularly low income households

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.

[1] Essential Services Commission of South Australia, Residential Energy Efficiency Scheme Annual Report - Administration of the Scheme for Stage 1 2009 – 2011, June 2012, p.22

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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.

2. Key Recommendations for REES Amendment

Simply Energy's recommendation is for the REES to be discontinued. However, if DMITRE decide the scheme must continue, we urge the consideration of the following recommendations to limit the cost to all South Australian consumers. We believe that by implementing both recommendations, the majority of DMITRE's concerns raised in the Issues Paper will be addressed.

2.1. Service Provider Accreditation

Current approach
Under REES, obliged retailers are responsible for the performance of energy efficiency activities and energy audits. As this is not energy retailers' core business, many choose to engage specialist energy efficiency service providers to undertake these on their behalf. Service providers report on the activities and audits undertaken to their contracting retailer, who submits this to ESCOSA.

Obliged retailers remain ultimately responsible for the compliance of these activities and audits with the REES Code. This represents a substantial risk to these retailers, who are often three or more degrees separate from those performing the activities and audits in households. Maintaining adequate assurance of service providers' compliance is an onerous and time-consuming responsibility.

ESCOSA manage all aspects of REES compliance through the obliged retailer only, as they do not have a direct relationship with service providers. This can be an inefficient approach, where required information and assurances may be more readily acquired by approaching service providers directly.

The only way for service providers to participate in REES is where they are able to win a contract with an obliged retailer. As a result, the range of products and services offered, and the geographical areas serviced, is limited. This in turn limits customer access to REES activities.

These factors contribute to the short supply of REES activities and audits, and increase the contracted price for obliged retailers to secure these. The sum effect is higher costs to consumers.

Recommendation
Simply Energy recommends DMITRE introduce 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 their 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.

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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.

Benefits:
Service provider accreditation allows a greater number of energy efficiency businesses to participate in the scheme than under the current REES model. This means:

- Greater supply of REES activities and audits
- Improved competition
- Lower cost of acquisition
- Broader range of activities and products offered
- Improved consumer access to services, including in remote and regional areas

In particular, this model would allow the participation of community welfare organisations who may directly assist low-income households to access REES.

The accreditation process would provide ESCOSA with greater assurance of compliance, as they are able to work directly with service providers. Concerns raised in the Issues Paper around customer protection could also be more directly managed.

Specialist energy efficiency service providers are best placed to manage the risks associated with occupational health and safety, and the high-quality delivery of energy efficiency solutions. They can therefore manage these risks at lower cost than retailers. By removing the need for obliged retailers to manage contractors and associated risks, the cost of compliance would be greatly reduced. This is turn would reduce the cost of the scheme to consumers.

Service provider accreditation would also assist the harmonisation of REES with other environmental obligation schemes, further lowering participant costs.

Costs:
In adopting this recommendation, additional costs to service providers are expected to be minimal. Obliged retailers currently require their contractors to demonstrate their capacity to meet REES compliance standards, which may be similar to ESCOSA's accreditation requirements. Under VEET and ESS, accreditation applicants are also required to pay a once-off fee to cover the administrative cost of ESCOSA assessing accreditation applications.

ESCOSA would incur some new costs under this recommendation; namely the cost of the accreditation process (which may be recovered from service providers as described above).

2.2. Certificate-based scheme

Current Approach
The units used to account for REES activities and audits are tonnes CO_2-e, and numbers of audits, respectively. Although in practice these are often referred to as REES credits, they are not registered as property rights.

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Under REES, obliged retailers submit their activity and audit data to ESCOSA to acquit their liability. ESCOSA perform some compliance checks on the data, however they are not officially registered as valid credits. ESCOSA are free to question the compliance of the activities and audits in the future, and potentially disallow their use in the scheme.

The potential for future data rejections leads obliged retailers to over-contract supply, to mitigate the risk of retrospective target shortfall. This increases the cost of compliance, and therefore the cost to consumers.

Regulations provide for obliged retailers to enter into arrangements with other obliged retailers to transfer REES activities and audits between the parties. In practice, this rarely occurs, for two key reasons. Firstly, the fact that REES activities and audits are not registered as valid credits means there is no clear delineation of responsibilities. The obliged retailer who submits the data to ESCOSA to acquit their liability is accountable for the compliance of the associated activities and audits, even if they acquired them from another entity. Given the details of contracted parties are commercially sensitive, the receiving-retailer may not be able to access information about those activities and audits to demonstrate compliance.

Secondly, an obliged retailer would only offer to transfer their activities or audits where they had a surplus, which is generally not known until the late stages of a compliance year. This means that the activities and audits are offered at a premium to a normal contracted price.

Because REES activities and audits are not generally traded, there is no price transparency. Contracting parties cannot know whether they are negotiating terms which accurately reflect true supply and demand. This also impacts ESCOSA, who currently rely on anecdotal evidence of supply and demand as a basis for their regulatory decisions.

There is no public platform for tracking liability, rather an obliged retailer must track its progress and reconcile this with ESCOSA's determinations. This is particularly difficult when managing target shortfalls and surpluses across compliance years.

Recommendation
Simply Energy recommends the registration of REES activities and audits as discreet property rights, or certificates. The VEET, ESS, RET schemes, QLD Gas Scheme and the Carbon Farming Initiative all operate under a certificate registration model.

After receiving a REES data submission, and validating compliance, ESCOSA would register the activities and audits as certificates (one certificate is equivalent to one tonne CO_2-e or one energy audit). Once validated, certificates may be traded between participants, without transfer of the compliance responsibility. Certificates are invalidated once they are used to acquit an obliged retailer's liability.

Should non-compliance later be identified in relation to one or more certificates, the participant who originally submitted the data (the creator) would be required to make good by invalidating equivalent certificates from its current holdings. This ensures future owners are not impacted in the event of invalid certificate creation.

We also recommend an online certificate registry is developed to manage and track certificates. Activity and audit data would be submitted directly to ESCOSA through the registry, where certificate validations are performed (similar to REES-R). Once certificates are registered, they appear in a

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participant's account, and then may be transferred to another party or surrendered against a liability. Progress towards REES targets would also be tracked in the registry, providing visibility of any shortfall or surplus.

Benefits:
The key benefit of a certificate-based scheme is improved tradability. Obliged retailers can easily enter into arrangements with any certificate supplier through direct negotiations, brokers, certificate aggregators and intermediaries. This would improve market liquidity, and allow obliged retailers to access supply at least cost. This has the potential to significantly reduce the contracted rate of REES activities and audits, and therefore the cost of the REES to consumers.

Obliged retailers may rest assured that registered certificates are a secure property right. There would be little need to over-contract supply, as there is now no risk of being impacted by other parties' non-compliance.

A well-functioning certificate market provides price transparency, reflecting market supply and demand. This informs participants, regulators and policy makers about the operation of the scheme, and can indicate the presence of market failures.

Certificate registration under REES would also represent a significant step towards harmonisation with other environmental obligation schemes, lowering participant costs.

Costs:
The primary cost of adopting this recommendation would be associated with the set-up and maintenance of an online registry. Learnings from the systems currently in operation under the VEET, ESS and RET schemes may offer opportunities for price minimisation.

Certificate-based schemes generally require participants to pay a fee for certificate registration, and sometimes also for certificate surrender, to help support the regulator's expenses in performing these functions.

3. Other Matters

3.1 Expansion to other sectors

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 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 (particularly if our service provider accreditation recommendation was not adopted).

3.2 The 5,000-customer threshold

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An energy retailer becomes an obliged retailer under REES when they reach the threshold level of 5,000 residential customers. Simply Energy supports competitive neutrality, and believes all energy retailers should be allowed to compete on the same terms. It is therefore our recommendation that the threshold be removed. We note the ESS currently functions without such a threshold, applying liability to all retailers.

A 5,000-customer threshold is also currently being utilised under VEET. Under VEET, this threshold has been shown to lead to competitive distortions, particularly when the scheme expanded beyond the residential sector. The Department of Primary Industries are currently consulting on an alternate definition for liable entities to resolve this issue.

3.3 Shortfall Penalty Regime

The REES shortfall penalty regime is the most expensive of all state-based environmental obligation schemes, or the RET (see Table 1. below). It is also the only scheme to include a fixed charge for each target in deficit, in addition to a variable charge per credit shortfall. Simply Energy is concerned about the adverse impact of this regime on consumer energy bills, in the context of a declining REES supply.

Table 1. Shortfall penalty regimes for the 2012 compliance year

Scheme		Variable ($/credit)	Fixed (per target)
REES	Audits	$200	$10,000 (4 targets)
	Activities	$70	$10,000 (2 targets)
RET		$65	N/A
VEET		$41.23	N/A
ESS		$24.86	N/A
QLD Gas Scheme		$13.50	N/A

The shortfall penalty charge should be viewed as a mechanism to cap the cost of the REES to consumers. This is because the shortfall charge acts as a ceiling to the contracted price of REES activities and audits. Where supply of these activities and audits continues to fall, the cost will rise towards the penalty rate. A high penalty charge allows the cost of the scheme to become very high before obliged retailer shortfall is reported. We recommend DMITRE review the REES penalty regime, so that rates are in line with an appropriate cap to the cost of the REES to consumers.

3.4 Priority Group Targets

The priority group targets under REES require 35% of all energy efficiency activities 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. In particular, we note analysis undertaken by the Brotherhood of St Laurence finding the VEET supported substantial energy efficiency improvements in low-income households, without a ring-fence[2].

[2] DCCEE & DRET 2011 National Energy Savings Initiative Issues Paper, December 2011, p.68.

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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 basis of the 35% priority-group allocation is unclear. The Issues Paper highlights that this exceeds the level of residential electricity customers are on concessions or hardship programs. This target unnecessarily increases costs, and will become increasingly unachievable.

The Issues Paper also suggests removal of the priority-group target, given the introduction of the Commonwealth Home Energy Saver Scheme. This scheme has a broader focus than the REES, supporting low-income households with financial products and advice to enable access to greater energy efficiency improvements. Simply Energy considers this a more effective approach to assisting this market segment managing the impact of energy bills, and recommend DMITRE remove the priority-group focus of the REES.

3.5 Credit Bonuses or Multipliers

The Issues Paper questions whether the use of bonuses or multipliers would be appropriate to encourage the uptake of higher-cost activities, or the servicing of households in remote or regional areas. Simply Energy does not support any such 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. 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 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 will no longer be a relevant metric 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,

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triggering substantial regulatory intervention in a bid to minimise market impact. ESCOSA should avoid making the same mistake in relation to the REES.

3.6 Transition to a National Energy Savings Initiative

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 measured. 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.