

Briege Tyrie  
Utility Regulator  
Queens House  
14 Queen Street  
Belfast BT1 6EB

22 February 2016

Dear Briege,

### **Draft Forward Work Programme 2016-17**

Power NI welcomes the opportunity to respond to the recent draft Forward Work Programme 2016 - 2017 published by the Utility Regulator (UR).

Consistent with the 2015/16 Forward Work Plan (FWP), the 2016/17 FWP describes at a high level, a substantial number of major projects. In setting such an ambitious programme, the UR must be mindful of the time and resource commitments it is making through the FWP. The FWP sets an expectation for market participants who will commit their own resources to engage with the UR. It is critical that each of the areas are afforded full consideration and not expedited to meet an unrealistic timeframe.

### **Specific Items**

The FWP contains a number of strategically important projects which directly impact Power NI.

- **The Retail Electricity Market**

Power NI notes the continuation of the flagship project in relation to the retail electricity market in Northern Ireland – ‘Review the effectiveness of competition (phase 2)’.

This project was derived from the UR’s obligations under the Third Energy Package. The UR should however, be mindful that at a principle level, the Third Package is designed to facilitate a competitive market in electricity and gas across the European Union. The requirements on the UR could not be clearer; the UR must work towards developing a competitive market while ensuring the protection of vulnerable customers.

As previously communicated, Power NI strongly believes that it is time for the UR to consult on the removal of price regulation in the non-domestic sector. For the following reasons this issue is urgent and should be expedited without delay.



- European Context and the absence of harm

Within previous correspondence Power NI has outlined concerns in relation to Phase 2 of the “Review of the Effectiveness of Competition” highlighting ACER and the European Commission’s views on the retention of price regulation. The Commission has repeatedly stated its requirements in relation to price regulation. Publications such as the EC Communication “Making the internal energy market work” (November 2012, but published January 2013) states that regulating of prices should cease.

In particular, section 3.2.1 states that:

*“Member States should seek to cease regulating electricity and gas prices for all consumers, including households and SMEs, taking into account universal service obligation and effective protection of vulnerable customers. Suppliers should clearly spell out the different cost elements in the final cost for their customers, to encourage well-informed decision-making. The Commission will continue to insist on phase-out timetables for regulated prices being part of Member States' structural reforms. The Commission will continue to promote market-based price formation in retail markets, including through infringement cases against those Member States maintaining price regulation that is not meeting the conditions laid down by EU law.”*

ACER has also commented on the position of regulated prices:

*“Regulated end-user prices are not compatible with the objective of establishing liberal competitive retail markets. Therefore, CEER will develop guidance, based on experiences at national level, on the approaches to be used to facilitate the phasing out of regulated end-user prices, as soon as practicable, whilst ensuring that customers are properly protected where competition is not yet effective”<sup>1</sup>*

The European commentary highlights the negative impact that price regulation has on competition and that any active market intervention to address a clear identified harm must be time limited. Further, the focus on the domestic context emphasises that there should be specific policy reasons for the retention of price regulation, which is not the case for the non-domestic sector in Northern Ireland. As set out in our previous correspondence concerning the “Review of the Effectiveness of Competition”, the analysis conducted by Cornwall Energy does not adequately consider this context.

In Northern Ireland the non-domestic market has active competition, unrestricted switching, Codes of Practice (including a Marketing Code) and will soon have full Market Monitoring. Given the level of competition in the non-domestic market in Northern Ireland, we fail to see what specific and identified harm is mitigated by the continuation of price regulation.

- Previous decision to retain price regulation

During the 2014-17 Price Control process, Power NI strongly argued that the retention of price regulation for the non-domestic market was no longer appropriate. The UR did not accept this position and expressed a view that Power NI, together with Energia, retained a dominant position and therefore price regulation should be retained to provide consumer protection.

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<sup>1</sup> ACER - Energy Regulation: A Bridge to 2025 Conclusions Paper (19 September 2014), and in particular, para 51

It seems clear to us that the current market conditions necessitate a consultation on the removal of price regulation in the non-domestic sector as there is a clear lack of dominance. Further, the retention of price regulation in the non-domestic sector is ineffective, distortive and has disproportionate effects on the development of competition and the wider electricity supply market.

- Absence of dominance

The UR analysed the non-domestic market by reference to three market sectors (0-50MWh, 50-100MWh, and 100-150MWh per annum) during the previous price control process. Disappointingly, the UR does not publish market share information that allows for a like-for-like comparison with the data included in the price control decision. Nevertheless, Power NI has reviewed the information made available in the Quarterly Transparency Reports to assess the Power NI non-domestic market share. Using <70kVa as a proxy, the Power NI/Energia market share of the rolling 12 months consumption in Northern Ireland has been less than or equal to 50% for in excess of a year. As a result, the dominance trigger set by the UR has been met and a consultation exercise should be undertaken.

The Cornwall Energy Report does not clearly distinguish between domestic and non-domestic consumers. Nevertheless, we note that the Cornwall Energy Report highlights that the current segmentation of the market for the purposes of the assessment of dominance is unhelpful and should be considered further.

Separately, from a European perspective, the relevant market for the assessment of dominance may be the Island of Ireland, rather than Northern Ireland alone. This is due to the operation of the single electricity market, with price coordination and an aligned regulatory framework. This further strengthens the evidence that Power NI is not dominant in the non-domestic sector and therefore price regulation should be removed.

- Ineffective

The UR's 2013 Decision Paper included an assessment as to whether competition was sufficiently effective so as to "protect the interests of consumers in relation to price". The Decision Paper concluded that the UR considered the 0-50MWh non-domestic sector remained in need of regulatory intervention.

Power NI considers this decision was fundamentally flawed. Price regulation is not in place for the entirety of this sector but rather a sub-section of a sub-section of the market share figure described above i.e. it is not in place for the entire 50% of the combined Power NI/Energia share but rather a percentage of Power NI's share only.

Based upon latest figures, Power NI supplies only 29,613 MPRNs or 274GWh of annual sales on price regulated tariffs. Positioning this within the August UR Quarterly Transparency Report this means that only 22% of consumption in the <70kVA reported sector or 6% of non-domestic consumption is subject to price regulation. In terms of customer numbers this equates to 46% of <70kVA or 43% of non-domestic consumers are subject to price control.

For the majority of customers price regulation offers no protection.

- Distortive

Power NI has argued consistently that the retention of a price control in a market that is demonstrably competitive compromises the proper operation of that market and is counterproductive. A regulated tariff that acts as a market reference price but is based on an unrepresentative set of cost drivers distorts the market and lead to poor customer outcomes.

These outcomes are clearly not in the best interests of customers generally, or those customers who are taking supply from a competing supplier, whose price offer is distorted upwards in line with the unrepresentative reference price. The UR is now faced with a situation whereby 9% of consumption<sup>2</sup> is driving the offers for the remaining 91%.

As set out above, the European Commission is increasingly concerned about the distortive effect that the maintenance of price regulation can have on the development of competition in electricity supply markets.

- Disproportionate

The retention of price regulation in the non-domestic sector has a significant impact on the Power NI business. As you will be aware, linked to the price control requirements are additional licence conditions in relation to business separation, independence and the use of assets. These conditions prevent Power NI from realising efficiencies and economies of scale which would benefit consumers. The current standpoint of the UR has not been adequately justified, particularly in light of the UR's statutory duty to protect consumers, including by way of promoting competition within the electricity supply sector.

Power NI believes that by actively restricting its managerial and operational model, the UR is treating Power NI in a manner which is not consistent with its competitors, some of which are part of much larger organisations and are actively utilising the economies of scale their respective Groups can offer. The restrictions placed upon Power NI are increasing cost to consumers and restricting the further development of competition in Northern Ireland.

- Summary

In summary, Power NI strongly believes that the context and basis of the decision to retain price regulation in the non-domestic sector has changed and the UR should publically consult on the removal of this unnecessary restriction without delay.

- **Wholesale Market**

Power NI is somewhat surprised that the ISEM Project features as only one of a number of flagship projects in the FWP. Within the period covered by the FWP the various ISEM workstreams will need to conclude their determination of the detailed design and market rules. This is a critical piece of work which must enable the market to be delivered by the 2017 deadline. The UR should not underestimate the level of commitment required to deliver this outcome.

At this stage, a number of workstreams have suffered slippage and Power NI is increasingly concerned. There is little doubt that this project is on the critical path. Such time pressure has required a number of interdependent workstreams to be scheduled in parallel. This can create a silo approach to design which, without adequate consideration of the interdependencies, risks unintended consequences and a sub-optimal design.

Compressed timetables have, in previous major market projects, led to a shortening of the design phase and a compression of the implementation and testing phases. This represents a significant risk to the market and its participants.

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<sup>2</sup> Price regulated demand as a percentage of non-domestic excluding LEUs who will seek bespoke tariffs

In defining the detailed design of the I-SEM, the UR must be cognisant of its statutory duty to protect consumers. Only the largest commercial customers are realistically in a position to dynamically interact with the market place. All small and medium enterprises and domestic customers' source, and will likely continue to source, their electricity needs via a supplier. Even mindful of the aspirational goals of smart metering and demand side participation, the overwhelming demand from customers is, and will continue to be, a requirement to have certainty and consistency in electricity pricing.

To deliver this requirement, suppliers must offer fixed, non-volatile tariffs that can be easily presented. Simplicity in market design is key to customer engagement. To this end it is imperative that suppliers are able to hedge the majority of volume in the Forward Market to ensure tariff stability, cognisant that the price in the Forward Market is the price consumers pay. It is therefore crucial that any design has a properly functioning Forward Market in terms of volume, price and flexibility i.e. liquid.

There is a pre-conception that liquidity is simply volume; this is not the case. Liquidity refers to the availability of hedges based upon a competitive price formation, covering a variety of timeframes at times when there is demand to buy them, not purely when generators choose to sell.

A liquid and transparent Forward Market enables suppliers to hedge efficiently; it shields consumers from volatile spot markets and facilitates competitive tariff structures. An effective Forward Market also provides open access to mitigate market power and concentration, as well as send price signals to drive investment. The effective functioning of a Forward Market is therefore vital for competition and consumer choice.


It is mindful of the volume and complexity of the ISEM project commitment that Power NI expected ISEM to feature as a number of 2016/17 FWP Projects.

- **Consumer Protection Strategy**

Power NI is committed to providing the highest levels of consumer protection and has over the years since privatisation implemented numerous process, policy and documentation changes to improve protection for consumers, particularly vulnerable customers.

As described in our response to the relevant consultation, Power NI has a major concern that whilst the proposed strategy does have a 'focus on affordability' as a specific objective, it doesn't address or even acknowledge the significant costs that are likely fall upon consumers in the coming few years. These include: Smart metering; ISEM costs; EMR costs; the costs of the Moyle Interconnector, back up plans and the costs that would otherwise be avoided if a North South interconnector was in place etc. None of these costs are within control of suppliers but are policy decisions taken by governments and regulators but they will have real consequences for customer bills and are likely to adversely impact those consumers that this strategy is seeking to protect.

Whilst Power NI is in favour of protecting consumers, the industry, including its regulator, must be open to acknowledging the relativity of the impact of many of the actions proposed in the

strategy will be minor when compared with the significant impact on customer bills by the issues highlighted above. Work is required by the UR to ensure transparency in relation to the impacts of these policy decisions/consultation processes – Power NI believes that this should be included in the consumer protection strategy work 

- **Smart Metering**

Power NI maintains its view of Smart metering as communicated in response to last years plan. To reiterate; Power NI is conscious that the policy decision in relation to Smart Metering lies with DETI. As the UR is aware however, other European countries are at a more advanced stage of their implementation programmes. Power NI would encourage both DETI and the UR to reflect on the practical experiences from other markets both in refreshing the Cost Benefit Analysis and in the implementation planning phase.


Smart Metering will require a significant investment in infrastructure and on going maintenance. This cost will ultimately be funded by consumers and therefore it may be prudent to continually review plans and decisions in light of new information available.

Recent information from both the Irish and German markets suggests that as more details regarding implementation have become available, especially on the supplier side, the associated costs escalate above original projections. Such information may undermine the Cost Benefit Analysis completed in Northern Ireland, which incorporated a light touch supplier cost element, and therefore the refresh DETI are undertaking is most welcome.

Power NI believes that there is a case for a targeted as opposed to a universal implementation of Smart Metering. For example, high consumption customers, those with electric heating such as heat pumps, difficult/expensive to read premises and customers with micro generation.

The Northern Ireland market also has a significantly higher installation of prepayment meters in comparison to other markets and it is of critical importance that the consumer benefit derived from this solution is not negatively impacted by Smart metering.

## **Conclusion**

Power NI is committed to working constructively with  the UR across the range of projects references in the FWP and hopes that the UR will address those issues highlighted above. Should you wish to discuss the content of this response please do not hesitate to contact me.

Yours sincerely



William Steele  
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