THE VOICE OF BUSINESS
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CBI response to Utility Regulator's consultation paper on retail Market Competition, June 2008

Introduction

1 CBI Northern Ireland welcomes the opportunity to contribute to the Utility Regulator's considerations on electricity and gas retail market competition in Northern Ireland. We have consulted our members and discussed the key issues raised in the paper. There is broad support and agreement with the overall thrust and contents of the consultation paper.

2 We are keen to stress the CBI's support for the key principles which should underpin policy in this area:

- Competition is not an end in itself – we need to create an efficient and lowest cost energy industry
- There is a need to avoid adding to costs in a small market – NI already faces disproportionately high costs and a key focus must be to reduce these
- The Northern Ireland, and indeed the Single Electricity Market, are relatively small markets, requiring both a cautious and pragmatic approach in the area of retail competition
- Northern Ireland business, competing in global markets should not be competitively disadvantaged through policy that burdens business with charges in excess of the cost of generation, transmission, distribution and supply of that business profile

3 In terms of priorities in developing a more competitive market on the island of Ireland the most important area to focus on is to ensure we have a competitive wholesale market. Competition in retail will not be meaningful unless we also have effective competition in generation (where the major costs lie). It is not sufficient to say that we now have a wholesale market (the SEM) where suppliers can buy generation capacity. This is only a 'spot' market. Suppliers need to be able to hedge prices for more than one year (rolling) to provide fixed tariffs, though with two major players controlling around 90% of generation this could act as an important block on other suppliers finding appropriate hedges. There is also a need for products that enhance short term liquidity that allow participants to trade out imbalances in their position. **Encouraging higher levels of liquidity in the market is a key priority**. The cancellation of certain Power Purchase Agreements in 2010 would of

Nigel Smyth – Director
DL: 028 9010 1100 **E:** nigel.smyth@cbi.org.uk
CBI Scottish Amicable Building 11 Donegall Square South BelfastBT1 5JE
T: +02890 101100 **F:** +02890 101119 **E:** ni.mail@cbi.org.uk **W:** www.cbi.org.uk/ni
Director-General: Richard Lambert President: Martin Broughton

course still leave ESB with a dominant position in the market. The Deloitte report for the Irish government (some years ago) made this point very clearly.

4 There is some surprise that this issue is being looked at on a Northern Ireland basis only, given that we are now in an all-island Single Electricity Market. While there are clearly some unique NI issues there may be value in comparing and contrasting experiences and issues across the island. Indeed members suggest that there are higher levels of retail competition in the Republic of Ireland. Some members have also commented that the unique market design may itself be a barrier to entry – the value of the market may not be worth the implementation effort.

Specific comments in response to Questions raised

5 In this section we have responded to the key questions raised in the Consultation paper.

Chapter 3
Do we agree with the overall summary of the NI energy retail market competitiveness or has anything been missed?

We agreed with the overall analysis provided.

We note that there is ‘tentative evidence’ that non-domestic customers are continuing to switch. However we believe there are relatively few large customers in this category – partly because supply margins are relatively low, while acquisition costs discourage active customer ‘recruitment’.

The domestic market is likely to remain unattractive due to its relative small size and limited supplier margin. There is also a higher risk of bad debt. Incumbent operators will have a natural advantage, while new suppliers will face significantly higher risks, especially with small numbers of customers.

Many large companies are frustrated at the lack of supply companies prepared to offer competitive quotes. One suggestion for consideration is that companies who retain a supply licence (in gas or electricity) should be compelled to submit competitive tenders on x% volume or customers – the information would be held and reviewed by the Regulator.

Some members have suggested that confusion exists between supply companies, networks and meter readers etc and consider that some network re-branding may be necessary – this should be reviewed to assess how significant an issue it is, but bearing in mind the attendant costs of re-branding .

Are there additional indicators of the current state of competition that need to be considered?

We believe there are additional indicators which should be used to determine if effective competition exists. We recommend that the Regulator considers the following:

- Absolute number of tenders made and units tendered (level of offers)
- Absolute number of therms/units which are switched in the course of a year (as a percentage of total)
- an effective competitive landscape analysis should cover – levels of switching (ie incumbent gains / incumbent losses, other suppliers transfers), products (commercials and term) and quotation activity

The first two would demonstrate activity levels and true 'success' levels. Some caution may be required here with affiliated companies operating in the market place.

NIAUR needs to consider what its prime objective is – low prices or numerous competitors trying to innovate on services and products.

There should also be transparency on the level of competition in the generation market – the HHI index measures the degree of dominance on an all-island basis, and this should be regularly monitored.

Chapter 4
Have the major potential barriers to competition in the domestic and non-domestic markets (electricity and gas) been identified, or are there any additional barriers?

We believe the key barriers have been identified.

As we highlight elsewhere the K factor is a particular barrier, together with the relatively low 'supplier margin' making it less attractive for new market entrants.

In the non-domestic gas market there are punitive costs for a shipper. Exceeding nominations are more likely to impact on new entrants who, with a similar customer base, will have a much greater exposure (and risk) to variations in consumption versus an incumbent with a large portfolio that smoothes out the variation.

Chapter 5 – policy options
Has anything been missed re potential actions?

K factor – we believe that the K factor should be removed by April 2009 in the non-domestic market. The use of the K factor has a distorting effect on retail markets as the adjustment can lead to: increased margins (ie thus setting a high benchmark price in the market) in the case of an under-recovery situation, or reduced margins (ie limiting competition potential), in the case of an over-recovery situation. In essence the K factor reduces the risk profile of NIE Energy Supply. As the consultation points out it reduces NIE costs and therefore acts as a subsidy to the incumbent. We do however acknowledge that the incumbent supplier margin may increase but overall the removal of the K factor should result in more competition and a more efficient market.

More caution is required when considering removal of the K factor from the domestic market, unless regulation of margins continues.

Fuel switching offers potential to increase competition and should be encouraged – clearly finding mechanisms to extend the natural gas network, particularly in the west of the Province, should be encouraged. With rapid increase in energy costs the previous cost benefit analysis of further investment may have changed significantly. There is also a need for incentives for new connections ie grants for gas burning equipment will lower electricity consumption at peak periods. It is important that the Regulator fulfils one of its primary objectives, namely the promotion of the natural gas market within existing gas areas to encourage both domestic and commercial/industrial connections to the network – more connections results in lower use of system tariffs for all customers.

We also believe load management should form a key part of the strategy – peak demand drives both network (transmission and distribution) costs and generation costs. Reducing the 'peakiness' of demand should be in all consumers interests, yet many customers across the domestic and non-domestic sectors have no incentives to reduce demand at peak periods. Measures to encourage SMART metering which will help change behaviour are to be encouraged, and should be given higher priority, and all suppliers encouraged to utilise them.

With regards to gas there may be merit in considering if an agreement can be made with Firmus to open up supply competition more quickly, perhaps linked to an initiative to secure a further extension of the gas network. The licence allows a period of exclusivity during which conveyance tariffs are arbitrary in order that customers have access to the best possible prices to encourage conversion. However early opening of the market, and the establishment of published conveyance tariffs could mean the payback periods for customers could be elongated.

Do we agree with the initial assessment of impacts of the proposed regulatory actions?

We agree with the initial assessment. In addition we strongly welcome the commitment to 'cost-effective competition' and that the cost implications must be taken into account in coming up with solutions to problems.

There are clearly some priorities emerging which we would be keen to see early action to address, notably:

- Promoting market liquidity is a key priority – measures to encourage more flexibility in the nature of contracts available would be helpful in breaking down the illiquidity in the current market
- Improving data availability, more transparency and better information on trends would all be helpful (and undertaken at little or no cost)
- Removal of K-factor for non-domestic sector as soon as possible
- Facilitating better use of the interconnector to help cap peak load demand/supply pricing in the SEM
- Minimising PSO costs

Market synchronisation will be helpful although elements of this may deliver better, and faster returns than others ie there are particular issues associated with the Moyle interconnector which need to be reviewed. In the medium and longer terms there might be increasing value in changing retail systems (UK systems are already developed), as we move to a larger ‘British Isles’ market, making a bespoke model unattractive.

Do we agree with the analysis re scenarios and their interplay with options?

No comments to make.

Other Comments

6 As a general point one of the best ways to have more competitive prices is to encourage the SEM to be part of the wider UK and EU markets. Anything we do now with regards to interconnection, systems etc should be done with this in mind i.e. create an easy path rather than an obstacle for further unification of the electricity system.

7 With escalating fuel costs there is increasing concerns about the impact of fuel poverty across households in Northern Ireland. This is likely to remain a major issue with global fuel prices expected to remain high. Better energy efficiency, higher specifications for insulation through building regulations, and the option of grants etc to alleviate this issue will all have important contributions to make. However such support mechanisms should not be provided and subsidised by the non-domestic sector which faces its own challenges in competing in global markets.

CBI Northern Ireland
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