

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

17 February 2016

Dear Briege,

### **Draft Forward Work Programme 2017-18**

Power NI welcomes the opportunity to respond to the recent draft Forward Work Programme (FWP) 2017 - 2018 published by the Utility Regulator (UR).

Consistent with previous work programmes, the 2017-18 FWP describes at a high level, a substantial number of major projects. At the workshop hosted by the UR on Friday 27 January 2017, the UR outlined how the FWP may be adversely impacted by wider governmental and Brexit related issues. This workshop was helpful in managing expectations and describing the wider regulatory context. Cognisant of such wider context, in its final determination the UR should recognise that the FWP sets an expectation for market participants who will commit their own resources to engage with the projects. Should the FWP be overly ambitious this sets an unrealistic expectation and risks critical areas of consideration being expedited without full consideration and consultation. Power NI believes a realistic prioritisation of projects is in all stakeholders interests.

### **Specific Items**

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

- **The Wholesale Electricity Market**

The UR has highlighted through a number of priority projects, aspects of the ISEM design and delivery. The ISEM project is in all likelihood the largest draw on UR resources in 2017-18 and is of vital importance to all electricity stakeholders.

The ISEM design is extremely complex. Participants have expressed concern in relation to the design in consultations and throughout the rules review period. Power NI is concerned that unnecessary complexity will act as a barrier to entry for all types of new participant and increases operational risks for existing participants. The UR via the SEM Committee should recognise that the all island wholesale market in Ireland is characterised by small participants, high levels of intermittent renewables and 'chunky' thermal generation.

Concerns have been raised in relation to the algorithm and process used in determining the Balancing Market Price. For the Balancing Market to act as a check and price signal to the market thereby encouraging economic behaviour, it must be, to some extent, predictable and capable of being understood by participants. Power NI is concerned that it will not be possible to either shadow settle or forecast the Balancing Market Price. This raises concerns that errors in central market systems will be unidentifiable. This will adversely impact the efficiency of the market and Power NI would welcome the UR under its general ISEM project and via the SEM Committee looking to clarify and simplify the Balancing Market pricing process.

Within this general ISEM project Power NI would also welcome the UR reviewing participants credit obligations. Credit requirements are an important market consideration for suppliers and represent a cost to consumers. While the development of ex-ante markets theoretically was intended to increase working capital obligations (which in itself is an issue) and reduce credit requirements the implementation has not facilitated such an outcome. Ex-ante markets with a significant price cap make it difficult for suppliers to contemplate being a price taker due to the pre-funding requirements. The Balancing Market also assumes that all future volumes will be bought in that timeframe however does not consider generation in the same manner. This significantly reduces the offsetting netting capability of participants. Initial estimations suggest that the levels of credit required under the ISEM will be significantly higher than under the SEM. This is particularly problematic and costly for suppliers.

Power NI would again welcome the UR via the SEM Committee revisiting the issue of offsetting generation collateral in the Balancing Market. Under the current drafting the ISEM will have more collateral posted than the SEM a market acknowledged to be typically over collateralised. For the avoidance of doubt, earlier payments should not be considered as a solution to collateral issues. Earlier payments create greater problems for suppliers as this is a working capital issue and cash typically costs more than collateral. Power NI instead would strongly recommend that the burden on suppliers (and ultimately customers) is reduced by adjusting the analysis percentile, the undefined exposure duration and by exploring ways of appropriately crediting expected generation in the Balancing Market.

The UR has also identified the ISEM Capacity Mechanism as a major project. Power NI would agree that this aspect of the ISEM design requires significant work. The Capacity Workstream has chosen a complex methodology by which to implement a capacity mechanism in the ISEM. This complexity is reflected in the settlement algebra and represents a significant risk to all participants. Issues such as the operation of the socialisation fund illustrate the potentially sizeable new risks which participants will be exposed to under the ISEM design.

As raised at the above workshop, the operation of the Forwards Market is of critical importance in delivering tangible benefits to the consumer and underpinning retail competition. Northern Ireland customers and their elected representatives have clearly communicated a desire for

tariff stability, which can only be delivered through an effective and liquid forward market. In addition, lack of access to hedging product is a fundamental barrier to entry in the retail market which will have long term adverse effects on competition if not addressed, and the introduction of the new market represents an ideal opportunity to tackle the problem.

The UR has committed to a Decision Paper in relation to the design of the Forwards Market in early 2017. Power NI believes the need to follow through on forward market intervention is clear; liquidity in the SEM has been perennially poor in comparison to any other relevant market and it has been widely acknowledged, that there is nothing inherent in the new market design that is likely to significantly improve this. A continuation or even worsening of the liquidity outlook post the beginning of the ISEM is detrimental to the interests of consumers. Unhedged suppliers will pass through the risks of wholesale market volatility to customers, thereby reducing tariff stability in a market where consumers clearly value cost certainty. This is important for consumers across the board from the domestic market (note the adverse response to multiple regulated tariff changes in 2008), through to SMEs & LEUs where demand for fixed price contracts has long been a feature of that market. For suppliers and those without large physical assets to naturally offset this risk, the inability to hedge and the difficulty in passing through increased costs in a timely manner has the potential, in extremis, to result in bankruptcy; a scenario that would have significant implications for the entire market.

- **The Retail Electricity Market**

The UR has also identified a number of strategically important projects in the retail electricity market area, primarily in relation to SME protection measures, domestic standing charges and the Consumer Protection Strategy.

Power NI welcomes the URs commitment to further work in these areas and Power NI is committed to engage positively with that process.

In relation to the protection measures for SME customers Power NI believes there is now an opportunity to work towards the implementation of a prepayment solution for business customers. Power NI believes such a solution as witnessed by the domestic market, can assist in business budgeting, manage cash flow and would alleviate any concerns business representatives have over the use of deposits.

Power NI further believes that the UR should begin work on a code of practice or other regulation of brokers as part of this package rather than a separate project; a ban on rollover contracts which include a price premium and restrictions on the use of notice periods. It is important to recognise that these issues, to some extent, exist in the market currently and are not linked to the removal of price regulation in this sector.

As also discussed at the above workshop, Power NI believes it is inherent upon the UR to continue the process undertaken under the heading of 'review of the effectiveness of competition'. This process is not complete. Competition in the domestic electricity market is well established and the URs position that Power NI is dominant is becoming untenable. As the UR acknowledges Power NI's market share is approaching the point at which the retention of price regulation is ineffective as a protection measure, is distortive to competition and discriminatory against Power NI. Rather than wait for that position and Power NI would argue that this is imminent and therefore it is inherent upon the UR to fully

consider and implement the measures which should be put in place across the market to ensure competition thrives alongside appropriate protection measure for all vulnerable customers. Power NI agrees with the UR's view that this will be a significant change for the Northern Ireland electricity market however this is unavoidable and the UR should deploy sufficient resources to ensure that it is fully considered and implemented in a well managed manner.

Power NI also notes that NISEP has been extended for a number of years and there is currently no clarity around its future. If NISEP is further extended, Power NI would recommend that a comprehensive review is completed however this is not included in the draft work programme.

## **Conclusion**

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

Yours sincerely



William Steele  
Power NI