Airtricity Response to Consultation on

Electricity and Gas Retail Market Competition in Northern Ireland

16 July 2008

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Consultation on Electricity and Gas Retail Market Competition in Northern Ireland

Introduction

Airtricity welcomes NIAUR's consultation on retail energy market competition in Northern Ireland. This is an extremely important issue, given the limited success of liberalisation in the electricity market compared with the much greater level of enthusiasm with which the Single Electricity Market has been received. The timing of this consultation is also very significant, given the intended development of an all-island gas market and the differing stages of retail competition development in the two jurisdictions.

This combination of separate development, alongside the goal of integration between markets, represents the greatest risk to retail gas competition in NI. It could potentially repeat mistakes made in developing electricity retail market liberalisation from 2004 onwards and our response to the current consultation reflects on some of the lessons that can be learned from that process. In this context we welcome the Authority's willingness to consider adopting a third-party gas market design as a way of reducing market opening and operational costs, but our fundamental concern relates to regulatory risk. Unless we understand exactly what the Authority considers to be a competitive market, there is a risk that independent market participants will commit to competitive strategies that are unsustainable will ultimately lead to exit rather than growth.

There are many examples of barriers to development of competition in the NI energy sector and we have provided examples of these in Appendix 1, based on our own experience. We have included a summary of the issues in the main body of this response.

Consultation response

Q1 Do respondents agree with our overall summary of NI energy retail market competitiveness and do you feel we have missed anything of significance that should have been noted at this stage?

In addition to the issues described in the consultation, there are three significant issues that have contributed to the lack of effective and embedded competition in the electricity sector and that should be recognised in development of the gas market arrangements. These are;

- lack of clarity in communication of the Authority's vision of what a competitive market would look like,
- the perceived closeness of Authority's working relationship with the incumbent, and
- incumbent power to control development of market arrangements.

The impact of each of these is considered below.

Competitive vision

The Authority is clear that competition at any price is not an option. However it is also clear that there is concern as to lack of competitive activity in retail energy supply.

Genuinely competitive markets, for energy and other products, are risky and offer no guarantees of profitability. Net margins in such markets are typically around double those of NIE Supply. Experience shows that it is close to impossible for a start-up electricity supply businesses to achieve profitability in NI, since acquisition costs and essential discounts against low-margin incumbent tariffs combine to impede achievement of operational scale necessary to achieve sufficient scale economy to compete effectively.

It is little different for a large and experienced supplier entering the market, since the bespoke NI market design undermines achievement of scale economies. A large market entrant may be able to sustain losses for longer than a startup business, but shareholders are unlikely to support an unprofitable business in the long term. Key question is whether expected returns can justify investment required to deliver economies of scale.

We wonder what the Authority believes effective competition would look like in NI;

alternative models of competition
There are perhaps three main perspectives on the meaning of competition;

- high level of customer switching away from the incumbent,
  - In GB, Offer/Ofgem took explicit view that 1998 market liberalisation meant customers should change supplier.
  - Suppliers under pressure to pursue customer acquisition and incumbent suppliers clearly understood it was more important to lose customers than to reduce tariffs.
  - Regulatory control exercised through setting maximum tariff prices for domestic and SME (<12,000 kWh/year) customers.
  - regulatory pressure on licence holders to engage in meaningful competitive activity outside of traditional supply geographies
  - no regulatory concern over compensating incumbents for stranded costs
- prices seen to be close to marginal cost,
  - Assumption that competition delivers lowest prices, so price level is best indicator of successful competition.
  - Unimportant whether customers actually change supplier or not, provided retail prices close to long run marginal cost.
- variety of available products and service levels, with prices reflecting product offering
  - Different suppliers offer different combinations of price and service, or environmental benefit,
  - some customers willing to pay more for their energy if these other aspects delivered.
  - ROF market for renewable power was delivered by this model, until it was destroyed by regulatory policy decision to increase balancing cost by 300%.

In practice, the Authority;
- is concerned about the lack of competitor activity,
- wants to see customers switching as evidence of competition,
- sets prices to reflect an essentially low-risk business model,
- is surprised by lack of competitors willing to incur acquisition costs and offer prices below low risk level.

Current uncertainty as to what the Authority believes effective competition in NI would look like, in addition to the many issues identified in the consultation, mean that NI is not currently a particularly attractive market for non-incumbent energy suppliers.

Airtricity would welcome clarification from the Authority as to its interpretation of the phrases, "wherever appropriate" and "effective competition", in the electricity legislation and "facilitating competition", in the gas market and a clear statement of its vision of effective competition in NI.

NIAUR (Ofreg) relationship with Incumbent

Incumbent power to control market implantation is a source of additional cost to market entrants. There are ongoing issues with electricity market governance and asymmetry of information. In the past the Authority's views have been significantly correlated with those of the incumbent. No secret has been made of bilateral meetings to agree policy, prior to consultation meetings.

For example, it is unclear why;

- Authority has been willing to pre-commit, to the incumbent, on market design/operational decisions that clearly entrench market power,
- Authority has been overly-reliant on the incumbent for advice, without obtaining a balance of perspective from other market participants,
- Authority agreed to a 2,000 customer switch limit without consulting market participants,
- Until recently, smart metering solution has been decided without consulting non-NIE participants and without attempting to synchronise with RoI, when many other retail issues are discussed in the context of the all-island market,
- agreement given to implement systems that lack capacity to support fully competitive market,
- Authority agreed not to require global aggregation – why was no effort made to pursue suggested use of Elexon design for aggregation,
- it has always been assumed that incumbent organisation is best placed to deliver competitive market arrangements, or
- it has been necessary to reinvent market designs for NI, when there are tried and tested models elsewhere.

We fully acknowledge the significant improvement in the Authority's approach to energy market regulation in Northern Ireland, as evidenced by the current consultation. However, the market will suffer from past regulatory decisions for some considerable time, as it will be expensive to overcome the legacy of past decisions.

Incumbent power

Incumbent power is manifested in many non-obvious ways;

- implementation decisions for market design – even when following an underlying third party template,
- pre-agreement on key issues with Authority, eg
  - no implementation of global aggregation,
  - limit on customer switching capability,
  - agreement (later withdrawn) that customers would have to change meter in order to change supplier,
  - decision to roll out significant expansion of keypad metering, before it was known how the technology would support retail market competition – "our research showed that these meters were best for **our** customers"[1]. (emphasis added) - pre-empted more effective solution,
  - decision by NIE not to procure a full set of demand settlement profiles for larger non-domestic customers,
  - development of changes to fit SEM design separately in NI and RoI resulted in similar data, where available, being differently presented and often only available by manual download in NI.
  - timetables for aggregation resettlement have been implemented differently.
  - overall poor visibility of market design information and lack of publicly-visible document maintenance

In terms of delivering effective competitive arrangements, there is a lack of practical accountability for performance of obligations under the TSC. For example, there is no apparent means to enforce

[1] email from NIE to Airtricity

correction of material settlement data errors within TSC dispute timelines. In practice, the wholesale market rules offer no redress against failure of retail aggregation performance.

We believe the Authority should remove the automatic right of NIE T&D to operate the retail market; it should be put out to competitive tender.

Q2 Are there additional indicators of the current state of competition that we should be considering?

No. We believe the consultation accurately summarises the state of competition in the market. Our only comment would be to reinforce the point made on page 11; that "Energia, an affiliate of the incumbent NIEE, has been the most successful of the new suppliers". We believe that, among other issues, this may well reflect the relative perceptions of market risk by independents compared with the affiliate.

Q3 Do respondents agree that the analysis above has identified the major potential barriers to competition in the domestic and non-domestic electricity markets or are there additional barriers that you feel we should take into consideration?

In general, we agree that the analysis captured the major barriers to competition. More detailed points have been included in Appendix 1, but a brief summary is included below.

on wholesale market liquidity
There was even less wholesale market liquidity prior to introduction of SEM, but the design of DCs/NDCs could be improved to avoid "cliff-edge" pricing from year to year by enabling rollover of some products across the year end.

on k-factors/headroom
Price cap regulation was used successfully in GB electricity supply and would overcome problems caused by k-factors. This would overcome problems in attributing share of joint costs attributable to price-controlled sector as a result of information asymmetry. It should be remembered that tariffs set on basis of a realistic supply margin would provide customers with an incentive to switch supplier and competition would not necessarily result in everyone paying more.

on market implementation/data availability[2]
Design of market implementation failed to address incumbent incentive to differentiate market arrangements and increase cost of entry/operation. Some aspects of electricity market are manual and inconvenient to operate. Authority approached preparing for competition with mindset that it was not a worthwhile exercise, because competition was unlikely. Resulting difficulties are partly due to lack of willingness to take bolder steps to ensure design implementation provided capacity for volume competition and level playing field between incumbent and market entrants.

Current retail market design documentation is inadequate and published information is not maintained on a readily-accessible website. Potential suppliers cannot enter the market successfully if they are unable to access a clear, up-to-date market design baseline description.

The market design needs full implementation so that competing suppliers can minimise operational and transaction costs. Since (18 month late) delivery of "2005" market opening and suppliers continuing to incur project costs associated with ongoing technical changes, current market systems have not delivered an enduring solution. This is not scheduled for delivery until 2011; six years after initial market opening.

The GB market has high levels of churn between suppliers and systems that support these transaction volumes. This provides incentive for Suppliers to offer good service and low

[2] In November 2006 we requested NIAUR to require customer data (MPRN, UoS, profile, MCC etc) to be made available to all suppliers, on a regular basis. As yet, although agreed, this data has not been provided. It remains in discussion between the Authority and NIE T&D, who do not want to provide it.

prices. We believe a properly competitive market in NI would show similar characteristics and systems/rules should be directed towards achieving this objective.

on operation of the SEM, retail market and value for money
SEM market rules for operation of Moyle require estimation of shadow prices in order to dispatch flows. This is inefficient in an ex-post market and reduces efficiency of hedging via the interconnector. Global aggregation is needed to level the cost and risk profile between incumbent and independents and operation of the retail market should develop towards becoming a competitively contracted-out service.

Fuel poverty is a serious issue, but it will not be solved by lowering prices or cross-selling dual fuel products; energy efficiency measures to reduce consumption are the only long-term way to address this problem.

on costs of market entry and setup
Customer acquisition costs are a significant barrier when combined with the necessity of pricing at a discount to incumbent prices that reflect low-risk subsidised by k-factor regulation. There is a material bias of market risk against independent suppliers

on competitive activity
We have earlier highlighted our concerns with market operation. However the Authority appears unduly optimistic about the impact of the SSE takeover of Airtricity on competitive activity. While entry of such a large and experienced competitor must be welcomed, possession of a strong financial base should not be mistaken for an open-ended commitment to invest resources in a market suffering from fundamental flaws. This current review of competition issues in NI must be seized as an opportunity to correct these flaws and encourage further market entry by an experienced supplier.

Meter readings, or estimates thereof, are largest current source of customer complaint. Consultation suggests (table 6, page 38) that dual fuel offers would benefit customers through, inter alia joint meter reading services. We agree with this, but clearly an essential pre-requisite would be the unbundling of meter reading from other network charges to enable delivery of the dual-fuel benefit. A further benefit of unbundling would be the avoidance of suppliers paying, as they currently do, for an undelivered service, then paying again to a third party in order to obtain an actual read. To demonstrate competitive intent, a project should immediately be initiated to enable competition in half-hourly data collection. The incumbent should not be allowed to dictate process design or systems.

We would welcome the Authority's confirmation that it intends to manage development of the gas market in a more independent and transparent manner than was the case for retail electricity market opening.

Q4 Do respondents agree that the analysis above has identified the major potential barriers to competition in the domestic and non-domestic gas markets or are there additional barriers that you feel we should take into consideration?

Gas development – avoid repeating mistakes from electricity
As Airtricity prepares to enter the gas market, our assessment is that the consultation broadly captures the current barriers to competition, although the proposed policy options offer hope that lessons have been learned from introduction of retail market competition and delivery of the SEM.

In terms of market reform, we believe delivery project for gas market reform should;

- be run by the Authority, but the Authority should not depend on the incumbent for advice, solutions or policy
- if at all possible, adopt the GB market design (state of RoI development means it is already difficult to implement a single gas market operator, plus there is no good reason to burden NI customers with the stranded cost of excess RoI interconnector capacity to Scotland),

- engage Xoserve to run the market on a UK (and Ireland) basis,
- if all else fails procure that the market is operated by MO/SONI, Northern Ireland Energy Holdings, or otherwise removed from the incumbent.
- ensure all charges are fully unbundled

We fear that;

- RoI market delivery will be well advanced and preclude possibility of common arrangements for independently-operated, common market systems, in spite of this consultation,
- it will be argued (as for electricity) that
    - there is insufficient time to investigate integration of market with GB, and that
    - competition is unlikely to develop, therefore
    - cheap implementation by the incumbent, with under-capacity systems, is the best way forward.

Succumbing to this logic will result in systems and market processes delivery that;

- cannot support full competition,
- are likely to be highly manual and expensive to operate,
- are bespoke to NI, and
- represent a significant sunk cost that will discourage material competitive development for the foreseeable future.

Integration with GB market would prevent erection of the major barrier to competition represented by bespoke platforms, procedures and data interfaces and reduce cost barriers to market participation. A regional market of this scale would allow instant accessibility for a large number of suppliers to the NI market, on basis of existing systems and incremental service cost; enabling scale economies to benefit customers without further investment or imposition of contentious policies, such as customer divestment. Another major benefit of this approach would be certainty that the market design works, has very clear rules and is sufficiently resourced to maintain design documentation effectively.

While the consultation suggests that a downside of buying into another market might be that investment could be stranded if forced to accept design changes, this is a false concern. Participants in normal competitive markets;

- invest without certainty of return and may find some investment stranded,
- promote/agree to market changes in the expectation that better market operation means lower cost operation – this is also true for the SEM and existing electricity retail markets
- are fully able to participate in market decision-making and influence changes

other considerations - dual fuel

We are surprised that the consultation seeks information from NIE, Firmus and PNG on development of their plans for dual fuel offers; failing to recognise the experience of a participant with over two million existing dual fuel customers.

As previously discussed, the suggestion that dual fuel offerings can bring about savings through shared services, such as meter reading, is not currently possible without breaking the T&D monopoly. However we would welcome UoS charge unbundling, as was done in GB 10 years ago.

In terms of expanding the gas market, the Authority should consider using energy efficiency/sustainability funding to provide grants for installation of gas appliances. This would align with the Authority's sustainability objectives of seeking a switch to gas from higher carbon fuels.

We believe that the proposal for market synchronisation represents one of the most positive proposals of this consultation and that it should be vigorously pursued. If there is some genuine show-stopper preventing integration with GB, then the Authority should work with the CER to move retail market operation to the SEM MO and properly synchronise retail market design on the whole island. There should be no bespoke market design/implementation allowed in Northern Ireland.

Q5 Have we missed anything important in relation to potential actions – are there additional regulatory actions that the Utility Regulator should consider beyond those described above?

Sell landbank

While we agree with some of the proposed policy options, one that has been missed out would be to sell the landbank; its retention is a throwback to a dirigiste view of market oversight that is an anachronism in a competitive market. The landbank should be seen as an asset to be developed, rather than a burden to be imposed on the PSO-paying customer.

Now is the time for customers to receive some return, through the sites being sold off for development. Facilitation of additional independent generation capacity would increase the non-incumbent capacity available for trade and would improve wholesale contract market liquidity. The market needs flexible capacity, so there is no better time to release for development

service charge unbundling

Electricity UoS charges include meter operation and meter reading. There is no reason why meter reading should be a monopoly service; indeed the dual fuel discussion suggests otherwise. However, even if the service is obtained from another party (eg Phoenix) the electricity supplier still has to pay for the service from T&D. Unbundling of charges will allow suppliers only to pay for the services they require. Arrangements should be put in place for meter operation to become a competitive activity; a start would be for this charge to be unbundled at the same time as meter reading. Even if suppliers remain with T&D, the service they receive is likely to improve, since the credible threat of competition can be almost as effective as real competition.

wholesale contract market liquidity

While improving wholesale market liquidity would undoubtedly be beneficial to the market, regulatory action should be confined to managing contracts associated with control of dominance. Commercial arrangements for creating products for screen trading are well under way; driven by market participants. A useful regulatory action would be to create arrangements whereby PSO-supported generation could trade on the commercial screen, rather than being auctioned as standard products, but without necessarily losing PSO support.

Q6 Do you agree with the initial assessment of the impact of the proposed regulatory actions on the electricity and gas markets? Do you think we have materially mis-estimated potential impacts?

gas connection/rollout

There is a material cost difference between connection of customers close to the network and large scale rollout of the infrastructure. Concentrating on provision of incentives (eg grants) to maximise utilisation of existing infrastructure would lower system cost per customer and provide the option of passing the savings back to customers, or using a proportion to build more infrastructure. We believe that concentration on connection offers more immediate benefits to the market.

All utility connections should be contestable, allowing other gas infrastructure owner operators into the market as is done in GB, where a single connections organisation will connect water, gas, electricity and telecoms.

Increasing the market size by a few tens of thousands of customers will not solve the market scale issue; market synchronisation offers most potential benefit in this respect. However, incremental benefits should be developed wherever possible and we support the provision of connection incentives. We disagree with the assessment that this imposes a negative cost impact on customers.

synchronisation with other market

This is an excellent policy suggestion and its implementation would show that the lesson has been learned from experience in the electricity retail market, where bespoke implementation is an ongoing challenge. Reinventing the wheel is never a clever option. However, we do not believe it is possible to synchronise gas with current RoI market developments, unless CER agrees to move to an independent market operator model, where the operator is, or is similar to, the SEM MO and has no connection with BGÉ. We believe the best market with which to join would be GB, because of its proven delivery of transparency and competition – and the fact it is a stable design that it works effectively.

We believe this is the best means of delivering increased competition in gas. This would also be an ideal solution for electricity, but as the opportunity was ignored at the outset, it is probably now impractical to deliver.

It is not clear why the cost to distribution companies should be high with this approach; other markets only require basic functionality from network operators. Nor is it clear why the initial cost to suppliers should be considered a disincentive. For many suppliers there would be virtually no cost in using existing systems; for others cost would be no higher than equivalent systems for a bespoke market implementation.

Why would GB synchronisation be only a long-term option, when it is probably the most practical way forward right now? We disagree with the assessment that this means higher costs to customers. There is no credible reason why it should not be the cheapest implementation.

price control

Perhaps k-factor regulation is based on the Regulatory obligation to ensure that licence holders can sustain their operations financially. However to avoid discrimination between licence holders, the Authority ought to take account of the effect on independents when setting incumbent returns. If the margin is going to be set too low for competition (remember they price at a discount), then licences should not have been issued as there is no way to ensure the licensees are financially viable.

Effect of providing subsidy to the incumbent is admitted in table 8, but providing an incentive to change supplier would boost competition and allow those who switch, to save. Price level is an important issue; it highlights the need for clarity on regulatory vision of competition described earlier. The more structural regulatory control that is maintained in the market, the greater the risk of unintended consequences. We believe regulation is best applied to specific market/conduct failures, with competition encouraged to provide innovation in customer service and products. Current structure of price regulation incentivises cross-subsidy between customer groups, but otherwise it is unclear what residual costs are involved in removal of the k-factor, or why these should fall disproportionately on domestic customers. Truly competitive markets encourage correct cost allocation, otherwise price anomalies will be exploited by competitors.

We would welcome the Authority's explanation as to why k-factor regulation is seen to be superior to price cap regulation for domestic/SME tariffs. The consultation recognises the downsides of the approach. We agree that k-factor removal would be a great step forward in promoting competition; providing a more stable and cost-reflective basis on which customers can assess the value of investment in energy equipment.

Market Structure

shallow supply

A shallow supply model depends on there being a number of small suppliers, for whom setup investment costs are unaffordable, poised to enter the market simultaneously. Whoever creates the systems, they still have to be paid for. Investment as a shallow supply service provider would be risky, in the absence of guaranteed customers all looking for exactly the same service. This means that charges would reflect an investment risk premium unless some guarantee was provided as to compensation for stranded investment. This would become yet another burden on customers. We would be particularly concerned if the project were handed to T&D for implementation.

It has already been shown that there are far more-material barriers to market entry that stand in the way of suppliers being able rapidly to achieve economies of scale. These need to be addressed as a priority, otherwise even a shallow supply model will be non-viable. If any service provider feels that the market is looking for a shallow supplier service provider, they will volunteer to develop appropriate systems. It would not make sense to pursue regulatory procurement of an unwanted service and we think this proposal is pointless.

divestment

We assume that NIAUR has the legal power to enforce divestment, but this would be a drastic step to take, when other policies could deliver significant improvement to the competitive environment. In any case, it is unlikely that existing market systems could cope with the transaction volumes associated with significant divestment.

However, this may be a useful backstop policy. In the shorter term, it might be appropriate to prevent NIE Energy from taking on new connections, or accepting re-registration of customers who had previously switched to another supplier. In this context, both the PES and Energia should be treated as a single entity, since the distinction between incumbent and "competitive" businesses owned by the incumbent, is largely cosmetic.

Assessed negative cost impact on customers depends on the Authority's perception of what real competition should look like. We believe current regulatory policy delivers sub, real-market pricing in the short term, since it does not reflect real market entrant risk; a barrier to achieving scale economies that will deliver lower prices.

contract market liquidity

Improved contract market liquidity would be a significant improvement in the market, but unintended outcomes are more likely to occur from regulatory intervention trying to catch up with events. We believe that participants are best placed to develop trading arrangements that best suit market requirements; an SEM trading screen has recently been set up on Bloomberg.

Regulatory action to support contract liquidity should focus on removing structural rigidities, such as directed contract durations matching the "SEM year" and PSO generation only being made available in a similar way. Arrangements should be put in place to enable PSO generators to trade directly, without losing their PSO support.

operational rules and governance

We believe that all aspects of market rules and governance should be reviewed and modified to create a level playing field for all participants. The Authority should enforce;

- global aggregation,
- full ringfencing of market operation from T&D,
- removal of T&D discretion to interpret market rules,
- publication of anonymised market data for all customers

We do not believe set-up and maintenance costs for a data registry would be a significant cost burden on customers, in the context of market operation. If quality of existing data is poor, requiring considerable cleansing, then this suggests a more material problem than one of mere data availability. It is important to address the underlying causes of issues, rather than seeking only to fix the symptoms.

One structural issue not considered is the need to work towards integration of retail and wholesale market operation into a single focused, single purpose, single operator arrangement, to avoid suppliers bearing the cost of buck-passing between the two organisations, when settlement errors occur.

Any measure that creates a more level playing field will definitely benefit competition.

Q7 Do respondents agree with our analysis above in relation to scenarios and their interplay with options, and with our proposed actions?

Future scenarios
Airtricity believes that, given a favourable environment, competition will develop in a way that meets the needs of customers. If they don't get what they want, they will switch supplier. Effective market processes are therefore essential to ensure that suppliers deliver on price and service. We believe that it is pointless trying to deliver market scenario outturns through regulatory manipulation, because trying to move the "dead hand of the market" in this way, will always result in unintended consequences.

Regulation should be directed towards correcting market failures and minimising transaction "friction", from whatever source, to ensure competition can develop and deliver the products and service standards that customers want. As described earlier, true competition will ensure cost-reflective pricing.

Electricity

Priority focus
We agree with the Authority's proposed short-term goals, but we believe addressing market conduct issues identified earlier would build participant confidence; particularly by providing clarity on its competitive vision.

Our most significant concern relates to the pricing distortions caused by the volatile margin fallout of k-factor regulation. Elimination of this competitive distortion should be a top priority. A review of allowed regulated margins must be seen as extremely urgent, rather than an issue for more leisurely review.

Medium term
In the early medium term we believe that progressive change to NI market systems will be expensive, although a single project to deliver full market transaction capacity, automated participant interfaces and global aggregation should be pursued in the medium term, along with transfer of market system operation to SONI/SEMO.

Gas

Priority focus
We believe that a high priority is to create the maximum technical market size for Northern Ireland, by becoming a region of the GB gas market and pursuing co-operation with RoI, rather than an attempted joint market. But, as for electricity, review of price level is the highest priority for a commercial participant, unprotected by a revenue guarantee.

It is essential that the Authority considers carefully, and explains to actual and potential market participants, the perceived benefit of joining the NI market to that in RoI, rather than GB.

Medium term
In the medium term, the Authority should seek to increase the connection rate to the existing network,

as a means of reducing charges to existing customers and financing further rollout of the network.

Electricity and Gas

In the medium term, for both electricity and gas, the Authority should create a framework, similar to that in GB, that allows energy service companies to build and own network connections and other infrastructure.

Some further comments in relation to consultation issues

impact of k-factors
Table 8 on page 41 of the consultation states that removal of the k-factor could, "increase NIE Supply cost in the short-run, due to higher wholesale price risk and need for higher margin". On pages 42 and 47 it suggests that k-factor removal would be good for competition and for non-domestic customers, but might be bad for domestics, who would face higher charges.

Issues with status quo are;

- interactions between different aspects of market mean regulation often suffers from unintended consequences,
- it is wrong to suggest that nothing should be done about k-factor, because customers are not perceived to benefit if wholesale market remains illiquid. It is always worth making an improvement in one area, even if another area lacks perfection,
- k-factor was an issue long before the SEM was contemplated
- k-factor has already been removed in large customer sector, so implication is that cross-subsidy currently exists; why should a competitor find this market segment attractive?
- active competitor participation is undermined by incumbent access to low risk pricing basis and impact of different customer mix/temperature effects on k-factor,
- revenue guarantee artificially depresses prices and therefore represents a subsidy to the incumbent supplier - unduly discriminating between licence holders,
- in spite of considerable efforts over the last six years to move towards product-differentiated marketing model, experience shows discounts remain essential to induce customer switching; market entrants have to price below the incumbent's low risk tariff levels to gain customers,
- price cap regulation protects customers but does not distort competition.

Suggested way forward;

- the Authority should recognise that a more commercially realistic margin for the incumbent would not prevent customers obtaining lower prices by switching supplier – they could still pay less,
- k-factor removal would be an effective step to encourage competition. Remembering that GB regulator in was proactive to ensure licence holders fully supported the competitive market; a similar co-ordination of pricing adjustment with competitive commitment could be choreographed in NI,
- in non-domestic market, removal of the k-factor results in all short-term price risk being passed to the customer. Risk in domestic market should remain with suppliers who are best placed to mitigate price volatility; Pool price pass-through tariffs are not the answer.

In an effective competitive market, domestic customers would;

- pay tariffs based on defined process,
- find change of supplier process simple,
- regularly change supplier whenever better prices become available,
- expect to pay different prices, dependent on service, payment method or environmental impact

market implementation
A major defect in the retail electricity market design is the lack of global aggregation and the existence of certain rules that apply only to non-incumbent suppliers. Flaws in the delivery process were;

- selection of incumbent to deliver competitive market arrangements (no test of value for money),
- pre-agreement between Authority and NIE on market design aspects that could impose major barriers to competition (incumbent/Authority relationship),
- implementation of RoI market design with significantly different processes and message structures – independent suppliers could only influence detail but not fundamental market divergence. (market synchronisation essential for small market),
- no recognition of natural incentive on incumbent organisations to implement own design preferences that impose development and operational costs on competitors (independent delivery essential),
- failure to co-ordinate SEM changes with RoI (incumbent power),
- timing; never enough time to explore alternative designs; always playing catchup with RoI.

Key lessons to learn from SEM implementation;

- project lead by Regulatory Authorities, no dominant incumbents,
- developed with clear rules and procedures covering all aspects of market,
- rules, processes and technical interfaces identical for all Participants, in either jurisdiction and all Participants can interface to the MO systems to the level of automation they choose,
- obligations on all Parties clearly laid out and market operated by organisation having no business activities in common with any Participant,
- market development controlled by balanced Modifications Committee, with elected Chairperson who does not have to belong to Market Operator organisation. Proper balance of interest in control of market structures.

In contrast, retail electricity markets north and south;

- have separate and different business processes and technical interfaces (although supposedly following same design),
- some NI data can only be retrieved manually from NIE T&D servers,
- market design baseline not easily ascertained and web page not maintained. market rules on Authority website are 16 Market Procedures for “Market Opening Go Live” and 13, mainly updated versions of “go-live” set, described as “Domestic Market Opening”,
- smart metering being pursued separately in NI and RoI, despite all-island market objective (recent change of policy)

data availability
In retail electricity market, solutions are required for;

- unequal cost drivers between incumbent and competitors due to lack of global aggregation - no incentive to price cost-reflectively,
- rule implementations that still require some customers to change their meters in order to change supplier; incumbent should fully implement metering rules across whole market (as done in GB),
- NIE business separation seems to mean the various businesses are reached through a single web portal – supply benefits from association with wires and perception of special reliability. Proper separation of incumbent web addresses should be implemented,
- suppliers being required manually to download data from NIE systems,

- integration of market systems with NIE business systems; a significant entrenchment of power, protected revenue, operational inefficiency and therefore cost to customers
- fully align NI and RoI retail electricity market rules and processes,
- disaggregate meter reading from UoS tariff and apply as transaction charge - to incentivise data collection, allow scope economy through dual-fuel products and avoid payment for service not required/delivered
- market design rules data not easily found and not obvious what changes are in process or what is current baseline documentation - single (and properly maintained and change controlled) source of information on market rules and operation. (NIAUR in short term?)
- incumbent control of market implementation, design and degree of integration with non-market systems – incumbent has natural incentive to include design differences that increase competitors' costs.

Addressing these changes would lower costs for independent suppliers, reduce scope for ongoing divergence of market design, reduce the operational overhead of running the retail market and improve transparency of market design. It would also integrate retail change management and design control with that of a larger operation, such as the SEM, which is a more effective market management organisation.

value for money

Dual fuel should not be seen as the solution to all competition issues; it is likely to be an added benefit to customers but more fundamental issues are likely to offer greater benefits. One area that should be considered by the Authority, in relation to the domestic market, is the need to ensure that consumer protection is not so rigidly constructed that it incentivises delinquent behaviour and undermines profitability of the sector.

For the gas market, a bespoke market design, with or without implementation of separate systems for Firmus and Phoenix would signal lack of any meaningful commitment to competition. In all situations, value market for money market implementation should be demonstrated by competitive tender. An all-island gas market should only be considered if it is managed by an independent operator, in order to create a level competitive playing field..

market operation

Apart from price level, economically viable supply economics depend on automated and explicitly defined market rules and business processes. In discussing uncertain timing associated with the existing gas customer transfer process, the consultation states on page 31, that "uncertainty over timings ... is not unexpected for the first few times the process is executed". Competition cannot work when this type of casual approach to market entrants' finances is indulged. This is one of the most compelling arguments for adopting the proposed policy of market synchronicity.

Setup costs

Although Participants may not have identified billing and IT setup as a major concern in the non-domestic market, this may have been because at this stage in the electricity market these are sunk costs. Certainly, in the case of Airtricity, the cost was seen as a non-optional necessity to maintain participation in the market. The additional cost of domestic market participation was a bridge too far in the absence of a sustainable supply margin and additional cost of customer-service-related requirements.

The consultation suggests (Page 24) that setup costs are unlikely to be a major concern if, inter-alia, "the company has long-term financial backing". We believe this to be an unrealistic view of normal commercial decision making, as no business is likely to subsidise a loss-making enterprise indefinitely. Solid financial backing will undoubtedly support a growth rate above the capability of a business relying on pure organic growth, but there must be prospect of a reasonable return at the end of the investment phase. This brings the argument back to allowed rate of return and k-factor issues.