Preface

Thursday, 27 November 2008

Dear Iain,

Below is my report on the recent electricity price increase.

The timing of this report, amidst all the distress and suffering which flows from the turmoil in the world's financial markets, at least means that there cannot still be many people left who believe that unregulated markets know best and that the short term private interests of individuals or companies in some inexplicable way is automatically aligned with the public interest.

I am, on the contrary, reinforced in my belief that we have in Northern Ireland the potential to create, together with our neighbours in the Irish Republic, a well regulated electricity market which could not only deliver lower costs to customers but also manage the transition to the low carbon electricity system to which our legislators aspire.

Nothing that I have observed in the weeks during which I have been carrying out this review gives me any cause to doubt that you and your staff have the skills and capacity to deliver such an outcome for customers – if given a sound policy framework by policy makers.

But for this to happen I believe that they and you and the other stakeholders in the industry have to be prepared to set aside text book theories and other people's outmoded economic mantras and work out pragmatically what is the most practical of way of harnessing market forces and constructing and empowering effective policy delivery vehicles in the specific circumstances in which we find ourselves in Northern Ireland so that these all together work in the interests of customers.

With best wishes.

Yours sincerely,

Douglas McIldoon

Northern Ireland Electricity Consumers – Orphans in the Energy Storm

Contents

Executive Summary

1. My review of the 33⅓% price increase is divided into two principal parts. The first part deals with the process which led to the price increase. The second part looks at the wider issues of the structure and evolution of the electricity supply industry and whether there are improvements which might be made which would benefit customers.

2. My Part I findings are as follows:

   i) the process which was followed was similar to the process which had been followed successfully in the past and which in 07/08 enabled customers to secure their electricity at below current cost levels; it was no less rigorous than in previous years;

   ii) in this context the price increase was an inevitable outcome given the rising fuel prices and in that sense was justified;

   iii) there exists within the Northern Ireland structures what I have described as a partial correction mechanism which should in most circumstances provide an element of relief retrospectively in circumstances such as those which applied this year when the market moves in the opposite way to the expectations of those who formulated the tariff.

3. My Part II findings are as follows:

   iv) the creation of a single electricity market on the island of Ireland is the most creative approach which Northern Ireland has taken in the last 40 years to its chronic situation of energy dependency but it needs to be developed;

   v) electricity prices are higher than they need to be because policy is confused and contradictory;

   vi) unless there is further development the present market mechanisms will neither drive down prices nor deliver the desired transition to a securer, less fossil fuel dependent electricity supply industry;

   vii) the core of the problem is the haphazardly extravagant way in which we procure and reward generation. This in turn is causing us to drift towards a bilateral market lacking both transparency and genuine competition;

   viii) the least cost system would be one in which:

   - generation is secured by competitive tender under contract;
   - all electricity is sold as at present through the pool but without contracts between generators and suppliers;
   - suppliers compete by the value they add, in the form of other services, to the electricity they sell;
   - arrangements for purchasing generating fuels collectively could be explored to reduce the risk exposure as under these proposals generators would not need to compete to secure a competitive advantage in fuel costs;
   - power stations whose fuel cost was below the system's marginal price in any half hour would continue to receive that surplus

(known as infra marginal rent or IMR) and this would be set against the price of their contract. Should they earn more than the amount specified in the contract this would be reimbursed to customers – as it is at present under NIE Power Procurement Business's contracts.

Changes to give effect to this type of system could be effected without any structural change to the market. New generation would be secured by competitive tender and existing stations could be given contracts based on the true costs which they still face.

ix) specific measures should be put in place to stimulate investment in non wind renewables including the purchasing of customers equity stakes. These measures should apply at both the micro or household level and at the scale which is needed for selling into the pool;

x) fuel poverty cannot be defeated through the structure of the electricity market in the near future and additional policy instruments are required;

xi) tariffs should be re-sculpted - so that those who pollute most through high usage pay more. This would both take some households out of fuel poverty and reduce the burden of energy costs for others as well as aligning price signals with environmental policy objectives;

xii) endowing customers with an increasing degree of generation "ownership" would progressively reduce the incidence of fuel poverty and further align energy and environmental policies;

xiii) NIEES should not be constrained by the need to buy all its electricity for 12 months in a pre-set two month period. It should be encouraged to purchase electricity more opportunistically within certain parameters. If energy markets' volatility makes one year tariffs appear risky more frequent tariff reviews should be allowed;

xiv) NIEE (PPB) should be allowed to hedge a percentage of its fuel purchases;

xv) the euro/sterling exchange risk should be netted off within the market before it becomes a threat to the market's continuing existence;

xvi) households' stake in domestic scale renewables should also be developed on a sustained basis which would integrate economic, social and environmental policy objectives; and

xvii) the role of the Consumer Council does require clarification. In particular it should assume a role which is less implicated in the process of the tariff review and more focussed on the wider social context and implications of the review.

The report concludes with a number of strategic policy questions which MLAs might wish to consider.

Introduction

4. The primary duty of the Electricity Regulator as laid out in the Energy Order[1] is to protect the interests of electricity customers. Electricity companies are only the means to serve that end. When potential market entrants looking for new opportunities for profit welcome price rises, which inevitably bring additional misery to hard working families and all households on low or modest incomes, they clearly do not understand that the primary duty is precisely that – to ensure that customers do get the best possible deal.

5. The provision of an affordable supply of electricity is the essential prerequisite for living in the 21st century. When Benjamin Franklin wrote "in this world nothing is certain but death and taxes" he was not allowing for the ability of the super rich to avoid taxes. But he was also in no position in 1789 to know that two centuries later the two certainties would be death and the absolute need to have a supply of electricity. For better or for worse a supply of electricity makes possible almost all human activity in the western world of today. Future generations may well regard the human species of this age not as Homo Sapiens but as "Homo Electricus".

6. While all over the world consumers are facing higher energy costs it should be noted that the position of the electricity consumer in Northern Ireland is particularly perilous. In Great Britain there is a single Government, a single Parliament and a single regulatory authority who between them must assume responsibility for their single electricity market as well as for the success or failure of energy policy. Moreover as the United Kingdom is one of the largest member states of the European Union energy users in Great Britain are heavily represented at every level of the Union's decision making bodies.

7. The contrast with the position of electricity consumers in Northern Ireland is stark. Our electricity market straddles two states and two currency zones. There are two regulatory authorities and two Governments. Our weight in the decision making processes of either the United Kingdom's Government or the European Union is slight to non existent.

8. However providing an electricity supply is not a finite project to be completed and put into a final state. It is always going to be a work in progress as new preoccupations such as eradicating fuel poverty and combating climate change become political imperatives.

9. In our case it involves the continuous engagement of the policy makers in the Irish Government and the Northern Ireland Executive. It is important to recognise that although Northern Ireland is only an autonomous region of one state and the Irish Republic is a fully sovereign state, the development of a satisfactory electricity market for the whole island requires a close working relationship between two equal partners. The relationship involves some limitation of sovereign power willingly accepted by the Government of the Irish Republic at an operational level.

10. The management of the electricity market on a day to day basis is efficiently carried out by professional staff working together in both jurisdictions. This

[1] Article 12 of "Energy (Northern Ireland) Order 2003. See appendix 4 below for the full text of the Article.

report identifies a need for strategic policy changes if the market is to produce even better outcomes for electricity users in both parts of Ireland. The only way such changes can be implemented is by a joint commitment by the policy makers on both sides of the border to engage in the process of developing the market. Should they fail to do so I am convinced that both parts of Ireland will experience electricity costs which will increasingly diverge from those of other member states in the European Union.

The Review

11. Following the announcement of the NIE price increase in September and the widespread public concern it caused I have been asked to carry out a review of the process. The terms of reference are set out in full in Appendix 1 to this report.

12. In order to carry out my review I have had many meetings with those most closely concerned with the process. I have also looked at the correspondence which passed between them and the information in the form of presentations by which parties to the process either informed others or were informed by them.

13. In addition I have had meetings with journalists who have observed the process and with participants in the industry who have expressed to me their views on the way in which the electricity market is operating. In all I had 25 meetings with 27 different people. However this does not include any of the meetings - long or short - which I had with NIAUR staff as I have sought to ensure that I fully understood various aspects of what was going on in this process.

14. This report therefore falls into two parts. Part I - covers what happened in the recent review of tariffs. It is largely about facts rather than opinions.

15. But for anyone who pays an electricity bill in Northern Ireland the outcome was profoundly unsatisfactory however impeccable the process may or may not have been. To see other companies welcoming the large price increase which came out of that process simply rubs salt in the wound. Part II is concerned with remedies and wider policy issues. There will be some cross reference between the two parts as in Part II points which are alluded to in Part I will be dealt with further.

16. In the almost 40 years which have lapsed since the first OPEC induced oil crisis we have had to learn that the key to managing the price we pay for electricity must be through driving the electricity supply industry in a direction where as large a proportion as practicable of the costs are locally controllable.

17. In this context the decision to construct a Single Energy Market (SEM) to develop the energy resources of the island which Northern Ireland shares with the Irish Republic – in particular as we enter a period in which energy policy is dominated by both security of supply issues and the urgency of weaning the developed world off fossil fuels – is the most constructive and farsighted policy strategy for asserting local control of our energy future which has been taken by a Northern Ireland administration in the last 40 years.

Part I - What happened

The Annual Tariff Adjustment.

18. Each year since long before privatisation NIE operated an annual review of its tariffs. Until the creation of the Single Electricity Market the tariff year ran from 1st April until the 30thMarch. With the advent of SEM it was moved to 1st October to 30thSeptember. With the liberalisation of the electricity markets this tariff has become mainly concerned with domestic customers as businesses and other larger users moved to individual contracts with separate suppliers. Although the domestic customer market is fully open to competition, in the absence of any other supplier entering this market NIEES - which sells electricity directly to domestic customers - is still subject to price controls and regulatory oversight. While NIAUR does not set the tariffs it does establish annually the amount of money which NIEES is entitled to recover from its customers.

19. From one year to the next the main cost variation is in generation costs and in practice this means fuel costs. Customers bear the full risk of these costs changing. Historically falling costs for coal, gas and oil have resulted in price reductions and increases have been reflected in increases in the price of electricity. Until very recently price fluctuations were within what, with hindsight, seems to have been much narrower bands. But dramatic fluctuations in the cost of generating fuels also occurred in earlier decades so we have been here before.

20. Within the British Isles Northern Ireland has been historically atypical in the degree of its exposure to fluctuations in the price of primary fuels. In Great Britain by contrast power stations were either nuclear or were fuelled by British coal or North Sea gas until the early years of the present decade. Its exposure to the volatility of international markets in oil, coal and gas is therefore very recent. The story for the Irish Republic is similar. For its first fifty years the state-owned ESB ran the Republic's electricity system on a combination of hydro and peat. These were later supplemented by Kinsale gas. For the Republic therefore the exposure to the volatility of the international markets is also a recent phenomenon.

21. Northern Ireland was different. In the early 1970s we broke with our total dependence on British coal and turned to oil to be almost immediately hit by the first major hike in oil prices. The thread which runs through the almost perpetual crisis in our electricity industry since the early 1970s is our exposure to internationally set prices for the primary fuels used for generation. There is a bitterly savage comic element in this: we changed to a cheaper more efficient fuel only to see the price increase, we converted Kilroot back to coal when oil prices were less aggressive; we didn't discover our substantial lignite potential until lignite had become a fuel source which would be environmentally unacceptable; we finally hooked up to Britain's gas supplies as they started to run out.

22. In the 1980s this exposure to externally set fuel prices resulted in a running subsidy from the Government to peg prices at the level of the dearest region in England and Wales. In the worst year, which was 1984/5, this peaked at

£105.6m. In the most difficult year the price increase would have been 40% in the absence of the subsidy.

23. So there is nothing new in the fact that the electricity user – either as consumer or taxpayer – has been fully exposed to variations in the costs of the fuels used for generating electricity.

One question to which it will be necessary to return in Part II is whether in the current arrangements the symmetry of that exposure has changed. In the past if customers suffered the pain of high generation costs they also gained the benefits of cost reductions. Is this still the case today?

24. The process by which tariffs are set has not changed at a high level but it has changed at an operational level. The tariffs are still set on the basis of what NIEES believes it will have to pay for the electricity which customers will need over the coming twelve months. In the past this was based on the estimate of the cost of fuel and other payments which NIEE(PPB) – would have to pay for generation. With SEM NIEES is now freer to buy where it can from whichever generators will sell to it including NIEE (PPB). In practice some of NIEES's power is now sourced from ESB Power Generation (ESBPG). (The latter is obliged to dispose of a small proportion of its output to all suppliers who want it at a price overseen by the regulators).

25. Purchasing electricity in a different currency zone incurs the risks associated with currency fluctuations – a point to which I will revert in Part II.

26. During the period May to early July NIEES arranged to purchase almost all the electricity it believed it would require for the period October 2008 to September 2009. Once it had made these purchases it was contractually committed to purchasing the electricity at the price it had agreed. Unfortunately the period when the purchases were made was a period when the projected fuel prices for the coming year were rising. On the basis of the information available at the time fuel prices for 08/09 would be much higher than for 07/08 and would go on rising so that if NIEES delayed purchasing the situation would become even worse. This is in simple terms the background to the 33⅓% price increase.

27. However no tariff year is an island. Each new tariff year brings baggage from the previous year and 08/09 was no exception. The baggage comes in the form of NIEES having received either too much or too little money from its customers in the preceding year. To understand what happened in 08/09 we need to look at what happened in 07/08.

28. Although they did not know it customers actually paid 18.8% less for their electricity in 07/08 than it cost to produce given fuel costs in that year.

29. This is how it happened. In the previous year - 06/07 - there were over-recoveries which reduced the amount NIEES needed to recover from its customers in 07/08 as it – in effect – started with money in the bank. Secondly when it was making its electricity purchases in the late spring/ early summer of 2007 it bought electricity for the coming year at lower prices than it would have paid if it had just bought its electricity out of the pool as it needed it

later in the year. **In fact the annual bill for a typical domestic customer in 07/08 would have been £439.05 if NIEES had bought electricity at current prices instead of locking into forward prices; however customers were only required to pay £375.29.**

30. So exactly the same process followed in 2008 produced the exactly opposite outcome. Not only did it produce an artificially large percentage increase but it now appears that the purchases were made against a market expectation that fuel prices – and in particular gas prices - would continue to rise appreciably during 2008/9. In fact in the tariff year to date the outcome has not conformed to this expectation. While it is too early to predict what the outcome over the whole year will be, there seems to be a reasonable prospect that customers are locked into prices this year which are higher than they need to be. If the underlying fuel price follows the trend which was seen in October 2008 then this could be of the order of about 11%.

31. This is context in which I must address the terms of reference which I have been given.

    To establish where the process and outcome were robust by:

    a) looking at the proposed tariff increase; and
    b) hedging processes.

32. The process was exactly the same as the previous year. One background difference however was that whereas in 07/08 NIEES started with an over recovery from the previous year – ie "money in the bank" – this year it started with the need to make up a shortfall in the 07/08 year. That is to say, despite the good fortune which helped keep prices well below actual production costs, in 07/08 tariffs were set about 3% lower than they should have been to balance the books in year. There was therefore an in-year 14% tariff increase to make good the anticipated shortfall.

33. The absence of this comfort zone meant that setting the tariff required additional care.

34. Basically NIEES had four options:

    i) to proceed as they had in the previous year and sign contracts for most of their requirements;

    ii) to sign for a portion only of their requirements and buy the rest from the pool;

    iii) to seek a short term price increase to cover the first six months of the year and review the rest of the year later; or

    iv) to buy a hedging instrument which would offset some of the risk of locking in early.

35. All of these options were considered and the Consumer Council quite explicitly raised some of them with both NIEES and NIAUR.

36. NIEES explained to me that the reason they felt it would be imprudent to seek contracts for only part of their requirement was that when they went back into the market to buy for the remainder of the year they would find that all the best offers from generators would have been taken up by other suppliers. It would be a different matter if a six month tariff – for example – were accepted by all as the appropriate way to go in a volatile market. To get to this position would have required an agreement by both Regulators that this year tariffs should be set for only six months.

37. NIEES also showed me the sort of hedging instrument which they might have been able to buy in the market. This would have involved their paying a third party a sum of money in exchange for which they (NIEES) would get money back if the market price of gas dropped by more than 15%. NIEES's calculation was that to break even on this type of transaction the price of gas would have to fall by more than 22%.

38. It would have been remiss of NIEES and the other parties to the tariff discussion not to have considered these other purchasing options and they were right to do so. But it is also clear that whatever purchasing strategy NIEES adopted would have involved placing a bet with customers' money. **In doing what had worked in the past, purchasing in advance so that the extent of customers' exposure to future fuel price movements was minimized, NIEES was, in my view, acting prudently within the context in which it was required to operate.** Whether it would be possible to improve this operating environment is an issue I will address further in Part II.

39. Moreover there is another aspect to the NIEES purchasing strategy which constitutes an **inbuilt partial correction mechanism** which I shall deal with below and which to some extent offsets the risk of pre-purchasing all the electricity for the coming year.

40. At this point it is necessary to consider the role of NIEE (PPB). PPB was established as the counter-party to the long term power purchase agreements which were set up when the power stations were sold at the time of privatization. It also acquired a long term gas agreement (LTI3) which expires in 2009 and which for most of its life has obliged PPB to buy gas at well above the market price although since October 2007 it has held the total gas bill below market prices. When it was established PPB did practice hedging but investigation of its hedging performance revealed that in most years hedging was costing customers money. At present therefore PPB is not allowed to hedge its fuel purchases.

41. The result is that within the NIE Energy there are two businesses each of whose practice on hedging is, to a significant degree, the mirror image of the other's. NIEES hedges, that is it pre-buys almost all of what it believes, will be required by its domestic and small non-domestic customers in the course of the year. It is in this sense 94% hedged. PBB on the other hand sells its electricity for the best price it can get in the coming year, to a range of suppliers operating within the all-island electricity retail market, in the form of contracts which it must honour. But it is fully exposed to the risk that fuel prices during the year will differ from the underlying forward fuel prices

associated with the contracts that it had sold. The result is that PPB will be exposed if fuel prices rise to a higher level than it anticipated when it pre-sold its electricity; NIEES will be exposed if fuel prices fall below those it anticipated when it bought its electricity. But in fact in both cases it is the electricity customer who is exposed. A shortfall for either has to be made good by the customers. Logically these two risks should to a considerable extent cancel each other out. Thus if NIEES turns out to have paid too much PPB should accumulate larger surplus revenues than it anticipated – and those profits do belong to Northern Ireland customers. While all the beneficiaries of any PPB gains are Northern Ireland electricity consumers they are not all necessarily customers of NIEES.

42. This **partial compensation mechanism** to a significant extent – and without having paid any fees to a third party for hedging - helps to mitigate the risk that customers face if NIEES's purchasing strategy in any year turns out to have been wrong. It does not wholly compensate them as part of PPB's profit will go to other customers in Northern Ireland. This is fair as it is all customers in Northern Ireland and not just domestic customers who would be required to pay more should it be that PPB were in deficit. And it is symmetrical in that if NIEES has "beaten the market" the benefit which customers will see is reduced because by the same token PPB will almost certainly be in deficit as PPB is not at present allowed to hedge its fuel purchasing.

43. The key question therefore which arises for regulation is whether or not this partial compensation mechanism could be built on to improve yet further the overall efficiency with which customers in Northern Ireland purchase their electricity. This is a topic which I shall return to in Part II.

44. The question of the robustness of the process has also been raised and with it the suggestion that NIAUR did not subject NIEES to a sufficiently rigorous regulatory challenge.

45. It is certainly the case – and the Consumer Council has made the point well – that in the absence of a competitive market which protects customers by constant downward pressure on costs and prices the Regulator must seek to secure the equivalent outcome. However the time for a rigorous regulatory challenge to a regulated business's costs is during a price control when that business's own costs are in contention. The Regulator must seek to secure for the customer some or all of the realized or realizable efficiency gains and cost savings in a regulated business.

46. However a tariff review does not fall into this category. It is not NIEES's costs which were at issue. All the cost components of the new tariff are pass through costs. At least seven of them are costs which had been at an earlier stage the subject of price controls and/or other forms of regulatory review and I am not aware of any suggestion that these reviews were deficient. (They are outside my terms of reference.) Moreover the year on year variation in them represented a very small part of the change in tariff - about 5%.

1. To identify where improvements could be made - I will deal with this in Part II.

2. To explain the role of regulation in the context of wider energy policy.

47. The primary duty of electricity regulation is to protect the interest of customers. The duties are set out in Appendix 4.

48. This is to be achieved by promoting competition where practicable and otherwise through regulation. The Regulator has an obligation to ensure that a regulated business that is efficiently managed is able to finance its activities.

49. Electricity Regulation in Northern Ireland has now had more than fifteen years experience in regulating those parts of the industry which have a monopoly role in the industry and in seeking to develop competitive market pressures on those parts of the industry where there are several companies capable of producing electricity and selling it to final customers.

50. Regulatory oversight and supervision is inversely related to the degree of monopoly power which any company or business entity has. In the market for business and commercial electricity customers there are several suppliers closely linked in ownership or by contract with generators who compete in this market. There is no regulatory scrutiny into the internal transactions within those companies competing for these sales – and indeed this part of the electricity market on the island resembles in both its structure and its opacity the bilateral market in Great Britain.

51. Although the domestic electricity market is open to competition for reasons which are economically logical but which are beyond the scope of this report the domestic customer market remains a monopoly in both parts of the island market – for ESB in the Irish Republic and for NIEES in Northern Ireland.

52. As the market for domestic customers is a de facto monopoly it is quite rightly subject to regulatory oversight. Indeed part of the protection which domestic customers in Northern Ireland enjoy is the knowledge that, in contrast to domestic customers in Great Britain, the cost of their electricity is scrutinized by the regulator and the revenue which NIEES may collect from customers is controlled by the Regulator. All the costs which NIEES incurs in sourcing that electricity are known and NIEES has no opportunity to take additional profit from any of them. Consequently the margin which NIEES is allowed – not guaranteed as it can only obtain it if it is efficiently managed – has been set at 1.8% of turnover and indeed this has been reduced to about 1.4% in the light of the recent fuel price increases. The comparable indicative figure is 6% in supply businesses in Great Britain. Domestic customers at least have a system which- whatever its other shortcomings - is guaranteed to be honest.

Was the outcome (i.e. the 33⅓% rise) justified?

53. As was indicated above the true increase in the cost of electricity between 07/08 and 08/09 was not the 47⅓% represented by summing the two price increases but was about 29%. That is to say the true cost of electricity consumed in each of the two years was expected to increase from a true cost

in 07/08 of £460 (including VAT) for a notional average customer to a true cost in 08/09 of £584. In practice on one month's evidence it however looks as if this figure for the year 08/09 is too high.

54. However I do not believe that it is legitimate to answer this question by claiming perfect hindsight. Though it seems hard to avoid the conclusion that it was the size of the percentage increase rather than the true extent to which the underlying cost of electricity had increased which has triggered the degree of public outrage, the most pertinent question is not whether a particular percentage increase was justified.

55. On the contrary there are in my view two questions which need to be answered.

56. The first is whether the 33⅓% rise was justified given the process which had served well in the past and the methodologies employed for dealing with each cost and risk within that process. The answer to that is that I found no anomalies or shortcomings within the process by which the price increase was managed. It was the same process that had been employed in the past. In terms of the existing regulatory processes the increase was therefore justified. I remain therefore puzzled by the statement in the press of 2 October attributed to an official of prospective market entrant that he "was encouraged that the regulator had rubber stamped it". Such a statement seems to me to cast an unwarranted slur on the integrity of the regulatory process.

57. The second question – and in my view the only important question is - **does the present structure provide electricity customers in Northern Ireland with electricity on the best terms that might be achieved?**

58. As well as raising some issues of regulation this raises much wider questions of market structure, energy strategy and the absence of effective North-South engagement at a strategic level. I will turn to these issues in Part II.

Part II - Can we improve the terms on which customers buy electricity?

59. Efficiently securing its supply of electricity is one of the most important tasks which any modern society faces since it underpins the cost of almost everything else which the citizens of that society do in their working and recreational, private and public lives. It is therefore important that society has confidence in the processes through which it manages its electricity supply.

60. **The key issue for any electricity market including Northern Ireland's is the relationship between the users and producers of electricity – that is between the generators and the electricity consumer. In the rest of this paper I shall concentrate on this aspect for three reasons:**

    i) generation has always represented the major contributor to the electricity bill – normally 60% for domestic customers and 80% for industrial customers and this year this percentage has increased to about 73% for domestic customers;

ii) regulation has over the years been quite successful in capturing for customers the efficiency gains in the other parts of the chain and in particular transmission and distribution networks. Even if it were possible to reduce these costs by - say - a further 25%, the net overall effect on electricity prices would, however welcome, be small and greatly outweighed by the swings in generation costs; and

iii) generation is the part of the industry which is the source of policy concerns about climate change and security of supply. It is the part of the industry which is most implicated in the need to change and evolve if long term policy objectives of both the British and Irish Governments are to be met.

61. Under the traditional public utility model the customer was in theory fully in control through the proxy of public ownership and ministerial accountability to elected representatives. In practice this control was amateurish and less effective than it should have been mainly because of the weakness of public regulation at that time.

62. The justification for the liberalised electricity market was that it would deliver for customers a better outcome than the public monopoly model.

63. It is certainly possible to identify aspects of liberalised electricity markets where performance is measurably superior to the traditional utility - for example labour productivity; other aspects are less impressive - for example cost of capital. **But in practice because liberalised markets were born out of existing industries it is not at all evident that a liberalised electricity industry is capable of renewing itself at the lowest possible cost to consumers over time in a period of changing technology and a public policy agenda whose pre-occupation with carbon reductions, fuel security and fuel poverty moves the energy agenda a long way from the agenda which the energy market liberalisers thought they were being invited to manage. If financial institutions become much more risk averse over the next decade this will also have an impact on the cost of financing new investment – and particularly "at risk" investment – further weakening the capability of the unregulated market to both renew and transform electricity generation.**

How Can Customers Best Manage their Generation Costs?

64. It is questionable if the customer-generator relationship was ever satisfactory in either the period of public monopoly or in the period of liberalised markets. Since the electricity supply industry in Northern Ireland was privatised in 1993 it has been shaped and dominated by Governments' "love-in" with the generators. It is perfectly legitimate to ask if this has worked and will work in the future in the interest of the consumers who – in Northern Ireland especially - are always asked to pick up the bill. Leaving aside the excess cost of generation which Northern Ireland's electricity consumers have had to pay for the last 15 years my concern is that in some ways that relationship is at present moving again in the wrong direction. Is the risk for customers increasing rather than diminishing in the emergent all-Ireland market because

of the way generation is rewarded and looks like being rewarded for decades to come?

65. **Let me be absolutely clear about this point. The present way in which we reward generators gives customers the worst possible outcome. On the one hand an individual generator faces financial uncertainty and cannot be completely confident – no matter how efficiently the power station is managed – of recovering its costs. This makes every investment in generation more expensive to finance than it need be and therefore requires the price of electricity to be higher than it need be. But at the same time – and no doubt in order to reduce the perceived risk to new generators – we over-reward generation collectively. As a consequence we have a system which may require customers to pay for power stations twice. This is economically unnecessary, socially unjust and is simply not tolerated in those parts of the Electricity Supply Industry which are subject to regulation.**

66. Normally when a business sells its product into a market in recession it too suffers from falling sales and reduced profits. It might even run at a loss. The generators in SEM - if not totally - are largely protected from such a dire outcome. Indeed insofar as a recession and sales contraction discourage new investment recession may even improve the profit position of incumbents. It is as if when the Titanic hit the iceberg all the lifeboats were reserved for the crew!

67. The ultimate problem for electricity customers is their exposure to the risk that the lights might not stay on. But can this concern lead them to acquiescing in solutions that may become excessively high cost? The only way in which customers can reduce their risks is by enlarging the area under their control.

SEM

68. **The Single Electricity Market – properly reformed and developed -has enormous potential to deliver to customers across the island a cleaner, more secure and lower cost supply of energy.**

69. **Northern Ireland is fortunate in sharing an island with a neighbour, whose endowment in natural energy resources is proportionately much greater than our own. Geography makes us the most obvious partner to share in the sustainable exploitation of these resources. This potential has yet to be realised in full as fossil fuel dependence is still the industry's principal characteristic but already there are signs of the longer term prize. For example Northern Ireland customers already benefit from the size of the Republic's wind generation portfolio which has the effect of from time to time reducing the pool price of electricity.**

70. **But it requires vigilance and political engagement to ensure that the greater efficiencies of the industry in Northern Ireland influence the Republic's industry and not the other way round and that Northern consumers do not end up having to pay again for inefficient plant in the Republic which consumers in the South have already paid for.**

71. **The danger with SEM is that if its evolution is not properly thought through there will be a cumulative build up of excess costs and commitments which will add to the billions of pounds which the muddled thinking of the Direct Rule administrations has over several decades cost Northern Ireland's consumers.**

72. Within the generalised European Union's policy of creating a single European energy market the two parts of Ireland have been, since the beginning of the decade, moving towards the single electricity market which geography, the laws of physics and economic logic all suggest is the most sensible way of managing our energy requirements and protecting our future.

73. Although a single electricity market on the island of Ireland offers many potential advantages; it also carries with it significant risks – particularly for the smaller party if it allows itself to be over-awed by its larger partner. **For this single electricity market to work it must develop as a partnership of equals with a strong and high level commitment by both parties to policy making.**

74. SEM is intended to serve the interests of consumers but it does so indirectly. It is structured on the belief that the satisfying of customers' needs can only be achieved by satisfying those who will meet that need – that is the generators. While it is self evident that in any market customers' needs can only be satisfied if there are producers who feel that it is worth their while to satisfy them, with an essential but undifferentiated product, such as electricity, the interests of consumers must be paramount since every aspect of social and economic life is completely dependent on a supply of electricity delivered on economic and environmental terms which facilitate rather than frustrate every other human activity.

75. **What is at present indisputable is that SEM is only capable of delivering electricity at a price which is so high that perhaps at present over 40% of Northern Ireland's households must be in fuel poverty and no progress is being made to produce cleaner dispatchable supplies of electricity from indigenous sources**.

76. In theory new forms of generation could come into the electricity market through SEM. Wind does and indeed does very well under the SEM system - though it is worth noting that in neither jurisdiction have special mechanisms for wind been abandoned and northern wind generators receive around €100,000 per annum more per megawatt of capacity than their southern counterparts with no economic or environmental justification whatsoever. But **SEM does:**

- nothing to encourage the efficient use of energy by customers;

- nothing to stimulate small scale on-site generation; and
- nothing to stimulate large scale renewables - other than wind – which are either not viable in the SEM structure or not financeable given the uncertainty about future prices.

Indeed insofar as the raison d'être of SEM is to reduce prices to the lowest obtainable level the measure of its success is the extent to which it frustrates the sustainability agenda.

Cost and Contradictions?

77. If we look at the costs which consumers in Northern Ireland face and who injects those costs into the price of electricity which consumers must pay it becomes obvious that there are many different cost contributors. But few of them are answerable to Northern Ireland consumers.

78. The taxes which customers must pay are set by the UK Government. These include VAT and Climate Change Levy (CCL) for non domestic customers. Taxes also include the taxes paid by the companies in the sector.

79. The cost of carbon which is now added to fuel cost also comes from Government. Ironically even when customers buy "green" through the market they still pay for the carbon – even though there is none – because the payment wind receives from the market includes the carbon embedded in the System Marginal Price (SMP) set by the fossil fuel generators.

80. The cost of the Renewable Obligation is set by the Northern Ireland Executive/Assembly which determines the size and therefore the cost of the obligation but the value of ROCs is set in GB.

81. The cost of the regulated parts of the industry is set by NIAUR but its freedom to defend the interests of Northern Ireland consumers is undermined by the right of companies to appeal to the Competition Authority in GB whose continued role in one small part of the all island electricity market can only be regarded as an anachronism working to the disadvantage of Northern Ireland consumers.

82. The SEM mechanism affects the cost of generation and is regulated by the two regulatory authorities on the island. NIAUR does not have the power to change this unilaterally.

83. Although it has voluntarily given up some of its powers in relation to SEM the Irish Government as the owner of ESB and Bord Gaìs Eireann (BGE) as well as being in a position to make unilateral decisions as a sovereign government is in a position to influence prices in the electricity which affect the short and even more the long term prospects for electricity prices on the island.. Among the assets owned by the Irish Government are generation and a gas business in Northern Ireland. The System Operator for Northern Ireland will shortly be added to its portfolio. (The Northern Ireland Executive has of course the potential to exercise a countervailing power to ensure that the strength of the Irish Government in energy matters is always exercised in a way which is aligned with the interests of Northern Ireland's electricity consumers.)

84. Gas and coal prices are set by international markets.

And the Contradictions

85. It is worth pausing for a moment to consider the following contradictions and costs inherent in energy policy which electricity consumers in Northern Ireland are forced to finance.

1) Driving costs out or putting up the price to consumers?

Regulators are required to strive to reduce costs, Price controls are specifically intended to take out costs; competition in generation and supply have as their justification that they drive down costs; but

carbon trading and taxes such as the Climate Change Levy (CCL) are quite clearly designed to increase the cost of electricity so as to dissuade consumers from using so much.

2) Reducing CO2 emissions or reducing the financial room to manoeuvre?

Customers are urged to switch to renewables. Why do they still pay the full cost of carbon when they do so? Where is the incentive to go green?

3) Fuel and generation diversity are regarded as essential to security;

Why then do we acquiesce in market structures which totally disregard risk to security of supply and arguably incentivise investors to aggravate this exposure?

4) Why has the Single Electricity Market been designed so as to frustrate the development of an island wide market in renewable electricity?

SEM is a single market but the incompatible incentive systems for renewables in the two jurisdictions ensure that the proportion of electricity which can be traded on the island must decline over time to close to zero if carbon reduction targets for 2050 are to be met.

5) A low cost of capital or a risky place in which to invest?

The market is supposed to provide confidence for investors and its outworking protect the interests of customers through reducing the cost of capital – yet customers will reward some generators twice or more and other generators cannot necessarily be sure that they will get their money back.

6) Why are customers urged to make investments in energy efficiency but deprived of the means to do so?

Customers are urged to invest in measures such as energy efficiency and micro renewables which would reduce carbon but their financial margin for doing so is eroded by Government inspired measures for increasing the costs of their electricity bills;

7) Value for money or environmental fetishism?

Measures which purport to reduce CO2 emissions do not seem always to have been subject to rigorous costs and benefits tests. While initially such measures may be dressed up as contributing to sustainability if they are not effective in reducing emissions at reasonable cost they in time damage the credibility of the sustainable development agenda.

8) Economically efficient or economically dogmatic?

One of the objectives of energy market managers should be to seek to reduce the gap between the peaks and troughs in the demand for electricity. Demand at winter peaks should be discouraged. On the other hand night time demand should be encouraged if it succeeds in moving demand from peak periods or in attracting new customers who switch from more carbon intensive fuels – for example for space heating or transportation. As the amount of wind energy in particular increases it is surely more desirable to have marginal wind farms heating hot water or powering heating systems than have them turned off. Capacity payments - which are paid by customers through their suppliers to generators - need to be rebalanced so that the cost of night-time electricity falls relative to prices at periods of peak demand.

86. Any policy which has multiple policy objectives and especially a policy whose various objectives are not functionally or organically related to each other will inevitably have a degree of tension between those policy objectives. If there is a single policy objective it may be possible to achieve 100 per cent success. With several objectives it is more likely that the best that can be achieved is a high degree of optimisation. But to do this it is necessary to refine the policy measures so that as far as practicable they are all pulling in the same direction; at present several seem to be pulling in opposite directions.

87. Perhaps it is time to look at certain aspects of energy policy to check the extent to which policy instruments work against energy policy aspirations:

- Higher prices are incompatible with measures to reduce fuel poverty and strengthen the regional economy: therefore no measure which increases prices should be acceptable unless it is the least cost way of achieving another policy objective. The aim of Government and regulation should still be to drive out costs.

- Carbon emissions are incompatible with climate change policy and – in the absence of large indigenous sources of gas and coal – fuel security. In

addition they certainly store up long term additional costs. Policies to facilitate new generation should be structured in such a way as to ensure that the amount of carbon dioxide emitted by the generation sector declines year on year.

- Policies which seek a year on year reduction in electricity consumption may produce perverse economic and environmental consequences. Renewable electricity has the potential to replace carbon intensive fuels for urban transport and space and water heating and the expanded requirement of night time renewable energy into these areas should be welcomed and certainly not discouraged.

88. **While many of the costs are beyond the control of anyone in Northern Ireland, and while we may have no choice but to accommodate ourselves to the policy confusions and contradictions which come from beyond our shores, it is important that policy makers are fully aware of all the factors that contribute to electricity costs and seek both to influence other inputers into the cost, where it is practicable to do so, and adjust their own behaviour in the light of all the factors affecting the price which consumers pay for electricity. At the very least even before consulting on any policy measure DETI and NIAUR should test as fully as is practicable not just the direct effects of the measure in question but its indirect impact cost and contradictory impacts so that when a public consultation is launched they can list both the benefits of the measure but also its adverse effects in so far as these can be estimated in advance.**

Taking SEM to the next stage

89. In theory generation should cost less in a competitive market than under a state monopoly system and that is the test by which it should be judged. It is difficult to see why generation built in the 1980s or earlier should be receiving in excess of €650m a year when in a publicly owned monopoly system it would have been fully depreciated by now. For that reason the remuneration of generators within SEM requires investigation. Certainly old generating plant which is still useful has costs which must be met but customers should not be paying off its capital costs for a second – and in the case of Northern Ireland customers – a third time!

90. Moreover while most of the rewards in the system go quite logically to the newest and most efficient plant a disproportionate amount seems to go to three plants. In at least one of those cases customers in Northern Ireland were excluded from the opportunity of sharing in those profits by the dogma of the Direct Rule administration.

91. SEM is intended to do two things: the first is to dispatch electricity on the day so that it is generated in the least cost way i.e. using that combination of power plants which because of their fuel costs and efficiencies will generate the quantity of electricity consumers require at the lowest possible cost.

92. The second objective of SEM is to create the conditions in which new generation is provided and old generation closed down so that over time consumers on the island enjoy electricity at the lowest possible cost.

93. Clearly these two tasks are not of the same order and there is no obvious reason why the same mechanism should deliver both with maximum efficiency – though the possibility that it might should not be excluded.

94. The first task – efficient on the day generation – is a task which takes place in a totally closed context. The number of possible permutations is limited by the plant which is physically available on the day as well as other factors which are given such as the amount of wind power on the day. All the data that is necessary for optimising the generation outcome is available, measurable and the algorithm for managing this data and producing the best fit answer is capable of being put in place customised to the situation on the island. Moreover there is – at least in principle – one decision point and total agreement as to what should be driving the decision that emerges – namely the minimisation of costs.

95. The second task is of an entirely different order. It is open ended; the possible combinations of generation options in the future are extraordinarily numerous – indeed might be thought of as infinite. The balance between micro on-site generation and large scale grid connected generation is one factor. The extent to which future generation should be renewable and/or have an emphasis on carbon reduction are other factors. Then there are questions of location. Who decides where new generation should be located since if electricity is not consumed on site it has to be transported to consumers at considerable cost. Then there are the questions of who bears the risks and how are they to be assessed with regard to future electricity prices over the 10 to 15 years that an investor would be expecting to justify a large scale investment.

96. Without existing and future investment in generation there will be no electricity. Ever since electricity markets began to be liberalised in the 1990s the keystone of energy policy has been the perceived need to reward generators adequately and predictably.

97. Generators face two kinds of risk. They run the risk that the plant they own will not work efficiently – that it will break down frequently or perform less efficiently than its potential. Secondly they run the risk that even when they perform efficiently they will not earn enough to justify the investment.

98. The first risk generators are well able to manage. There is considerable evidence that the independent generators –whether private sector or state owned - who have invested in new plant are indeed well able to manage these risks and that they do so better than the traditional public utilities.

99. The second risk they are much less capable of managing. The first risk they can manage because they are in charge. But they are not able to create certainty around their future revenue streams. All sorts of factors can influence these – new entrants, movements in relative fuel prices, changes in Government policy – in several areas – the construction of interconnectors,

the general performance of the economy, regulatory changes affecting transmission charges, rewards for capacity and ancillary services and so on.

100. Consequently generation investment is risky and the cost of capital reflects this. Generators seek to optimise their own decision and in consequence impose on customers their high cost of capital and, where they can, the cost of sub-optimal locations.

101. In SEM generators receive two kinds of payments which are supposed to remunerate them for their fixed costs – basically the capital cost of building and maintaining a power station.

102. The first payment is the system marginal price (SMP). This price is set in every half hour of the year by the combination of power stations required to generate electricity in order for the system as a whole to produce the amount of electricity that customers want in that half hour. It is the least efficient power station (to simplify slightly this means the highest fuel cost per unit of electricity) in that group of power stations which sets the price for that half hour as the price must be sufficiently high to cover its fuel costs. All the other generators running in that half hour will by definition have a lower fuel cost and therefore will receive more than they need to cover their cost of fuel. This extra amount (called in the jargon of the industry the Infra Marginal Rent – IMR) goes towards meeting the fixed costs.

103. The second payment which generators receive is called a capacity payment. Each year a sum of money (the Capacity Pot) is decided by the two regulators and this sum is divided between all the generators in proportion to the amount of time that they were available to generate irrespective of whether or not they were called upon to generate.

104. The Capacity Pot is calculated by multiplying the estimate of the system's generating capacity requirement in the following year by the estimated cost of acquiring a megawatt of new generation to meet peak demand. The process is repeated annually, is subject of consultation and is totally transparent. As a result of the process the size of the Capacity Pot could increase or diminish from year to year. The weaknesses of this system are:

- the rewards paid to a generator are the outcome of the interaction of a number of factors. Consequently they do not guarantee what the generator needed to justify the investment. Investment in generation therefore remains risky unless the overall level of rewards to generators is so large as to overcome this perceived riskiness. This in turn means that the cost of capital for new generation will be higher than it need be;
- to minimise risk generators are incentivised to locate in the least cost location for them, use the least cost technology maximising their chances of being able to write off their capital cost at the earliest date. There is no incentive to optimise location, or generation mix or fuel diversity or minimise carbon emissions. In other words it is not obliged to harmonise the generator's private interest with the public interest – as expressed in policy objectives of Governments in both jurisdictions - of moving towards a cleaner, securer more sustainable energy future;

- there is no barrier to customers having to pay for power stations twice over. Stations whose capital costs have been fully paid are as entitled to payments from the Capacity Pot as are brand new stations which certainly do need to meet their financing costs. This might seem a strange anomaly. The regulation and price controlling of the other major capital element in the electricity industry – the wires – is quite specifically designed to ensure that customers do not pay twice for the same assets;
- SEM - with its systemic favouring of least cost technologies – is inherently hostile to renewables other than wind. This is because SEM in its present form is not capable of taking into account costs which cannot be readily managed by the market as it is today. It would not matter if there were adequate alternative mechanisms for stimulating other renewable technologies but these are all in a very elementary stage. However the new fossil fuel generation brought in by SEM's mechanisms is likely to have a lifetime of 20-30 years and to either severely narrow future policy options or make them much more costly;
- a criticism that has been made to me repeatedly is that suppliers face relatively high charges for capacity when taking electricity off the system at times of low demand. The structure of the capacity pot's payments does not appear to incentivise the optimum utilisation of the generation park.

105. **In fact there seems to be policy confusion as to the role of SEM in replacing and renewing generation plant over the medium to long term. Either:**

(a) SEM's role should be limited to managing efficient dispatch – a task for which it is particularly well equipped – and there should be other policy instruments explicitly designed and put in place by the governments of Northern Ireland and the Irish Republic to secure timely investment in new generation; or

(b) SEM needs to be given those additional features which will enable it to not only secure generation over the long term but also ensure that such generation reduces emissions, costs and fuel insecurity.

Electricity Market Structure

106. There is necessarily a close relationship between the structure of SEM and the structure of the electricity market in Ireland. Moreover the public concern over the recent price increase gives rise to an obvious question of whether the market structure in Ireland – north and south – is capable of delivering electricity to customers at the lowest possible cost or whether we would not be better served by a market that is closer to the bilateral market which exists in Great Britain.

107. In theory the Irish market is a very transparent market in which most of the costs, which are not price controlled, are revealed in the market mechanism. By contrast the market in Great Britain is much more opaque though this year at least it seems to be delivering lower prices to customers. Which model is better?

108. The market in Great Britain is characterised by integrated companies. That is the companies which retail electricity to customers also produces it in power stations which they own. They therefore have to own or buy gas and coal for their power stations. They are free to buy their fuel as they find it opportune to do. And just as motorists might be expected to switch their petrol supplier if their normal filling station's price gets out of line with that of other nearby stations in this sort of market the customers' freedom to move to another supplier provides, in the absence o of supply price controls, a theoretical check on exploitative behaviour.

109. The GB model however needs to be treated with a degree of caution. Customers do not know what goes on inside the cost chain which determines their prices. The rationale for this lack of regulatory scrutiny is that the market is competitive and customers can switch to another supplier. It does however seem to be the case that it is a difficult market for would-be entrants who do not fit into the integrated supplier/generator model. Recently small supply companies have folded and, with EDF's take-over of British Nuclear Energy, the concentration of the market has become even more accentuated.

110. But what does seem to be plausible is that the commercial independence of GB companies has allowed them more leeway to purchase their generating fuels more efficiently than has been the case in Northern Ireland.

111. In fact at present we do seem to have for the non domestic market this type of vertically integrated structure. Airtricity, Energia and ESBIE all own or have close contractual links with generators. It is only in the domestic arena that this type of relationship is prevented from happening.

112. If this type of vertically integrated structure is good enough for non domestic customers it is difficult to see why it is not good enough for domestic customers. If a vertically integrated model is the most economically efficient why are domestic customers in both are parts of Ireland the only customers in the British Isles to be denied access to it?

113. It is possible that the answer lies in a view that to allow the vertically integrated model to develop for domestic customers might prevent the emergence of competition in the domestic sector. But if domestic customers are to benefit from competition the new market entrant should be good enough to attract them away from a super efficient incumbent and not from an incumbent which is prevented from making the sort of efficient economic purchasing decisions that suppliers in the non domestic market are free to make and which the putatative new entrant in the market would be free to make.

114. NIEES and NIEE (PPB) could both be required to provide the best possible value to customers by their purchasing, trading and hedging arrangements with the market in general. And this must include where appropriate with each other.

115. Since the vertically integrated model appears to be permitted within SEM there is no reason why it should not be extended to the domestic customer subject – in the absence of competition in that sector – to strict regulatory supervision.

116. **But do we really want to move towards a GB type bi-lateral market?** If we do it is difficult to see what value the pool actually has. It transparently and very publicly displays to the entire world what the cost of generation was in each half hour of the year but the actual price which customers pay is the price which is in their contracts. The mechanism by which the Pool price exercises a downward pressure on the contract price of electricity in future years is very far from being a transparent process. **The GB model has very distinct disadvantages for customers and I would question whether it is better than the market structure which we have the potential to put in place through the development of SEM.**

- The GB model is not open to regulatory oversight and therefore customers do not have any way of knowing whether companies are excess profits in generation and supply.
- There seem to be increasing doubts in Great Britain as to whether competition is keen enough to drive costs down to an efficient level with the result that there is increasing pressure for political dictat from Ministers determining the movement in prices. While this might be regarded as the appropriate final resort for protecting customers in a democracy it would be more difficult to operate in a market which straddled two quite distinct political jurisdictions.
- It places the responsibility for deciding when new generation should be added to the system in the hands of the generators who are as we have noted vertically integrated businesses. There is no inevitable alignment of the private interests of generators and consumers in the matter of future investment in generation.
- Our entire electricity market has a smaller customer base than that of a single GB company. Even if the GB model minimised prices by competitive pressure it could not be replicated here because the scale of the market is different.

Taking SEM further : Generation Cost Transparency

117. The only significant cost in the electricity supply industry which is not transparent is the cost of procuring and operating generation. Unfortunately it is also the most important cost. All the other costs are transparent and regulated – from the fuel cost as revealed by the Pool to the supply margin in the domestic market and including also the cost of transmission and distribution, the cost of the TSO and of the Market Operator. And all these costs are managed according to the same philosophy – seek to drive costs down while allowing companies to recover their costs and secure a return appropriate to the risks they have to manage.

Why should generation be treated differently?

118. Policy in both parts of Ireland has for the last ten years been driven by the myth of the merchant plant – the independent investor in generation who will help out customers by producing new plants which will drive down the pool price. But both parts of Ireland have proved ineffective at securing this type of investment and even when we were short of generation these hypothetical investors didn't materialise. There is no reason why they would to-day and in any case the island does not need any new base load generation and needs to attract renewable and load following plant. **An energy policy based on a**

belief in a mythical type of investor for whose existence there is no positive evidence is rather like "Waiting for Godot" – but without the entertaining dialogue!

119. The consequence has been that new investment in generation has been by generation linked to supply. That is to say it has been investment which has largely ignored the logic of the Pool and has the effect of driving the market in the direction of the bilateral GB model with all the disadvantages associated with that model.

Competitive generation costs?

120. Generation is least cost when it is procured competitively but in conditions where risk is managed to reduce the cost of capital. This can only be done through competitively procured long term contracts. The contract which NIEE (PPB) has with the Ballylumford CCGT clearly demonstrates the value of this way of procuring generation in this way.

121. Under such a contract the performance of the power station risk is borne by the station's owners as they have the appropriate skills. Customers bear the risk of the station's not being dispatched because its marginal costs are above the Pool price but conversely they would benefit from the earnings of the station above the cost of the contract.

122. The standard objection to this type of arrangement is that the customers as a whole run the risk of the station being out of the market in a relatively few years. But this risk is very theoretical. In the first place as power station efficiency is measured at the margins – ie how many kilowatt hours of electricity can be extracted from a therm of gas - there is no reason to fear such a radical improvement in efficiencies as to drive a new station from success to not dispatching at all in the course of a few years and in fact as generators have become more efficient in recent decades the percentage improvement in each new cohort of generation is less than in the previous cohort of generators In the second place in so far as the generator is at the risk of short term obsolescence then the merchant generator will have priced this risk into the returns it will be seeking from the market in the short term. Thirdly even if there were a measurable effect on the SMP for a few years it would be small and would not outweigh the gains made overall in minimising generation costs.

123. The Moyle Interconnector plays a role in the system's security. It should also have a role in adding to the competitive pressure on generation costs. It is not clear that its potential contribution is being maximised.

124. Interconnector trading between two markets is potentially beneficial but may be fraught with difficulties particularly when they are unequal in size and operate to different rules. At present exports through Moyle are limited to 80 Mws. Moreover although Moyle provides security for the whole island the cost of Moyle - if its revenues are insufficient to meet its costs – is borne by Northern Ireland customers. Although Moyle is seldom fully loaded a second inter connector between Ireland and Great Britain is proposed.

125. It is unlikely that the regime in Great Britain will be changed to suit us so the question does arise as to whether the rules in SEM for bidding in Moyle delivered electricity should not be reviewed. As a first step it would be prudent to analyse the historic data to see if Moyle delivered electricity could have pushed down the SMP if there had been ways of overcoming the different gate closure regimes which apply in SEM and the GB market. If there is evidence which points to that conclusion then a special regime – for example allowing Moyle to bid late and queue jump – might be considered.

126. Finally on interconnectors it is worth making the point that the generation/customer relation proposed in this paper avoids the exposure which customers face from higher GB prices forcing up SMP in SEM and lower prices in GB being translated into lower retail prices in Ireland.

Supply Competition?

127. With a bilateral market supply competition is rendered more difficult because in effect there is a massive barrier to entry – you can't play unless you have a power station or two.

128. If all generators are obliged to sell into the pool and all suppliers buy from the pool then it might be argued that there would be no scope for supply competition because all suppliers would only have access to electricity at exactly the same price. I would argue that – however counter-intuitive - the opposite is the case.

129. This is because electricity is a very odd product. It is public policy to seek to drive down the amount which is required for any specific purpose especially if it is fossil fuel derived – and whether we like it or not most of the electricity which consumers in Ireland will be using in 20 years time will still be fossil fuel derived electricity.

130. The scope for genuine supply competition therefore is not in the ability of suppliers to obtain fossil fuel electricity at a lower price than their competitors but in their ability to add value to that basic product. For this reason the right to trade electricity should however be limited to those with a supply licence. With the current havoc in the financial markets the last thing the electricity market needs is commodity traders speculating on the price of electricity.

131. Customer procurement of generation could, by dramatically reducing the cost of market entry into electricity supply, open the way for a flowering of genuine supply competition in which customers might be offered:

- duel fuel which could be gas and electricity or biomass/oil and electricity;
- electricity from renewable sources;
- electricity plus micro renewables;
- electricity plus energy efficient appliances;
- electricity plus insulation or other construction industry services;
- electricity plus equity unlock to reduce fuel poverty;
- electricity plus transportation services.

The list of possible examples is as long as the creative imagination of entrepreneurs.

132. **Genuinely creative competition in supply could be a very effective way of harnessing market forces to the policy objectives of reducing fuel poverty and carbon dioxide emissions. But the only practicable way of realising it would be through giving customers an effective interest in generation through appropriate procurement contracts.**

133. The fact that the Irish Republic's electricity consumers do have a stake – albeit in a not totally satisfactory form – through the state's ownership of ESB and BGE makes this issue a critical one of equity as between northern and southern customers. It also means that the necessary changes to the market which are required should be fairly easy to give effect to should the political will to do so exist.

134. **To summarise : SEM has the potential to build on the transparency which it already has to become a system in which generation is procured competitively at least cost and which creates the possibility for establishing a competitive supply market which aligns the trade in electricity with the public policy objectives of sustainability and reducing fuel poverty with:**

- **generation secured by competitive tender under contract;**
- **all electricity sold as at present through the pool but without contracts between generators and suppliers;**
- **the real barriers to entry faced by suppliers being effectively removed and suppliers competing by the value they add, in the form of other services, to the electricity they sell;**
- **arrangements for purchasing generating fuels collectively should be explored to reduce the risk exposure as under these proposals generators would not need to compete to secure a competitive advantage in fuel costs;**
- **power stations whose fuel cost was below the system's marginal price in any half hour would continue to receive that surplus (known as infra marginal rent or IMR) and this would be set against the price of their contract. Should they earn more than the amount specified in the contract this would be reimbursed to customers – as it is at present under NIE Power Procurement Business's contracts.**

135. **Changes to give effect to this type of system could be effected without any structural change to the market. New generation would be secured by competitive tender and existing stations could be given contracts based on the true costs which they still face.**

Recommendations with regard to SEM

136. SEM has great strengths. It is inherently more honest than the secretive world of bilateral markets. The next stage of its development should be to harness it to the wider energy and environmental objectives of both Governments.

137. It is therefore in order to integrate the SEM into the wider policy agenda to which the Governments of both jurisdictions subscribe – that is to reduce energy costs for customers, reduce emissions of carbon dioxide and improve energy security, that the following changes to SEM are put forward for consideration.

1) Electricity consumers should not be required to pay for power stations twice. Payments over and above an operating cost should not be made to power stations whose costs may reasonably be assumed to have been written down. If either jurisdiction wants to continue paying such power stations it may require its electricity consumers to do so but it should not expect consumers in the other jurisdiction to do so;

2) Constraint payments which arise from inappropriate location or delay in strengthening transmission networks should be paid for only by the customers in that jurisdiction. It is unreasonable that Northern Ireland consumers should pay for poor planning decisions in the Republic and vice versa;

3) Plants that want to remain on the system against the logic of SMP pricing – for example because they take a long time to warm up against once they are shut down - should be allowed to do so only in return for a negative constraint payment – in other words they should buy out the costs they are imposing on the system;

4) A Renewable Gateways Levy should be established to reduce the capital cost of other renewables with customer equity with such renewables then being dispatched on the same basis as the Republic's peat plants and the customers receiving a dividend in the form of a negative PSO;

5) The size of the Capacity Pot should be based on an objective assessment of the actual fixed costs of power stations so that the remuneration of generators should be more akin to PPAs whereby the generators take the technology and operating risks which they are best placed to do and both generator and customers minimise the market risk and hence the cost of capital;

6) The exchange risk lottery element should be removed from the capacity pot. While a new generator entrant needs to be confident of remuneration, existing generators have incurred their historic costs in the prevailing currency in their respective jurisdictions. It is on that basis that they should be rewarded. There should be no exchange rate windfall gain for them or penalty for the customers in that jurisdiction. Payments for capacity should therefore be based on the actual historic

and current costs in euros and sterling of generators in each jurisdiction;

7) The payments made and the charges made to suppliers should be sculpted to reflect demand reducing night time payments and increasing the proportion of total payments for peak and shoulder periods.

8) SEM should move from a bilateral market to one in which all suppliers buy from the pool rather than from a generator to which they are affiliated. Suppliers should compete on the services they add rather than on the commodity price. The only exceptions in which an integrated generator-supply chain should be permitted are:

   (a) if the chain is with a 100% renewable chain where there is a different case for hedging; and

   (b) if the generator is owned by the end customers – for example as an energy co-operative.

9) Arrangements should be put in place which would permit prudent hedging of fuel purchases with the IMR earned being returned to customers in the form of a negative PSO. If power stations are no longer incentivised to individually seek to compete with each other to secure fuel at lower costs than other power stations there would be scope for exploring the most cost effective way of minimising the total cost of fuel purchasing and thereafter ensuring that power stations were dispatched purely on the basis of their relative efficiency.

Hedging

138. Hedging is any measure which enables a party to a transaction to reduce the risk associated with that transaction. Various forms of hedging have applied in the Northern Ireland energy sector since privatisation. Since NIE's various businesses – and thus their shareholders - have been largely protected hedging has usually if not invariably been concerned with protecting the interest of customers. However it should be noted that in the 2007/8 NIEES saved their customers money by successful hedging. If they had not hedged tariffs would have been 11% higher in that year.

139. Hedging could refer to fuel, electricity or currency hedging ie movements of sterling against the dollar with regard to oil and coal purchases or more recently against the euro when it comes to buying electricity in the Republic.

140. Studies of hedging practices within NIE since privatisation have shown that on balance they did not save customers money and NIEE (PPB) is at presented prohibited from hedging. NIEES as we have noted has hedged its electricity purchasing for the 08/09 year – and hedging in this case means nothing more sophisticated than purchasing in advance at an agreed price. NIEES was not permitted to hedge against the Euro though NIAUR has recently given it the right to do so.

141. As noted in Part I the fact that customers in Northern Ireland are contractually committed to both NIEES and NIEE (PPB) does provide the customer in Northern Ireland with a degree of hedging.

142. Thus Northern Ireland customers are in effect hedged and this is only possible because there are two entities and one has hedged and the other has not. If NIEE (PPB) had been as fully hedged as NIEES then this possibility of gain would not have been realisable.

143. Insofar as NIEES is buying from NIEE it is not subject to a Euro exchange risk though it is in relation to purchases from the Irish Republic.

144. Clearly all the hedging instruments employed hitherto were of an unsophisticated nature. More sophisticated hedging instruments do – or did before the banking crisis – exist. But such instruments inevitably come with a cost. NIEES investigated some during the discussions leading up to the present price increase. Buying this sort of hedging instrument in effect means gambling with customers' money. In practice customers have always had to bear the risk of fuel price volatility – apart from those few years when the taxpayer did.

145. They cannot escape market price movements though they can over time reduce their exposure in aggregate and to the worst effects of market volatility by more intelligent energy purchasing.

Recommendations with regard to tariff setting

146. With energy markets as volatile as they have been and continue to be there are risks in having all prices determined within a relatively short window. Clearly decision makers are in an impossible position. If they do not lock into forward prices and the price rises further then they will be criticised. If they do lock in and prices drop then they will also be criticised. Moreover there is no formula or software programme which will enable them to get this right every time. The whole point about volatility is that market prices are dramatically affected by short term unforeseen events as well as by long term demand and supply expectations.

147. At present customers are totally exposed to the risks – the upside and the downside. It is moreover no answer to transfer this risk to the Supply business. NIEES simply does not have the fat to carry those risks and if the Viridian Group as a whole were to be asked to carry it this would come at a cost. So the net effect would be that customers would continue to pay for the risks though in a different way.

148. Domestic customers need affordable electricity prices but they, unlike the business sector, are not competing in international markets. For the domestic sector affordable prices which are stable are arguably more important than the theoretically lowest possible price in any particular year.

149. It is therefore recommended that:

1) NIEE(PPB) for a portion of their energy requirement should be allowed to advance purchase in modest incremental steps but do so opportunistically;

2) NIEES economic purchasing obligation should be interpreted to allow it to seek contracts for up to two years ahead at any time and not restricted to the present short window;

3) NIEES should offer a "tracker tariff" to customers who are prepared to themselves take the risks of gains and losses from fuel price movements and possibly a mixed tariff where half the price is fixed and the other half varies. Such tariffs would have to be based on the customer profile in the absence of half hourly meters in individual households but it should nevertheless be a reasonable approximation for those who wanted to take this option;

4) NIEES should offer a "Deep Green" Tariff – possibly coupled with an energy efficient appliances requirement on the customer – supplied through new contracts with renewable generators so that it can offer customers a renewable tariff that reflects the costs in the renewable sector and is immune from the price movements in the main electricity market. Perhaps the first customers to be given the right to lock into such a tariff should be those micro generators who both export to the grid but also are obliged to import some of their electricity. Customers on such a tariff would have to commit for an initial five years so that they would be committed to it when it was higher than the normal tariff as well as enjoying its benefits when its price is lower;

5) Exchange risks in year within the island market should be netted off by agreement between all the participants thereby avoiding the necessity for introducing currency hedging costs into the market and maximising thereby trade liberalisation. This could be managed by the Market Operator (SEMO);

6) A "Right to buy" product should be sponsored by NIEES in which customers could buy sold a portion of the equity in a new renewable development with their dividend being paid in the form of a discount to their electricity bill. This would be a logical development from NIEES's existing role as an aggregator of domestic micro generation.

Enlarging Customers' area of control

150. Much of the electricity market is already operated in the interests of customers. Costs are driven out by effective regulation and by regulatory vigilance ensuring that new costs are not allowed to creep in unchallenged. Interventions which increase customer choice in the sort of energy product they buy also help to extend the customer area of control and the recommendations listed above – if given effect – would increase further customers' control of their personal energy agenda.

151. But the crucial area of tension in the electricity industry which has never been satisfactorily addressed is the tension between generators and customers. Clearly they need each other but it is facile in the extreme to say that competition between generators is sufficient to ensure that the relationship is one which will work in the interest of customers. Generators decisions are made in their own interests not the public interest. This is perfectly

understandable since their primary responsibility is to those who are financing the investment but that does not justify policy makers tolerating a sub-optimal outcome.

152. If customers are to obtain electricity at a cost that is closer to its true cost they need to change the way they access generation at both a macro level and a micro level.

153. At a macro level what is needed is a system with regard to generators which best give effect to public policy in terms of cost minimisation, carbon emission reductions and location. These considerations point to the need for customers to be empowered through - for example - NIEES and NIEE (PPB) to sign contracts with new generation which achieve that effect. Two benefits in particular would thereby be secured. The cost of capital would be reduced and the customer base would share the benefit of their lower long term cost when SMP spikes as a result of unpredicted plant outages etc. This type of customer relation with generation is described in more detail above. But there is also a micro generation side to this as well.

154. At a micro level the most effective longer term way of enabling all consumers to reduce their electricity bills is by their beneficial ownership of the capital equipment which generates electricity and heats space and water. For example, even a modest photovoltaic installation could take 28% off an average household electricity bill.

155. Northern Ireland has the potential to provide much of the energy requirements of households from indigenous resources and moreover much of the equipment to do so is made in Northern Ireland.

156. Hitherto there has been a spectacular failure to develop the small scale businesses which could “green” our housing stock. Yet there is already evidence that appropriate technology can make a significant difference to the quality of life of households by providing both comfort and low running costs. A programme which required all new housing to have the appropriate technology and which converted, over twenty years, the existing house stock would, over time make, fuel poverty and excess winter deaths a thing of the past irrespective of what happens to fossil fuel prices in the wider energy market.

157. In order to stimulate such a programme a framework combining public supervision, private sector entrepreneurialism and financing mechanisms which combine public and private resources needs to be put in place. This type of energy market from the perspective of the individual house needs to be constructed alongside and grafted on to the SEM market to which it provides a natural complement. But it will not simply emerge – it needs to be brought into being by political decision.

158. The changes to SEM proposed above, which could lead to new entry supply businesses competing to add new services and products, offers the potential for an expansion of the market in micro renewables.

Tariffs and Fuel Poverty

159. It should by now be evident that the hope of eliminating fuel poverty through the price system in the energy markets as they operate at present will have to be abandoned. Energy prices are simply too high for those on very low incomes to be able to secure all their heat and power for less than 10% of their disposable incomes. Even when gas, coal and oil prices were much lower than they are to-day Northern Ireland had very high levels of fuel poverty. And even without fuel prices movements the problem of fuel poverty has been exacerbated by Government's predilection for gratuitously adding costs to energy bills.

160. This report is limited to looking at the cost of electricity so for the purposes of this paper I am assuming that those in fuel poverty would be those required to spend more than 3.5% of their disposable income on electricity for purposes other than space and water heating.

161. Figures prepared for me by NIEES suggest that the elimination of the electricity component of fuel poverty would – taking all other components of the cost of electricity as fixed – require the cost of coal and gas to go negative; in fact the price of coal would have to fall to **minus $54** a tonne and the price of gas to **minus 28 pence** a therm.

162. **The European Parliament has stated that the access to affordable power and heat is a basic human right. But using the present market structure to eradicate the scourge of fuel poverty is a mathematical impossibility.**

163. Making recommendations to Government on how fuel poverty might be relieved outside the structure of energy markets is beyond the scope of this report. There are however ways in which the discomfort of all consumers struggling to pay their energy bills could be ameliorated within the existing electricity market structure.

Drive down generating costs

164. The first is by continuing to put downward pressure on the cost of electricity and elsewhere in this report a number of areas have been mentioned which would contribute to that. The second is by changing the relationship of customer to generation as outlined in the immediately preceding paragraphs.

Tailor tariffs to the needy not the extravagant

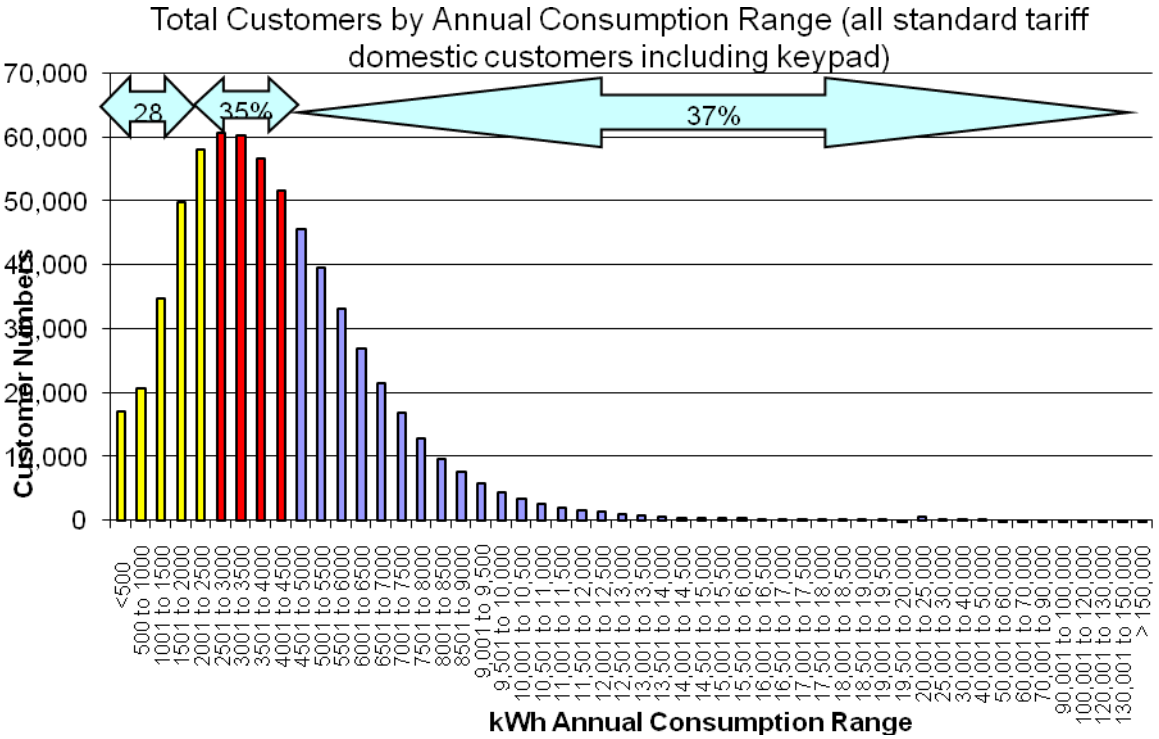
165. The second measure – which could be given effect quickly – would be to introduce what the Regulator has described as "block tariffs". This would involve customers paying less for the electricity which is essential to civilised existence and paying more for electricity which is optional.

166. The attraction of this measure is that it would considerably improve the cost effectiveness of energy efficiency investment whether financed by the Energy Efficiency Levy or by the better off at their own expense as the pay back period for such appliances would be considerably shortened. The objection that there may be fuel poor customers consuming large amounts of electricity

seems fanciful - though if there are such customers they need to be identified and assisted to a more sensible pattern of energy use as quickly as possible. At current prices they would need to be spending more than £800 per annum on electricity alone. The reality is that low income households are much more likely to spend modest amounts.

167. The measure would be very simple to operate. At present the average electricity consumption per household is just under 4200 kilowatt hours. But there is a long tail of demand generated by very high users.

168. If all units which a household consumes beyond - say - the first 2500 units per year were to pay a premium on top of the normal tariff this would raise money to reduce the cost of the first 2500 kilowatt hours. This could substantially reduce the cost of electricity for low users who are those most likely to be in fuel poverty and all customers with an annual consumption of up to the break even point would be better off. The number of low cost units and the additional premium on the higher cost units are matters of judgement. The attached graph shows one example among the many possible permutations.



Source: NIEES

Under this model 63% of customers would be better off and the long “tail” of high users do have the option of using electricity more efficiently.

169. Whatever threshold is chosen for the higher price and whatever level the premium is set at it should be set for ten years with a small annual tightening by for example reducing the threshold by 25 kw/hs per annum and increasing the premium by say 5% per annum. In this way the pay back period for energy efficient appliances would be not only reduced but sufficiently predictable as to make a clear case for energy efficiency investment.

170. A stepped tariff would align the policy of stimulating the take up of domestic scale renewables as the reduced requirement to import electricity from the grid would mean that fewer - if any – expensive units would be required thereby improving the economic case for installing domestic scale renewables.

The Role of the NI Consumers' Council

171. There is some ambiguity about the role of the NICC in the tariff setting process and this needs to be clarified. In my discussions with NICC representatives it became very clear to me that the NICC wanted to see its role clarified. In addition the Assembly in its resolution of 30 September made it clear that it wanted the role of the NICC clarified.

172. It is not just the role of NICC which needs to be clarified but the respective roles of NIAUR and NICC and their different but complementary roles in protecting the interests of consumers of electricity.

173. The NICC has a distinct and unique role set out in the Energy Order (see Appendix 4) as a statutory consultee. This clearly means that NIAUR is obliged to volunteer information and involve NICC in the process in a way it is not obliged to do with regard to any other organisation including those with a legitimate claim to represent the interests of customers or large groups of customers. Organisations representing for example - the fuel poor, trade unionists or pensioners - would have perfectly legitimate claims to represent ordinary and in many cases disadvantaged customers. Moreover the information to which NICC is given access may include information which is commercially confidential and would not be disclosed to any of the other sorts of organisation mentioned even using the powers available to them under the Freedom of Information Act (FoI): though it has to be acknowledged that most of the information made available would be discloseable under the FoI Act.

174. However given that it has a privileged role there exists confusion as to exactly what that role is. Understandably one possibility has been for NICC to be placed in or drift into the role of a "revising chamber" for whatever is emerging through the "lower house" of NIAUR. But NICC does not wish, nor does it have the resources, to act as a revising chamber or second regulator; that is not its role and it should not allow itself to be pushed into that role for which it has neither the aptitude nor the appetite.

175. But the papers show the emphasis placed by some parties on getting an NICC "sign off" on the increase which makes it is clear that the other danger is for NICC to be cast in the role of a figure head or constitutional monarch whose assent is required but who doesn't really have any influence on the outcome.

176. I do not believe that NICC should be expected to function as either a revising chamber or as a constitutional monarch giving a "royal" assent.

177. In saying this I am strengthened by my reading of Part IV of the Energy (Northern Ireland) Order 2003 which is quoted in Appendix 4. Part IV of the Order leaves no doubt as to the special role in which the NICC is placed in relation to representing the interests of electricity consumers and the considerable powers which it has in carrying out that function. But nothing in

the Order states or implies that the role of the NICC is to second guess the Authority in the execution of the technical aspects of its work.

178. NIAUR and NICC are both required to protect and promote the interests of customers but they are not in competition for the same space. Their roles are different but complementary and while they are both on the side of the customer this does not mean that their views on everything should be identical.

179. NIAUR has to obtain the best deal it can for customers in a prescribed regulatory framework set out in legislation enacted by the Assembly and developed by Ministers. Its powers are considerable within the regulatory framework but limited outside that framework. The amount of scope NIAUR has depends entirely on the decisions of the Assembly and the Executive to extend or diminish its powers. Within the framework it has substantial power – and NICC will want to ensure that NIAUR maximises its use of that power in the customer interest – but its role and its capabilities are technocratic and it does not have discretionary powers which go beyond its prescribed limits.

180. NICC operates to defend customer interests in rather different ways. It is certainly concerned to see that public bodies – in this case NIAUR – exercise to the greatest extent possible the powers they have been given to protect customers. Their role in the tariff process is therefore not to second guess the technical decisions which NIAUR has made but to challenge them to ensure that they have asked the right questions, challenged the company's case, tested other options and set what they do in an appropriate public interest context. Where there is a conflict between the interests of customers and of shareholders NICC will want to test the regulator's conclusions to ensure that he has come down as close as he safely can to producing a customer friendly outcome.

181. But the NICC role in my view should be even more widely drawn. All decisions by economic regulators take place in a wider, social, economic and political context. NICC is entitled – indeed is bound - to draw attention to the wider context. Moreover to carry out its role effectively and ensure that important issues are debated in the public domain it will often have to stimulate discussion through the media and by lobbying key decision makers – the latter in public and private. An economic regulator may have little freedom to manoeuvre and the best outcome which regulation can achieve may, despite the best endeavours of the Regulator, still be one which increases the levels of social damage. NICC must draw attention to these sorts of issues. It may have no power to do anything about the consequences itself but it has a duty to ensure that they are on the public agenda.

182. It is therefore quite possible that from time to time the NICC will feel impelled to attack what emerges from the regulatory process; failure to do so could be failing in its duties to customers.

183. Both NIAUR and NICC have a duty to "protect the interests of consumers" and in the case of NIAUR – and the Department - it is their "principal duty".[2] The

[2] The Energy (Northern Ireland) Order 2003 Article 12 (1).

critical difference is that NIAUR has to balance this with other duties such as its duty under Article 12 (2) (b) of having regard to "the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by or under Part II of the Electricity Order or this Order". NICC's duty is not so constrained. Its duty to protect the interests of customers is in no way caveated by other duties. In my opinion it therefore follows that NICC has a clear duty to not only protect the interests of customers within the existing statutory and regulatory framework but it has also a duty to operate outside that framework. This means that when the existing framework is in its view failing to protect the interests of customers – as evidenced for example by the increasingly large proportion of customers falling into fuel poverty – then NICC may well see that it has a duty to challenge the legitimacy of a system within which the protection of customers' interests becomes "mission impossible".

184. This may at times make for uncomfortable relations between NICC and other key parties in the industry including NIAUR. But it should not. Public debate is a sign of a healthy society. No one should find this possibility embarrassing or uncomfortable. Admitting such a possibility is the basis on which both organisations can most effectively work together to promote the customers' interest and enables both of them and the wider public to understand that they have distinct but complementary roles.

Questions for Policy Makers

1. Is there a high level and sustained political oversight of the Single Electricity Market by the Northern Ireland Government and the Irish Republic's Government?

2. As the cost of capital is the most important long term influence on energy costs what is the best framework for minimising the cost of capital?

3. If currency fluctuation risks threaten the Single Electricity market but are manageable within it why do the two Governments not do so?

4. Do we have effective policy measures for building up the percentage of electricity which comes from renewables other than wind?

5. Are all the cost components of the price of electricity subject to a rigorous cost benefit analysis – and if not why not?

6. Given that fuel poverty cannot be eradicated by the normal methods of the industry ie reducing costs, does fuel poverty not require a radically different approach?

7. Should domestic customers not be able to avail fully of at least the measure of marginally more sophisticated energy purchasing which exists in the commercial/business sector?

8. How many times should customers be obliged to pay for the same piece of generating equipment given that they only pay once for wires and only paid once for generation in the pre-liberalisation days?

9. Are there ways in which the two administrations could reduce the fuel purchase risk on fossil fuels for power generation?

Appendix 1

Terms of the Review

At the time of the announcement of the Review, the terms of reference under which it would be carried out were published. The objectives of the Review, as set out in the terms of reference, are as follows:

1. to establish where the process and outcome were robust;
2. to identify where improvements could be made;
3. to explain the role of regulation in the context of wider energy policy; and
4. to ensure these findings are understood by a wide stakeholder group.

In order to deliver these objectives you are asked to specifically look at the following areas.

1. The Utility Regulator's scrutiny of:

    a. the proposed tariff increase; and
    b. hedging processes.

2. The consultation process between NIE Energy, the Utility Regulator, the Consumer Council and the Department of Enterprise, Trade and Investment.

3. Whether or not the outcome (i.e. the 33.3% rise) was justified.

3. Any regulatory policy areas that should be addressed to improve effectiveness and fairness of risk management in the NI energy industry.

The scope of the Review will not include the wide variety of related policy matters which have been the subject of public consultation (for example the NIE Energy supply price controls, or operation of the SEM). However, in the course of your review, you are asked to make any other observations on how the short and long-term interests of customers in the electricity market might be promoted, with regard to the price of electricity.

Outputs from the Review

The outputs from the Review are:

1. to produce a written report which will be published by the Utility Regulator without amendment (mid November); and

2. to present a public seminar (including supporting documents) to explain the findings of the review (early December).

The Consumer Council's Six Questions

The Consumer Council raised five specific queries through the press on the 19th of September. I gave an undertaking to the DETI Committee that my report would cover these five questions. The questions are set out below together with the Consumer Council's commentary on each question. Below the Consumer Council's comments are my responses - in italics to clearly distinguish them from the Consumer Council's comments. A sixth issue was raised with me by letter and I have included it in this appendix.

1. **Why has the 33.3 per cent increase figure been on the table since June and remains unchanged on 10 September at the conclusion of the negotiation?**

Comment: The tariff increase figure was presented as 33 per cent in June. This figure was provided before all purchasing had been completed by NIEE. The increase estimate then dropped to around 30 per cent in August which became the working figure. A final submission was to be received by NIEE in week commencing 18 August but this was not provided until after close of business on 4 September which was only 4 working days before the tariff announcement on 4 September. On 4 September the tariff increase rose by 11 per cent from 30 per cent back to where it started at 33.3 per cent. The Consumer Council became advised of this by the media and then this was confirmed by NIEE verbally.

When the Consumer Council received both final papers from NIAUR and NIEE there were discrepancies in the figures within both their tables and yet both produced the same 33.3 per cent increase figure (see question 2 below).

Response: This question relates to the seemingly unchanged position of NIEES and NIAUR between June and September despite all the new cost information – whether positive or negative with regard to final prices – which emerged in the interval between these two dates. Accordingly the starting point for understanding what was going on is to inquire of those who prepared the figures as to what they thought that they represented.

The figures which NIEES provided in June were indicative and suggested a tariff increase in the region of 33%. NIEES was able to estimate its wholesale energy cost (the largest single cost element in tariffs) on the basis of purchases to that point. However the following charges/costs were at this stage only forecast by NIEES as they were still not finalised: capacity charges, imperfection charges and Market Operator costs and as well as UoS, PSO, SSS charges and "k". These costs represent around a third of NIEES' total tariff costs for 2008/9.

The forecast tariff increase obviously changed as each of the finalised Capacity, UoS charges etc were published, and there were significant changes in a number of the cost components (e.g. capacity, where the indicative capacity pot was increased by a further 7.8% on 2 September). In total terms the aggregate of these charges/costs exceeded the figures indicated in June,

theoretically requiring a larger tariff increase than 33%. Given the scale of the total increase and the impact on consumers, NIEES actually absorbed the additional costs for the year as an under-recovery, preventing a tariff increase beyond the 33⅓%, despite the underlying costs justifying a higher tariff increase.

The conclusion which I would draw from this is that having at a critical stage locked on to a 33⅓% increase NIEES presentationally and psychologically could not credibly have presented the public with a higher percentage increase. Consequently later information which would have suggested a case for a higher increase had to be transmuted into accepting an in-year revenue shortfall which they hoped might be recovered in a later year.

1. **Why is there a £19.6m discrepancy or £25.45 per household in NIE and NIAUR's figures for revenue to be collected from households, and yet both come out with 33.3 per cent answer?**

Comment: This question remained unanswered when the tariff increase was announced on 10 September 2008. Following the Consumer Council continuing to try and get responses from NIAUR, on 24 September NIAUR advised that our question related to three things:

- an inaccuracy in their figures;
- a £6m adjustment in fuel costs made by NIEE but not incorporated into the NIAUR document; and
- that £14m of '1st year effect' had not been factored into the comparison.

Whilst this was an explanation of some or all of the gap, the facts remain:

- that NIAUR and NIEE's figures within their tables were different;
- the explanation as to why these end up with the same increase was inconsistent with previous explanations provided to the Consumer Council;
- both NIAUR and NIEE still were able to both calculate their tables at 33.3 per cent and yet the input figures had this gap.

This has further raised our concern over the rigour of the scrutiny and attention to detail for whatever reason.

Having raised these issues with regard to inaccuracies in figures with NIAUR, the Consumer Council finds that the original inaccurate figure remains in NIAUR's online document: 'Approval by the Utility Regulator of NIE Energy's 1 October Tariff Increase - A Background Briefing', eight weeks after bringing it to NIAUR's attention. Our question regarding different figures and same outcome remains unanswered.

Response: This is a rather detailed question of fact which I, in turn put to NIEES and NIAUR. They told that the figure that was published in the document "Approval by the Utility Regulator of NIE Energy's 1 October Tariff Increase – A background briefing" gave a total revenue requirement for NIE Energy of £733.52m. This was an indicative revenue requirement, and produced before other wholesale input costs were finalised. NIEES' final submission had a lower revenue requirement ie £727.7m (see table below which reconciles the indicative submission with final submission).

Comparison of Reported Tariff Inputs

Component	NIAUR Website	Rounding Diffs	*Adjustments*	Ref	Final Submission Column 3 ("Rounded")
	£'m	**£'m**	***£'m***		**£'m**
Energy	454.8		*-6.2*	1	448.6
Capacity	63.0				63.0
Imperfections	13.2	0.2			13.4
SMO	2.4				2.4
NIROC	5.5				5.5
					0.0
Duos	112.0	0.2			112.2
Tuos	18.5				18.5
PSO	8.0	0.2			8.2
SSS	11.1				11.1
					0.0
Supply	31.0				31.0
K	6.6				6.6
Total Pre "K"	**726.1**	**0.6**	**-6.2**		**720.5**
Carried forward "k"	-6.6		*-0.2*	2	-6.8
Total	**719.5**	**0.6**	**-6.4**		**713.7**
1st Year Effect	14.0				14.0
Total After 1st Year Effect	**733.5**	***0.6***	***-6.4***		**727.7**

Consumer Council Figure 2 "ALLOWED REVENUE"

Consumer Council Figure 1 "FULL YEAR REVENUE"

Source: NIEES

The Consumer Council have also described a discrepancy of £19.62m.

The differences making up CCNI's £19.6m are:

£14m first year effect (included in both NIAUR's figures and NIEES's)
£6.2m reduction in SMP for pass through customers only
(£0.6m) sundry rounding differences

_____
£19.6m difference

CCNI's query does not evaluate like with like. It is comparing NIAUR's "full year revenue" figure with the "allowed revenue" i.e. the net tariff income that NIEES expects to receive, which is also equal to the total costs NIEES expects to incur (including Regulated entitlement).

The full year revenue figure is what NIEES would expect to receive if the new tariff prices were applied to all units consumed in the tariff year. However, £14m of income will not be physically received by NIEES in the period due to the phasing in of the new tariff, in line with the credit customers' billing cycle – known as the "first year effect". This income would be received in any subsequent tariff period and included in the tariff setting process for that period. Tariffs are simply set on the basis of "full year revenue" so as to physically recover the "allowed revenue". The first year effect was correctly

included in both NIAUR's figures and NIEES' tariff calculations but has been omitted in CCNI's comparison.

The actual discrepancy between NIAUR's document and NIEES' tariff submission relates to an omission in NIAUR's document of a small number of final adjustments made in NIEES's final tariff submission (although it was NIEES' final submission which was reviewed and agreed by NIAUR).

The majority of this is accounted for by a change in the SMP cost. A SMP forecast was performed at the end of August to reflect significant changes in wholesale prices since the time of the original Gt statement. This is applied only to pass through customers as all the remaining customers are very substantially hedged and it has no impact on the price charged to domestic customers.

The remainder of the difference relates to a few very small changes in tariff input costs.

1. **Why are households here paying double the rate of rise in GB? Leading to a new divergence in prices.**

   Comment: DETI's Strategic Energy Framework (SEF), 2004, aimed to shape the agenda, key priorities and principles within the NI energy sector for the coming decade. It recognised that many challenges still faced the sector, and set as the primary energy policy objective for the Department, the "*achieving of a competitive, sustainable, reliable energy market, at the minimum cost necessary in an all-island, UK, and European contex*t."

   To help achieve this broad objective, it outlined four main goals for government, namely:

   (i) to reduce energy costs relative to other UK/EU regions;
   (ii) to build competitive energy markets;
   (iii) to protect our future by enhancing the sustainability of our energy supply and consumption; and
   (iv) to maintain the reliability of energy supplies.

   A review, completed earlier this year, provided a positive endorsement of the 2004 Framework. It concluded that the four main goals were, and still remain, the correct priorities to be addressed. It further concluded that the cost of energy remained a major concern, despite a convergence in recent years of Northern Ireland's electricity prices closer in line with those operating in Great Britain and the Republic of Ireland.

   When the new divergence of NIE's prices compared to GB in ten months of some 24 per cent, and double the rate of increase here compared to GB, the Consumer Council asked what we believe to continue to be a valid question reflecting the SEF's aim to reduce energy costs relative to other UK/EU regions. The question was raised by the Consumer Council upon analysis of NIEE's final submission on 9 September and again on 17 September. NIAUR has never responded to the Consumer Council on this question. The Consumer Council remains dissatisfied with the response given to the Chair of

the ETI Committee on this issue and has advised NIAUR and the ETI Committee of same on numerous occasions.

Response: The main body of the report covers this question. Leaving aside the issue of the nominal percentage of any price increase which, as the report shows, masks mathematically the avoidance of a significant increase at the beginning of the 07/08 tariff year despite significantly higher costs in that year, the current extent of divergence with Great Britain is a result of different market structures, different fuel and electricity purchasing regimes and possibly the greater susceptibility of the GB market to moral suasion by politicians. As the divergence did not exist in all previous year not much of it can be attributed to differences in physical characteristics such as the need to transport gas across the Irish Sea. The current divergence emphasises the need for a major change in approach in particular to the way in which generation is remunerated.

2. **Why in 10 months from January 2008 to October 2008 are NI consumers experiencing a renewed and severe six-fold diversion of prices with GB? We start the year paying £18 more and end up at £114 per household i.e. £75 million divergence.**

   Comment: As question 3 above.

Response: See response to question 3 above.

3. **Is there sufficient tension and robustness in the negotiation process and relationship between NIEE and NIAUR? NIEE's Communication Plan indicates their knowledge at 5 August of what NIAUR were going to do in the media, when and why during the negotiation process.**

   Comment: The Consumer Council is concerned by the lack of evidence of a robust and challenging relationship between NIAUR and NIEE. The tariff price review process appears to be one of an audit than a regulatory investigation. Northern Ireland has a monopoly based domestic electricity market where the Utility Regulator acts as the proxy competitor on behalf of consumers. In this role we would not expect to see the Utility Regulator providing a justification of the increase and focusing on "softening" consumers for a large increase. The press article published by the Utility Regulator at a time when negotiations were ongoing has left us uncomfortable, particularly coming after the Utility Regulator's public interviews on the level of increase at the opening of the negotiation process.

   While we recognise that NIAUR has no control over what NIEE include in their media communications plan, we are concerned that NIEE knew not only when but why and what would be written about by the Utility Regulator. The plan also indicates that the Utility Regulator would provide a signal to "journos" of when the increase would happen.

   We are also concerned that NIAUR has not required the necessary governance and investment requirements from Arcapita that NIAUR committed to securing at time of purchase of Viridian including a majority of

independents non-executive directors on the board of directors, provision of powers as the "ultimate controller", provision of credit rating information etc. During price review exercises, the Consumer Council has grown more concerned about the lack of open and transparent public explanation of increases, as well as the pursuit of our "sign-off" of the increase and drivers ahead of its announcement.

Response: The main body of the report covers the question of the robustness of the challenge. In summary my finding is that the cost drivers behind the price increase were pass through costs incurred by NIEES and that the challenge to those costs takes place at other points in the regulatory oversight of the electricity supply industry. The governance arrangements for Arcapita are outside my terms of reference and I did not seek to bring them within the scope of my investigation as no one produced any evidence that any issues relating to Arcapita's governance arrangements had an effect on the price increase though I have commented on the rather bizarre views on the desirability of higher prices by potential competitors of NIE as these were reported in the press. None of these comments takes away from the force of my view that the protection of the interest of customers requires changes in the way that generation is paid for.

Finally the report sets out my views on the ways in which the role of the Consumer Council might be clarified to avoid any suggestion that its involvement in the process as a statutory consultee is to give a degree of consumer credibility to a tariff review. This clarification would restore the Consumer Council to the role which was envisaged for it by Parliament as set out in the Order (see Appendix 4).

In addition to these five questions the Consumer Council wrote to me about mutualisation. The text of the letter is below.

Dear Douglas,

Re: Mutualisation

The Consumer Council is committed to protecting the interests of consumers and driving change to benefit consumers. We view your current Independent Review of the September 2008 Electricity Tariff Review as a real opportunity to initiate change that will benefit electricity customers in Northern Ireland.

In this spirit, the Consumer Council asks you to give consideration to mutualisation as a potential model for ownership of electricity infra-structure in Northern Ireland. You will be aware of Northern Ireland Energy Holdings (NIEH), a mutualised company that owns the Moyle Interconnector, Scottish and Northern Ireland Pipeline (SNIP) and the Belfast Transmission Pipeline. Attached is a short briefing paper on mutualisation and NIEH activity which we hope will be of use to you.

We note that within the Terms of Reference of your review, you have been asked to 'make any observations on how the short and long-term interests of customers in the electricity market might be promoted'. As such, we believe that it is appropriate for you to consider mutualisation as it represent a model of ownership that has the potential to bring short and long term benefits to the consumers of Northern Ireland.

Regards
Richard Williams,
Senior Consumer Affairs Officer

Response:

It is easy to see with hindsight that privatised utilities were allowed an excessively high cost of capital in relation to the risks they ran. It was on this basis that they were bought up by new owners who were in effect prepared to run them at a lower cost of capital than that originally allowed to their owners at flotation and under early price controls. It might of course be argued that the opportunity to earn profit by selling on the assets was part of the value that shareholders paid for when they bought the shares which made the original flotation a success.

Moreover Northern Ireland's own limited success story with mutualisation to which the Consumer Council alludes occurred in circumstances in which in each case there was a willing seller and the capital cost of acquisition was not inflated to neutralise the benefits of a lower cost of capital.

Consequently while I agree that this topic merits further examination – especially in the context of most of the island's energy infrastructure being in some form of public ownership whether through mutualisation or ownership by the state - and would agree that it would clearly be in the interests of customers to finance transmission and distribution infrastructure at a lower cost of capital if they could do so without assuming additional risks, I have not covered this in my report for a number of reasons.

In the first place it relates to topics which are covered by price controls which were specifically excluded – and for reasons with which I agree – from the issues covered by this report. In the second place the subject itself is a major topic in its own right and would involve a very considerable body of work before coming to a conclusion which could be the basis of public policy.

Appendix 3

Age of Power Stations

Moneypoint Unit 1	285	Coal	Baseload	1985
Moneypoint Unit 2	285	Coal	Baseload	1986
Moneypoint Unit 3	285	Coal	Baseload	1987
Aghada CT Unit 1	88	Distillate	Peaker	1982
Aghada CT Unit 2	88	Distillate	Peaker	1982
Aghada CT Unit 4	90	Gas	Peaker	1983
Marina CC *	112.29	Gas	Mid-merit	1979
Poolbeg Unit 1	109.5	Gas/Oil	Mid-merit	1971
Poolbeg Unit 2	109.5	Gas/Oil	Mid-merit	1971
Great Island Unit 1	54	Oil	Peaker	1968
Great Island Unit 2	54	Oil	Peaker	1969
Great Island Unit 3	108	Oil	Peaker	1974
Tarbert Unit 1	54	Oil	Peaker	1970
Tarbert Unit 2	54	Oil	Peaker	1970
Aghada Peaking Unit	52	Distillate	Peaker	1983
Northwall Unit 5	109	Distillate	Peaker	1984
Rhode Unit 1	52	Distillate	Peaker	2004
Rhode Unit 2	52	Distillate	Peaker	2004
Asahi Peaking Unit	52	Distillate	Peaker	
Poolbeg Combined Cycle	480	Gas	Baseload	1999
Aghada Unit 1	258	Gas	Peaker	1981
Lough Rea	90	Peat	Baseload	2004
West Offaly Power	135.65	Peat	Baseload	2005
Coolkeeragh GT8	53	Distillate	Peaker	
Northwall Unit 4	163	Gas	Mid-merit	1984
Tarbert Unit 3	240.7	Oil	Peaker	1977
Tarbert Unit 4	240.7	Oil	Peaker	1978
Coolkeeragh CCGT	404	Gas/Distillate	Baseload	2005
Dublin Bay Power	415	Gas/Distillate	Baseload	2002
Huntstown	343	Gas/Distillate	Baseload	2002
Huntstown Phase II	401	Gas/Distillate	Baseload	2007
Tynagh	373	Gas/Distillate	Baseload	2006
Ballylumford GT1	58	Distillate	Peaker	
Ballylumford GT2	58	Distillate	Peaker	
Ballylumford Unit 4	170	Gas	Peaker	
Ballylumford Unit 6	170	Gas	Peaker	

Ballylumford CCGT 31	240	Gas	Baseload	2003
Ballylumford Unit 32	240	Gas	Baseload	2003
Ballylumford Unit 10	103	Gas	Mid-merit	
Edenderry	117.6	Peat	Baseload	2000
Kilroot Unit 1	238.186	Coal/Oil	Baseload	1982
Kilroot Unit 2	238.186	Coal/Oil	Baseload	1982
Kilroot GT1	29	Distillate	Peaker	1982
Kilroot GT2	29	Distillate	Peaker	1982
Sealrock 3 (Aughinish CHP)	83	Gas	Baseload	
Sealrock 4 (Aughinish CHP)	83	Gas	Baseload	
GB Generators	400	Interconnector	Other	2002

Source: NIAUR

Appendix 4

The Statutory Duties of the Regulator and the Role of the Consumer Council

THE ENERGY (NORTHERN IRELAND) ORDER 2003
ARTICLE 9, 10, 11, 12 & PART IV

The duties of NIAUR are set out in Article 12 of the Order as follows:

The principal objective and general duties of the Department and the Authority in relation to electricity

12. - (1) The principal objective of the Department and the Authority in carrying out their respective electricity functions is to protect the interests of consumers of electricity supplied by authorised suppliers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission or supply of electricity.

(2) The Department and the Authority shall carry out those functions in the manner which it considers is best calculated to further the principal objective, having regard to -

(a) the need to secure that all reasonable demands for electricity are met; and

(b) the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by or under Part II of the Electricity Order or this Order; and

(c) the need to secure -

(i) that the prices charged to tariff customers by public electricity suppliers for electricity supplied under Article 19(1) of the Electricity Order to premises in any area specified in an order made by the Department are in accordance with tariffs which do not distinguish (whether directly or indirectly) between different parts of that area; and

(ii) that public electricity suppliers are not thereby disadvantaged in competing with other persons authorised by a licence or exemption to supply electricity to such premises.

(3) In performing that duty, the Department or the Authority shall have regard to the interests of -

(a) individuals who are disabled or chronically sick;

(b) individuals of pensionable age;

(c) individuals with low incomes; and

(d) individuals residing in rural areas;

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

(4) The Department and the Authority may, in carrying out any electricity functions, have regard to the interests of consumers in relation to gas.

(5) Subject to paragraph (2), the Department and the Authority shall carry out their respective electricity functions in the manner which it considers is best calculated -

(a) to promote the efficient use of electricity and efficiency and economy on the part of persons authorised by licences or exemptions to supply or participate in the transmission of electricity;

(b) to protect the public from dangers arising from the generation, transmission or supply of electricity;

(c) to secure a diverse and viable long-term energy supply;

(d) to promote research into, and the development and use of, new techniques by or on behalf of persons authorised by a licence to generate, supply or participate in the transmission of electricity; and

(e) to secure the establishment and maintenance of machinery for promoting the health and safety of persons employed in the generation, transmission or supply of electricity;

and shall have regard, in carrying out those functions, to the effect on the environment of activities connected with the generation, transmission or supply of electricity.

(6) In this Article "electricity functions" means -

(a) functions under Part II of the Electricity Order; and

(b) functions under this Order relating to electricity.

The Role of the General Consumer Council

The energy group of the General Consumer Council for Northern Ireland

9. - (1) The Council shall establish a group in connection with the exercise of the Council's functions in relation to energy.

(2) Accordingly, in paragraph 10(1) of Schedule 1 to the General Consumer Council (Northern Ireland) Order 1984 (NI 12) after head (b) there shall be inserted -

" (bb) a group in connection with the exercise of its functions in relation to energy."

(3) The following bodies are abolished -

(a) the group established by the Council under paragraph 10(1)(d) of Schedule 1 to the General Consumer Council (Northern Ireland) Order 1984 in connection with the exercise of the Council's functions in relation to the supply of energy (other than electricity); and

(b) the Consumer Committee for Electricity, established under Article 7 of the Electricity Order.

(4) In the following provisions of this Part references to the Council's relevant functions are references to the functions of the Council under -

(a) the Electricity Order;

(b) the Gas Order; and

(c) this Order.

Forward work programme of the Council

10. - (1) The Council shall, before each financial year, publish a document (the "forward work programme") containing a general description of the projects which it plans to undertake during the year in the exercise of its relevant functions (other than projects comprising routine activities in the exercise of those functions).

(2) That description shall include the objectives of each project.

(3) The forward work programme for any year shall also include an estimate of the overall expenditure which the Council expects to incur during the year in the exercise of its relevant functions.

(4) Before publishing the forward work programme for any year, the Council shall give notice -

(a) containing a draft of the forward work programme; and

(b) specifying the time within which representations or objections to the proposals contained in it may be made,

and shall consider any representations or objections which are duly made and not withdrawn.

(5) The notice under paragraph (4) shall be published by the Council in such manner as it considers appropriate for the purpose of bringing the matters contained in it to the attention of persons likely to be affected by them.

(6) The Council shall send a copy of any notice given by it under paragraph (4) to the Authority and the Department.

General

Co-operation between Authority and Council

11. - (1) The Authority and the Council (in respect of its relevant functions) shall make arrangements with a view to securing -

(a) co-operation and the exchange of information between them; and

(b) consistent treatment of matters which affect both of them.

(2) As soon as practicable after agreement is reached on those arrangements, the Authority and the Council shall prepare a memorandum setting them out and send a copy of it to the Department.

(3) Arrangements under this Article shall be kept under review by the Authority and the Council.

(4) As soon as practicable after agreement is reached on any changes to those arrangements, the Authority and the Council shall revise their memorandum and send a copy of the revised memorandum to the Department.

(5) The Department shall lay a copy of any document received by it under this Article before the Assembly.

PART IV

FUNCTIONS OF THE GENERAL CONSUMER COUNCIL

Preliminary

16. - (1) In this Part -

"the interests of consumers" means the interests of consumers in relation to gas or electricity supplied by authorised suppliers; and "consumer matter" means any matter connected with the interests of consumers.

(2) In considering the interests of consumers the Council shall have regard to the interests of -

(a) individuals who are disabled or chronically sick;

(b) individuals of pensionable age;

(c) individuals with low incomes; and

(d) individuals residing in rural areas,

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

Acquisition and review of information

17. - (1) The Council shall obtain and keep under review -

(a) information about consumer matters; and

(b) information about the views of consumers on such matters.

(2) Where the Authority is required by any provision of this Order, the Electricity Order or the Gas Order to publish a notice or any other document, the Authority shall send a copy of the document to the Council.

Provision of advice and information to public authorities and other persons

18. - (1) The Council may -

(a) make proposals, or provide advice and information, about consumer matters; and

(b) represent the views of consumers on such matters,

to public authorities, persons authorised by a licence or exemption under the Electricity Order or the Gas Order and other persons whose activities may affect the interests of consumers.

(2) Subject to paragraph (5), information which relates to the affairs of any particular individual or body of persons (corporate or unincorporate) shall not be disclosed in the exercise of the Council's power under this Article unless one or more of sub-paragraphs (a) to (c) of paragraph (3) applies to the information.

(3) Information relating to a particular individual or body may be disclosed if -

(a) the individual or body has consented to the disclosure;

(b) it is information that is available to the public from some other source; or

(c) it is not information the disclosure of which would or might, in the opinion of the Council, seriously and prejudicially affect the interests of the individual or body.

(4) Before deciding to disclose any information relating to a particular individual or body in pursuance of paragraph (3)(c), the Council shall -

(a) consult that individual or body; and

(b) have regard to any opinion expressed by the Authority as to the application of paragraph (3)(c) to the information or as to the desirability or otherwise of its disclosure;

and sub-paragraph (b) applies whether the opinion is given in relation to the information itself or to information of a description which applies to that information.

(5) Paragraphs (2) to (4) do not apply to a disclosure of information which is made to the Authority, the Department, the Competition Commission or any other public authority.

Provision of information to consumers

19. - (1) The Council may provide information about consumer matters, in such form as appears to the Council to be most useful to the recipients, to consumers of electricity or gas supplied by authorised suppliers.

(2) The power conferred by paragraph (1) may be exercised by -

(a) publishing information in any manner the Council thinks appropriate for the purpose of bringing it to the attention of those likely to be interested; or

(b) furnishing information to any consumer (whether in response to a request or otherwise).

(3) Information may only be disclosed in the exercise of that power if it is information that is available to the public from some other source.

Publication of statistical information about complaints

20. - (1) The Council may publish, in such form and manner and with such frequency as it thinks appropriate, such statistical information as it considers appropriate in relation to -

(a) complaints made by consumers about any matter relating to the activities of the holders of licences under -

(i) Article 10(1)(b) or (c) or (2) of the Electricity Order; or

(ii) Article 8(1)(a) or (c) of the Gas Order; and

(b) the handling of such complaints.

(2) In paragraph (1) "complaints" includes complaints made directly to the licence holders concerned (or anyone carrying on activities on their behalf) and complaints to the Authority or the Council.

Power to publish advice and information about consumer matters

21. - (1) If it appears to the Council that the publication of any advice and information about consumer matters (including information about the views of consumers on such matters) would promote the interests of consumers, the Council may publish that advice or information in such manner as it thinks fit.

(2) Information which relates to the affairs of any particular individual or body of persons (corporate or unincorporate) shall not be published under this Article unless one or more of sub-paragraphs (a) to (c) of paragraph (3) applies to the information.

(3) Information relating to a particular individual or body may be published if -

(a) that individual or body has consented to the publication;

(b) it is information that is available to the public from some other source; or

(c) it is not information the publication of which would or might, in the opinion of the Council, seriously and prejudicially affect the interests of that individual or body.

(4) Before deciding to publish any information relating to a particular individual or body in pursuance of paragraph (3)(c), the Council shall -

(a) consult that individual or body; and

(b) have regard to any opinion expressed by the Authority as to the application of paragraph (3)(c) to the information or as to the desirability or otherwise of its publication;

and sub-paragraph (b) applies whether the opinion is given in relation to the information itself or to information of a description which applies to that information.

Consumer complaints

22. - (1) This Article applies to a complaint which any customer or potential customer of, or user of electricity or gas supplied by, an authorised supplier ("the complainant") has in his capacity as such against -

(a) the supplier, in respect of any matter connected with the services provided by him in the course of carrying on regulated activities; or

(b) any other person authorised by a licence or exemption, in respect of any matter affecting those services which is connected with the carrying on by that other person of regulated activities.

(2) Where a complaint to which this Article applies (other than one appearing to it to be frivolous or vexatious) is referred to the Council by or on behalf of the complainant, the Council shall (subject to paragraph (5)) investigate the complaint for the purpose of determining whether it is appropriate to take any action under paragraph (6).

(3) Where it appears to the Council that the complaint relates to a matter in respect of which any enforcement function is or may be exercisable the Council shall (unless it considers that the Authority already has notice of that matter) inform the Authority of the matter.

(4) Where it appears to the Council that the complaint relates to a matter which constitutes a dispute of a kind which can be referred to the Authority under any provision of the Electricity Order, the Council shall inform the complainant that he may have the right to refer the dispute to the Authority.

(5) The Council is not required by this Article -

(a) to investigate a complaint, until the complainant has taken such steps as appear to the Council to be reasonable for him to take for the purpose of giving the person against whom the complaint is made a reasonable opportunity to deal with the complaint;

(b) to investigate any matter to which paragraph (3) applies, until the Authority has had a reasonable opportunity to exercise any enforcement function in respect of that matter; or

(c) to investigate any matter constituting a dispute which has been referred to the Authority under any provision of the Electricity Order.

(6) Where it appears to the Council to be appropriate to do so with a view to assisting in reaching a satisfactory resolution of a complaint referred to it under this Article, the Council shall make representations on behalf of the complainant to the person against whom the complaint is made about anything to which the complaint relates.

(7) After investigating a complaint the Council may make a report to the Authority; and such a report may include information about -

(a) any representations made by the Council under paragraph (6); and

(b) the response of the person against whom the complaint is made to the complaint or any such representations.

(8) No report under paragraph (7), or information about a complaint referred to the Council under this Article from which the complainant may be identified, shall be published or disclosed by the Council or the Authority in the exercise of any power under the Electricity Order, the Gas Order or this Order, without the consent of the complainant.

(9) Where a representation made to the Authority about any matter (other than one appearing to it to be frivolous or vexatious) appears to the Authority -

(a) to be about a matter which is or amounts to a complaint to which this Article applies; and

(b) to have been made by or on behalf of the complainant,

the Authority shall refer the complaint to the Council.

(10) In this Article -

"enforcement function" means a function under Article 42 or 45;
"regulated activities" means activities which are authorised or regulated by a licence or exemption.

Power of Council to investigate other matters

23. - (1) The Council may investigate any matter (not being a matter which it is its duty to investigate under this Part) which appears to it to be a matter relating to the interests of consumers in relation to electricity or gas supplied by authorised suppliers.

(2) Where the Council has investigated a matter under this Article it may make a report on that matter to the Authority, the Department, the Office of Fair Trading or any other public authority whose functions appear to the Council to be exercisable in relation to that matter.

(3) Subject to paragraph (4), the Council may -

(a) send a report on any matter investigated under this Article to any person who appears to the Council to have an interest in that matter; and

(b) publish any such report in such manner as the Council thinks appropriate.

(4) Information which relates to the affairs of any particular individual or body of persons (corporate or unincorporate) shall not be included in a report which is to be sent to any person under paragraph (3)(a) or published under paragraph (3)(b), unless one or more of sub-paragraphs (a) to (c) of paragraph (5) applies.

(5) Information relating to a particular individual or body may be included in such a report if -

(a) that individual or body has consented to the disclosure;

(b) it is information that is available to the public from some other source; or

(c) it is not information the disclosure of which would or might, in

the opinion of the Council, seriously and prejudicially affect the interests of that individual or body.

(6) Before deciding to include in such a report any information relating to a particular individual or body in pursuance of paragraph (5)(c), the Council shall -

(a) consult that individual or body; and

(b) have regard to any opinion expressed by the Authority as to the application of paragraph (5)(c) to the information or as to the desirability or otherwise of its inclusion in the report;

and sub-paragraph (b) applies whether the opinion is given in relation to the information itself or to information of a description which applies to that information.

(7) The power to undertake an investigation under this Article includes, without prejudice to the generality of paragraph (1), power to investigate any matter relating to, or to anything connected with, gas fittings (or their use) or the use of gas.

(8) In paragraph (7), "gas fittings" means gas fittings (within the meaning of paragraph 1 of Schedule 5 to the Gas Order) which are used or intended to be used by persons supplied with gas by authorised suppliers.

Provision of information to Council

24. - (1) The Council may direct -

(a) the Authority; or

(b) the holder of a gas licence or an electricity licence,

to supply to it, in such form as it may reasonably specify, such information specified or described in the direction as it may require for the purpose of exercising its functions.

(2) A person to whom a direction under this Article is given shall comply with it as soon as is reasonably practicable.

(3) Before giving a direction under this Article and in specifying the form in which any information is to be supplied, the Council shall have regard to the desirability of minimising the costs, or any other detriment, to the Authority or licence holder.

(4) If the Authority fails to comply with a direction under this Article it shall, if so required by the Council, give notice to the Council of the reasons for its failure.

Publication of notice of reasons

25. - (1) Subject to the following provisions of this Article, the Council may publish a notice given to it under Article 24(4).

(2) Information which relates to the affairs of any particular individual or body of persons (corporate or unincorporate) shall be excluded from any notice published under paragraph (1) unless one or more of sub-paragraphs (a) to (c) of paragraph (3) applies to the information.

(3) Information relating to a particular individual or body may be published if -

(a) that individual or body has consented to the publication;

(b) it is information that is available to the public from some other source; or

(c) it is not information the publication of which would or might, in the opinion of the Council, seriously and prejudicially affect the interests of that individual or body.

(4) Before deciding to publish any information relating to a particular individual or body in pursuance of paragraph (3)(c), the Council shall -

(a) consult that individual or body; and

(b) have regard to any opinion expressed by the Authority as to the application of paragraph (3)(c) to the information or as to the desirability or otherwise of its publication;

and sub-paragraph (b) applies whether the opinion is given in relation to the information itself or to information of a description which applies to that information.

Provision of information by Council to Authority

26. - (1) The Authority may direct the Council to supply to it, in such form as it may reasonably specify, such information specified or described in the direction as it may require for the purpose of exercising its functions.

(2) The Council shall comply with a direction under this Article as soon as is reasonably practicable.

(3) Where the Council refuses to supply any information under paragraph (1), it shall give notice to the Authority of its reason for the refusal and the Authority may publish that notice in such manner as it considers appropriate.

(4) In publishing any notice under this Article the Authority shall have regard to the need for excluding, so far as that is practicable, any matter which relates to the affairs of a particular individual or body of persons (corporate or unincorporate), where publication of that matter would or might, in the opinion of the Authority, seriously and prejudicially affect the interests of that person or body.

Articles 24 to 26: supplementary

27. - (1) The Department may make regulations prescribing -

(a) descriptions of information which the Authority, a licence holder or the Council may refuse to supply under Article 24 or 26; or

(b) circumstances in which the Authority, a licence holder or the Council may refuse to comply with a direction under Article 24 or 26.

(2) The Council may, if no person is prescribed for the purpose under paragraph (3), refer a failure by a licence holder to comply with a direction under Article 24 to the Authority.

(3) The Department may make regulations for the purpose of enabling a failure to comply with a direction under Article 24 or 26 to be referred by the person who gave the direction to such person (other than the Authority) as may be prescribed by the regulations.

(4) A person to whom such a failure is referred (whether under paragraph (2) or regulations under paragraph (3)) shall -

(a) consider any representations made by either party;

(b) determine whether the person failing to comply with the direction is entitled to refuse to do so and, if not, order him to comply with the direction; and

(c) give notice of his determination and any order under paragraph (b), with reasons, to both parties.

(5) A notice under paragraph (4) may be published by either party to the reference; and paragraphs (2) to (4) of Article 25 apply to the publication of such a notice as they apply to the publication of a notice under Article 24(4).

Annex illustration of domestic photovoltaic installation on household electricity bill

Domestic customer with 1.5kWp PV	2009
Average consumption kWh	4000
Price/kWh	17.724
Total charges (inc VAT @ 5%):	£744.41
Total charges assume 50%of PV output consumed on site	£632.74
Value of on site consumption in avoided imports is 600 X 17.724p (plus VAT)	£116.66
For customers with PV	
Average generation of 1.5kWp PV	1,200
Export value (p/kWh)	7.4
ROC value (p/kWh)	3.8
Contribution from export (assume 50%)	£44.40
Contribution from ROCs	£45.60
Total benefit from PV	£90.00
Net electricity costs	**£542.74**
percentage reduction to annual electricity costs	27.1

	2009
Normal cost	£744.41
Contribution from PV	-£201.67
Net costs	£542.74