



REGULATORY APPROACH TO ENERGY SUPPLY
COMPETITION IN NORTHERN IRELAND

AIRTRICITY RESPONSE TO
THE NORTHERN IRELAND AUTHORITY FOR UTILITY
REGULATION

SEPTEMBER 2011

INTRODUCTION

Airtricity welcomes the opportunity to comment on the Utility Regulator's (UR) consultation paper on the "Regulatory Approach to Energy Supply Competition in Northern Ireland"

It has always been our belief that effective competition is the best mechanism for bringing benefits to energy consumers. As highlighted in the consultation this competition will hopefully bring with it improved product innovation, improved choice, improved quality and effective competitive consumer pricing.

We agree that while this competitive market is developing, the aim of regulation is to correct for instances of market failure. Once competition is deemed to be well established in a market we envisage that the role of a regulator should move from that of revenue and tariff setting to one of conduct regulation and compliance monitoring within the market.

It is essential that both suppliers and customers have a clear understanding of how this transition will be managed, and we welcome this consultation as a first step in this process. We are supportive of the UR position that it is imperative that regulatory controls are not removed prematurely, as to do so could severely damage if not destroy the competition that has already started to develop.

It is with this in mind that we have reviewed the consultation paper and request that the UR take the following comments/response into account before making a final decision on the regulatory approach to energy supply competition in Northern Ireland retail energy markets.

GENERAL COMMENTS

It is imperative that the transition from a market with regulated prices to one without is handled with extreme care. If the process is rushed it will most likely undermine the early stage competition that has begun to develop.

We welcome this consultation on the UR's initial thoughts of what the competitive market, which is starting to develop, will look like and what regulatory structures need to be put in place to support it. It is a welcome first step on the path to a fully competitive retail electricity market.

We agree that there are wider energy market issues, such as liquidity within the wholesale market, that need to be addressed before a final decision on the full relaxation of the regulatory measures within the retail energy markets market can be reached.

We have broken our response into two parts, the first deals with the wider issues we feel need to be addressed, and the second part of our response deals with our views on the criteria/proposals as set out within the consultation document.

PRE – REQUISITES TO RELAXING THE REGULATORY CONTROLS

As highlighted within the consultation there are a number of current issues within the Northern Irish Electricity market, which we believe must be addressed before the process of relaxing the regulatory controls can begin.

In particular we believe that the issues of **global aggregation, wholesale market liquidity, market systems, branding, and the future role of the regulator** need to be addressed before a final decision can be made.

It is our opinion that the following issues must be addressed before any deregulation of the electricity market.

- **Global aggregation** - In the retail market, the issue of cross-subsidy can only be solved if all suppliers have to compete on the basis of the same market structures; allowing suppliers to compete on an equal footing. This means that the incumbent supply business should be included in the Settlement process in the same way as other Suppliers; **the move to global aggregation is therefore essential before deregulation can take place.**
- **Wholesale Market Liquidity** – As discussed in the consultation there are limited opportunities for hedging in the Single Electricity Market. This means that energy costs are largely inappropriately fixed at one point in the year, when hedging contracts are made available, at the fuel prices prevailing at that time.

Suppliers aim to stabilise the cost of wholesale energy through hedging, but available contracts last only up to 12 months and must be bought over a short period four to five months prior to the start of the tariff year. As the consultation highlights contracts on offer are insufficient to enable all suppliers to be fully hedged. This drives up the cost of hedging, but still leaves significant exposure to Pool prices. To avoid cliff-edge tariff price changes and unexpected mid-year changes, as has been seen over the last number of years, the regulators need to address the quantity and duration of hedging contracts available in the market.

As the contracting period lasts only a short while, it does not offer much opportunity to take advantage of dips in fuel prices to build a robust hedging contract portfolio. For example the 2008/9 tariff hedging period during 2008 coincided with rapidly increasing world fuel prices which resulted in suppliers having to lock in at prices that in retrospect were well out of the money.

More liquidity, variety of duration, and also volume available in the hedging market, would provide suppliers with more opportunities to accumulate and trade directed contracts during a year, thus ensuring that suppliers are able to buy hedging contracts at timely intervals and market reflective prices throughout the entire year.

Therefore as a prerequisite to deregulation we believe that the regulators must address these market failures by;

- **Continuing to support the development of secondary market arrangements that align with the GB market and support inter-market trading**
- **Working with industry to improve liquidity and volume availability in the wholesale contract market.**
- **Developing standard contracts of varying durations, which would be available throughout the year.**
- **Role of the Regulator** – We believe it is imperative there is a clear understanding of the role and responsibilities that the regulator will take once the regulatory controls within the market are relaxed. It is essential that market participants, in particular consumers, have an understanding of the structures and regulations that will be in place in this deregulated market. As the current consultation does not go into enough detail on this, **we would ask that UR clearly lay out what roles they see the regulator carrying out in this new market and also the structures that will be required to support these roles.**
- **Re-branding of Incumbent supply businesses** – For most consumers there is little understanding of the separation,

which has already taken place, of the constituent parts of the NIE group and the different brands associated with each.

The 3rd Package is clear that brand separation is a requirement for vertically integrated distribution system operators and the supply branch of such undertakings. **We therefore welcome the recent rebranding of the NIE Energy supply business as Power NI.**

- **Retail Market Failures** - A number of structural failures of the retail market require remedy before the relaxation of the regulatory controls can take place, for example the current market structures/systems in both gas and electricity markets are not fit for purpose and do not facilitate easy customer switching.

It is essential that the market systems enable all customers benefit from the competitive market that is developing, ahead of any deregulation taking place. In this regard, we welcome the work currently taking place on the implementation as part of the “Enduring Solution” & “Harmonisation” projects to put in place a fully functioning fit for purpose market system for the electricity retail market.

It is our belief that a similar exercise needs to be carried out for the retail gas market and would encourage the UR to address this as part of the CAG project.

CONSULTATION PROPOSALS

HARMONISATION

It makes sense that the greater harmonisation between the RoI and NI markets would allow suppliers greater potential to offer competitive offerings to customers in both jurisdictions.

The resultant efficiencies a harmonised retail markets/processes would provide would enable current suppliers to offer more competitive offerings to customers in both jurisdictions.

The retail markets in both jurisdictions are relatively small when compared with other European jurisdictions. The larger market scale that would be provided by greater market harmonisation between the jurisdictions would also act to make it more attractive for new suppliers to enter the retail markets. This is best evidenced when examining the retail gas markets in NI. The fixed costs associated with market entry for the NI gas market when compared with the size of the market make it extremely difficult for new supplier to make a business case for entering this market, however if the RoI and NI markets are looked at in conjunction the result is likely to be far more positive.

RELEVANT MARKETS

We are in agreement with the URs proposal to define 5 relevant markets for the supply of retail electricity and gas. While there is considerable overlap between these markets, the supply and demand economics of the relevant markets would imply that they should indeed be considered five relevant markets for the supply of retail electricity and gas.

The proposed breakdown should also be relatively simple for customers to understand.

TRANSITION TO THE RELAXATION OF REGULATORY CONTROLS

We believe that the removal of regulatory controls should only be contemplated in any of the relevant markets once:

- the pre-requisites highlighted above are met;
- At a minimum, independent suppliers, and by this we mean suppliers that are not in the ownership of the same shareholder, must have a market share not less than 30%.

- There must be at least 3 suppliers, two of which must be independent, again not in the ownership of the same shareholder, operating within the market before deregulation could be considered.
- The incumbent suppliers' market share must be less than 40%. We believe that this % market share must be assessed on an historic basis rather than based on at best subjective and most likely inaccurate forecasts;

CUSTOMER COMMUNICATION

It is imperative that as part of this transition to a fully competitive market that the regulator carries out an information campaign for customers, in particular domestic and small SME customers. This campaign should make consumers aware of the potential suppliers in the market and how to contact them; it should also provide customers with details of their rights within the market and the role the regulator in this new market.

REGULATORY SAFEGUARDS

If price regulation was to cease in any particular market we would find it hard to see how the regulator could step back in and reregulate prices. This is one of the reasons that we believe it is best to deregulate the market segments one at a time rather than in one big bang, as it would enable the UR to assess how the relaxation of the regulatory controls was working on one market segment at a time, and rectify any issue before the deregulation of the next.

In this regard we welcome the consultation proposals to continue setting a maximum tariff for a period of 3 years. This will allow the UR get a clear picture of the effect of the competition that is developing in the NI retail gas and electricity markets.

CURRENT REGULATORY ARRANGEMENTS

We agree with the assessment within the consultation that there is no need to change to current regulatory framework at this time.

We believe that the current framework does indeed strike the correct balance between consumer protection and allowing competition develop.

MARKET DATA

As a virtue of the dominant monopoly position of Power NI (NIE Energy) in the Northern Irish Electricity market they have had access to large volumes of historical customer related market data and information, such as historic consumption data, which independent suppliers have not.

This information provides an unfair competitive advantage to Power NI and we believe it should be shared with all market participants as to ensure a level playing field for all market participants.

MULTIPLE TARIFF REVIEWS

Airtricity is opposed to the idea of multiple tariff reviews. We believe that this introduces regulatory uncertainty to the market, and enhances market inertia, by causing confusion to customers who are considering a change of supplier. It has been shown that customers are reluctant to change supplier, when they believe that the incumbent supplier will be changing tariffs in the near future, as they are unsure as to whether they will miss out reductions.

As previously highlighted we believe that K-factors are fundamentally wrong in a competitive market as they distort competition and result in tariffs that are not cost reflective. Therefore while generally we are supportive of a tariff adjustment that reduces the effects of K-factors, we believe, in this situation that the disadvantages introduced due to the regulatory uncertainty would outweigh the benefits seen through a smoothing of the K-Factor.

CONCLUSION

Airtricity welcomes this consultation from the UR as a first step in the process of removing regulatory controls in the retail electricity & gas markets.

We do not believe that it is likely the market issues flagged in both the consultation and our response will be addressed, and competition sufficiently established, in the next number of years. In this regard we support the UR position to keep the regulatory controls in place for the next three years while continuing to keep a watch on the development of competition within the market.

We would encourage the UR to use this time to address the wider market issues, such as the market systems and lack of wholesale liquidity. This will ensure that the competitive markets that are now developing will continue to go from strength to strength and will also ensure that if the regulatory controls are indeed relaxed in the future that the market will ensure customers see the benefits that competition brings to the market.