Bord Gáis Energy Supply
Response

to the

Northern Ireland Authority for Utility Regulation

on the

Electricity and Gas Retail Market Competition in Northern Ireland Consultation Paper

Introduction

Bord Gáis Energy Supply ("BGES") commenced supplying electricity to the Northern Ireland market in April 2004, building up a small market share, mainly in the Industrial and Commercial ("I&C") sector, until March 2006 when a decision was made to suspend customer acquisition target levels. This decision was made due to a number of issues with the Northern Ireland retail market which were mostly regulatory related, but also included a lack of generation available to the market (and a lack of regulatory certainty around the regulated provision of same to the market). The introduction of the Single Electricity Market ("SEM") has in some way reduced the issues associated with access to generation although the consultation paper notes a liquidity issue with regard to the availability of Contract for Differences in general. The regulatory issues included:

- The lack of a formal consultation process with regard to incumbent revenue/tariff reviews, the incumbent tariffs themselves and regulator charges.
- The lack of sufficiently detailed information on how allowed revenues were recovered from the incumbent's range of tariffs; the lack of cost allocation principles for the different customer categories and cost reflectivity of individual tariffs.
- The requirement for customers, who wished to switch suppliers, to pay for a change of meter which could facilitate same.
- There was an issue with NIE in relation to business separation while the development of separated and market opening systems was extremely slow.
- The array of tariffs on offer from the incumbent resulted in Independent Supplier having additional difficulty in encouraging customers to switch supplier, thereby slowing down customer acquisition.
- The very high level of pass-through charges, such as the PSO, Use of System, System Support Service etc which existed in the market. These were generally published without consultation and lacked transparency. In the case of the PSO there were various different charges for each individual tariff without any explanation for same and it was unclear whether or not these were being charged to NIE PES customers. Furthermore, the higher the level of pass through charges the less feasible it if for Independent Supplier's to offer a meaningful discount to the incumbent tariff thereby discouraging customer switching.
- The issue above was further compounded by the provision of a 4% direct debit discount across the entire range of incumbent tariffs which did not appear to reflect the time value of money or administration costs saved as a result of same.

BGES therefore welcome the publication of the 'Consultation on Electricity and Gas Retail Market Competition in Northern Ireland'. As the Northern Ireland Authority for Utility Regulation ("NAUR") is aware, firmus energy, a subsidiary of Bord Gáis Éireann, holds a gas conveyance and supply licence in Northern Ireland. Therefore, the comments from BGES here are in relation to our own experience and views on the Northern Ireland electricity market only. The consultation paper is wide-ranging and comprehensive and we have outlined a broad response below by way of addressing the questions asked however we would be happy to meet with NIAUR to discuss the issues in more detail if that is required.

Questions & Responses

Chapter 3:

1. 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?

Chapter 3 of the consultation paper provides an interesting overview of the current electricity market structure in Northern Ireland. The paper notes that the larger I&C customers appear to have benefited most from the availability of Independent Suppliers retail price offers. This is generally the route utilised in the development of a competitive market and so this would be expected. However the fact that an affiliate to the incumbent NIEE is the most successful of the Independent Suppliers means that in reality one organisation, which includes the incumbent business, currently supply approximately 60% of the non-domestic market.

Against this background, the regulatory environment is very important. In 2007, the Northern Ireland Authority for Utility Regulation (“NIAUR”) published a decision on a price control review that was to run from April 2007 to March 2009. The publication itself provided little real information and given the short timeframe that it covered provided modest regulatory certainty as to how the incumbent will be allowed to operate in the retail market over a short/medium term timeframe.

One of the mains reasons we believe that larger customers have benefited most from the availability of Independent Suppliers is that access to Independent Supplier offers was effectively blocked for smaller customers thereby not allowing the benefit of the availability of Independent Suppliers. For an average ‘SME’ electricity customer there was effectively a switching charge in place. For the larger customers, Independent Suppliers may have elected to pay for the charge (approx. £300) however for customers under a certain level of consumption this practise was loss-making as it eroded the potential margin earned over 12 months – the normal contractual supply period - to a negative level.

The consultation paper refers to the fact that most NIEE costs can be passed through since these are subject to other price controls or regulations. Therefore the retail price control deals only with the revenue NIEE is permitted to collect from customers in order to recover its own supply costs. However the provision of information in this way limits the ability for Independent Suppliers to assess if there has been appropriate cost allocation across the range of tariffs on an ongoing basis.

2. Are there additional indicators of the current state of competition in the retail markets that we should be considering

As referred to earlier, any analysis of customer switching should incorporate analysis of the reasons why Suppliers do not make offers to certain customers or why customers have opted not to switch Suppliers. We note that certain meetings were held with market participants however we are unsure if NIAUR met with customers to identify any additional considerations, in particular SME customers without the required meters; including those who opted to switch and those who opted not to switch suppliers.

Chapter 4:

3. Do respondents agree that the analysis has identified the major potential barriers to competition in the domestic and non-domestic electricity markets or are there additional barriers that you feel should be taken into consideration.

As the consultation paper points out the main financial incentive for new suppliers to enter a retail market is the headroom that exists between the potential cost of supply and the tariff(s) offered by the incumbent supplier. This headroom provides new entrants with the incentive to reduce their own costs of supply, thereby providing benefits to customers. The paper goes on to state that the cost elements where there is scope for differential costs between new entrants and incumbent suppliers includes wholesale and supply business costs. In the electricity market, the current liquidity of the wholesale market results in all Suppliers having access to similarly priced Contract for Differences for part of their overall cost base.

The incumbent generators in the SEM (including those with control of generation) have access to long term (largely depreciated) plant output and contracts which is currently made available to the market through Directed Contracts. When such contracts are not made available to the market they will result in Independent Suppliers having to source similarly priced contracts to compliment any supply business cost efficiencies in order to offer a reduced cost supply to customers. Therefore, the regulators must give careful consideration to the issue of directed contracts and the impact that changes in relation to same will have on the retail market environment. While the advent of the SEM is a welcome development in the wholesale market, the lack of liquidity in the corresponding Contract for Differences market will limit retail market development until such time as the legacy plant and contracts expire.

K-factors will from year to year distort the cost reflectivity of tariffs however current regulatory arrangements, where tariffs are generally set annually, makes it difficult to reduce or eliminate them. Tariffs are set on an ex-ante basis using forecast volumes and costs and forecasts can reasonably be expected to deviate. It should also be noted that the current incumbent risk/reward ratio is based on the ability of the incumbent to fully recover its costs. Therefore, a review of k-factors can only realistically be undertaken in the context of an overall regulatory review. As far as we are aware, such a review is to be undertaken towards the end of this year and we look forward to any proposals that the Regulatory Authorities might put forward in relation to same.

In relation to Table 4 on pages 27 and 28 of the consultation paper we would advise that two additional barriers be added to the Networks regulatory regime: meter charges and the lack of transparency of Use of System charges. An additional barrier should also be added to Retail Supply regulatory regime: lack of transparency of pass-through charges such as the PSO. A consultation outlining the components of PSO recovery is required annually as well as the associated methodology for cost allocation. It is also unclear if NIE are collecting the same unit rates of PSO for each customer category. It should be a requirement on all Suppliers to separately identify the PSO charge on each customer's bill.

4. Do respondents agree that the analysis has identified the major potential barriers to competition in the domestic and non-domestic gas markets or are there additional barriers that you feel should be taken into consideration.

Our colleagues in firmus energy will be providing a comprehensive response to this question.

Chapter 5:

5. Has the consultation paper missed anything important in relation to potential actions – are there additional regulatory actions that the Utility Regulator should consider beyond those described on page 36 of the consultation paper?

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

The consultation paper acknowledges that points were raised during the work on developing the paper in relation to price control transparencies and future work requirements in terms of reconsideration of the level of allowed regulated margins and that both areas are already recognised within the Utility Regulator. Yet in late May NIEE announced tariff changes without any level of detail in relation to the basis for same. Changes to regulated charges or incumbent tariff arrangements should be made on a timely basis and applying accepted consultation principles thereby allowing for a meaningful consultation process.

BGES largely agree with the analysis outlined in Chapter 5 however we believe that section 4 – scope and structure of price controls - should be upgraded to a '√√' ranking as successful implementation of same would provide a benefit to Independent Suppliers which would translate into customer benefits.

Section 7 discusses improving contract market liquidity in the electricity market. This is a complex area however in an environment which is aiming to deliver effective competition and where there are barriers to entry (in this regard access to generation contracts) access to legacy contract arrangements held by incumbent organisations could be made available to all suppliers equally using a market based approach. The current Directed Contracts process could be used to facilitate this.

The same section, under the title 'Operational rules and governance', outlines the hope that the operation of the SIG group provides an effective means of dealing with many of the issues in an operational sense, a more general forum should be established for dealing with commercial issues so that there is a clear distinction between the two. The SIG group was established to deal with retail market opening while an 'IME' meeting was held quarterly to deal with commercial related supplier issues. We would recommend that the latter group be reformed, that clear terms of reference are established for both and that clear decision making processes are in place. The establishment of an 'IME' type forum would not however negate the requirement for timely consultation processes on commercial related issues.

Chapter 6:

7. Do respondents agree with the analysis outlined in this chapter in relation to scenarios and their interplay with options, and with our proposed actions?

We commend NIAUR for undertaking such a comprehensive study of the current market with the objective of identifying actions which it can take to deliver an efficiently competitive market for customers. However we believe that some of the actions listed under the medium-term scenario are actually capable of being delivered in the short-term; particularly the price control transparency issues and including the scope of the NIEE price control and the inclusion of k-factors in same.

A fully open competitive market environment requires a level playing field for all suppliers. It encompasses change to the incumbent business, operations and activities. The existence of efficiently competitive energy markets can only be achieved if a fair and effective regulatory framework is in place. The regulatory authorities should aim to provide such an environment to facilitate the development of competitive pressures which would result in the most cost reflective and efficiently set electricity charges, thus benefiting customers. Only after exhaustive efforts to provide this environment should regulators seek to explore the option of setting up alternative market structures. In an agreeable market environment, enterprise and innovation will naturally develop, providing benefits for customers.