

Mr Kenny Dane
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30 April 2014

Dear Kenny

Possible Cancellation of Generating Unit Agreements (GUAs)

Thank you for providing CBI Northern Ireland with an opportunity to comment on the UR consultation on the possible cancellation of the GUAs.

The key consideration, as set out in the consultation document, is whether continuation of the contracts will benefit Northern Ireland electricity consumers – this is the over-riding consideration from the perspective of CBI members. We also note that the contracts can be reviewed by the Utility Regulator at any period up to 2023 with a short notice period to direct cancellation.

The consultation paper concludes under its ‘base case’ scenario that the cancellation of the contracts will save consumers approximately £3.8m per annum – this is in sharp contrast to the April 2012 assessment where the reverse conclusion was reached with consumer saving around £4.5m per annum through **retention** of the contracts. The consultation would have been helped by a clearer explanation for this difference in such a relatively short timeframe, although we recognise the major driver of value is most likely due to the commodity pricing (coal and carbon prices have fallen quite sharply and gas pricing has remained elevated during the past two years).

CBI consultations with members have included a discussion with Power NI’s Power Procurement Business (PPB) who have provided evidence that a number of areas of the analysis in the UR paper uses incorrect information or has overlooked areas where benefits are captured that reduce costs for customers. They indicate that once these adjustments are included, customers will benefit significantly from retaining the current contractual arrangements. However other members consulted have different perspectives,



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and in some cases have concluded that the current UR analysis is broadly correct, albeit that some modifications to the UR assessment are required.

Our members are concerned by the significant differences between the UR and PPB assessments which require clarification and reconciliation. We also understand the GUAs are currently providing a surplus to reduce customer bills in current tariffs and that the actual performance in the year to date has exceeded expectations and that an even greater surplus is being captured (which will be returned to customers in the next tariff year). Clarification from the UR on why this position is expected to suddenly change at the end of 2014 is needed.

Electricity prices are a major issue for our members and any opportunity to reduce costs must not be lost. Whilst we are not in a position to undertake our own assessment, significant issues have been raised which questions the conclusions which the UR has reached. It is vital for customers that electricity costs are minimised and any decision to cancel the remaining GUAs must be based on robust analysis and show definitively that such a decision will lead to a reduction in electricity costs, and not an increase.

We therefore recommend that the UR review its analysis in light of the evidence submitted during the consultation (PPBs assessment concluded an initial improvement over the UR assessment of £7-8m per annum). In particular the following issues need to be reviewed and reconciled:

- revised contractual arrangements that have increased revenues and reduced costs;
- Capacity charges for gas transportation – it is suggested that UR's figures are too high;
- the value of market revenues that PPB has achieved which the UR analysis appears to have underestimated;
- elements of the regulated price control allowance of PPB, that are unavoidable and;
- additional costs relating to credit that Power NI would face if the GUAs were cancelled

It has also been suggested that further significant savings are potentially available from October 2015 by not booking firm capacity, though we believe changes to interruptible and short term gas transmission tariffs (partly driven by EU rules) are likely to mitigate some of these benefits – ultimately gas transmission costs are fixed and customers will ultimately pay and this will be addressed through postalisation. New short term products will be bid into the spot market as an avoidable cost and paid for as required. However it will be important for the UR to assess whether value can be captured in the GUA's from the likely changes in transmission tariffs.

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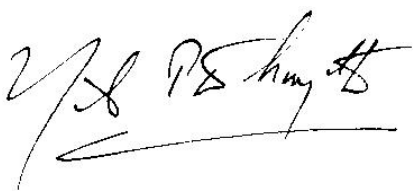
NI customers were previously burdened with the high cost GUAs and it would be perverse to cancel the remaining GUAs if there is an opportunity to finally benefit from them and help reduce costs for customers. However should the UR conclude following the consultation that it is clearly, and demonstrably, in customers interests over the remaining contractual period to cancel the contracts, particularly in light of the changing market arrangements, this must be the decision.

There are two other issues to raise:

- gas/coal price differentials - We believe it would be beneficial if UR was to provide more information on the impact on gas/coal prices movements and differentials. We would welcome clarification around whether the gain (which UR is estimating) is arising as a result of the relative movements of gas and coal since the last review and whether this is considered to be a structural, rather than a temporary change and are there 'expected ranges' of gas/coal price differentials that one particular outcome is much more likely than the other?
- Market dominance - the consultation paper does recognise both the importance of promoting competition and concerns regarding market power. With ongoing capacity constraints on both the Moyle and north-south interconnection, resulting in significant 'constraint costs', consumers are seeking reassurance that that appropriate measures to mitigate dominance are in place and are effective

We look forward to the UR's response to the consultation and in particular the need to reconcile the views and conclusions articulated by PPB.

Regards

A handwritten signature in black ink, appearing to read 'Nigel PE Smyth', with a horizontal line underneath.

Nigel PE Smyth
Director, CBI Northern Ireland