Regulatory Approach to Energy Supply Competition in Northern Ireland

A Utility Regulator Position Paper

Power NI's Response

23 September 2011

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Introduction

Power NI (the new name for NIE Energy (Supply)) welcomes the opportunity to respond to the Utility Regulator's (UR) recent Position Paper regarding the regulatory approach to competition in the energy supply market of Northern Ireland.

As the only price regulated supplier of electricity operating within Northern Ireland (and the wider all island market); Power NI is acutely aware of, and disproportionally affected by, the regulatory approach adopted by the UR.

The process of defining the regulatory approach is a vital element of any energy markets operation. As the UR is no doubt aware, providing visibility of regulatory strategy can only encourage engagement, certainty and confidence in the Northern Ireland energy markets. While Power NI therefore welcomes the development of the UR's position paper and the opportunity to respond regarding its content; it is tempered by the view that the document is long overdue and requires greater detail and clarification.

The paper describes 5 high level policy principles –

- Maintaining an overlay of regulation
- Developing effective competition subject to certain qualifications
- Transparency between retail and wholesale markets
- Reducing the build up and effect of "k"
- Continuing to set a maximum tariff for domestic and small business customers for 3 years

The UR sets these principles against a backdrop of a number of discussion themes including, the strategic policy environment, customer benefits, segmentation, monitoring, and customer protection. Power NI's comments regarding each of these discussion topics and policy principles are primarily set in the electricity market context, although general regulatory principles are also reviewed.

1 An Ideal Market

Underpinning the RAs paper is a vision of what characterises an ideal market. Power NI considers it important to clearly describe these characterisitcs at a high level to provide an aspirational benchmark for reviewing the principles and discussion topics contained within the UR approach.

An ideal electricity and gas market is characterised by:

- Consumers benefiting not just from competitive prices, but also from improved or differentiated service and tariff choices which better suit their requirements;
- Well-informed customers who have a clear knowledge and awareness of suppliers, products and tariff / service choices;
- Consumers can switch supplier quickly and simply and without undue cost or risk of error;
- There is transparency regarding price, product and service, resulting in uncomplicated, high-quality decision-making by consumers (the lack of this transparency has been cited by Ofgem as one of the reasons the market is not working effectively in GB);
- All sections of consumers either benefit from competition or are protected from being significantly worse off than they would have been had competition not emerged by ongoing regulatory action (the latter may involve price control of the incumbent supplier resulting in tariffs that new entrants can compete against or perhaps in the future price controls for non-switchers only; non-discrimination conditions, etc).
- There is confidence that prices were being set by the activities of competing suppliers;
- Open entry from more supply businesses offering a greater diversity of product and service bundles and who can find commercial space to grow;
- Successful entry and expansion of suppliers would not be necessarily dependent on vertical integration.

Power NI believe that it is important to be cognisant of these high level goals when defining a regulatory approach, stating policy principles and detailing regulatory actions.

2 Strategic, Policy and Regulatory Environment

Policy of continuing of retail price controls

The UR states that competition is a key feature in delivering consumer benefits and forms part of its statutory obligation to protect customers by promoting effective competition. Power NI believes that if a market is demonstrably competitive, the prolonged application of a price control will compromise the effectiveness of competition and is in fact counterproductive.

Unnecessarily extending price controls in competitive sectors is a policy which differs from other markets and creates undue regulatory risk. This could impact the efficient securing of capital as financial institutions who conduct their activity across jurisdictions are sensitive to regulatory inconsistency and will price this into the cost of capital.

Over recent years extensive competition and switching has taken place within the commercial sector of the electricity market in Northern Ireland. This has also begun to develop in the domestic sector. This clearly illustrates the evolving nature of the electricity market in Northern Ireland which has not been acknowledged within the UR's Position Paper.

Power NI believe that an important regulatory distinction must be made between the consumer protection that is provided and can be amended through the use of licence conditions (which apply to all suppliers) compared with price control regulation which impacts only one supplier. The implementation of legislation such as contained within the IME3 requirements will result in licence changes. It is correct therefore to state that legislation envisages regulation existing alongside competition however this does not imply that price controls should unnecessarily endure.

A lingering feature of the price controlled business operating in a competitive sector is the prolonged asymmetrical character of regulation, which historically was necessarily required to favour new competitors over the incumbent, where the incumbent was dominant. However, any unnecessary extension of such a regulatory dynamic, when demonstrably the market influence has shifted from the incumbent to the competitor community, introduces suboptimal competitive market conditions and thus could compromise the regulator's ability to comply with its statutory duty of promoting stable and sustainable competition.

In a paper published by Charles River Associates 2007, "Lessons from Australia - The effects of retail price regulation in Australian energy markets", compelling arguments were made against the coexistence of price regulation and competition. The study concluded that …. price regulation imposes direct costs in the form of the costs incurred by regulated businesses to participate in the regulatory process and comply with regulated price obligations as well as the costs incurred by the regulator to set regulated prices and monitor compliance with retail price regulation. This manifests itself in higher energy prices to consumers, and (potentially) lower returns for suppliers (which in turn create a barrier to further entry).

The indirect costs of retail price regulation, which are additional to the direct costs described above, arise from the distortions that are introduced when regulators impose asymmetric obligations on a regulated incumbent vis-à-vis unregulated entrants. In the situation where the regulated price is set below average retailer-wide cost, the market forgoes the full dynamic benefits that retail competition has to offer, including loss of innovation, customer service and the reduction of competitive pressure in wholesale markets. It also causes static inefficiency by distorting energy consumption decisions and investment decisions.

Should the regulated price be set equal to or above average retailer-wide cost, the market foregoes the full dynamic benefits that retail competition has to offer by dampening incentives to innovate and invest (when regulated maximum tariffs are binding) and by softening competition in retail energy markets. This causes static inefficiency by requiring regulated retailers to incur higher hedging costs than they would otherwise incur in a world without price regulation. Additionally, if price regulation embodies cross-subsidies it can cause static and dynamic inefficiency by artificially stimulating entry to cherry pick the more lucrative customers, which leads to inefficient duplication of fixed costs.

Alfred Kahn the eminent US economist, in his book, The Economics of Regulation, said … the mixed system [i.e. the coexistence of regulation and competition] may be the worst of both possible worlds. The problem is that continued regulation of incumbent companies in the presence of freedom of entry of essentially unregulated competitors introduces a host of distortions. In these circumstances, we cannot know to what extent the competition that has sprung up is competition on the basis of efficiency or to what extent it has been made possible only by the continued artificial restrictions on the prices and activities of the regulated companies.

Kahn's main argument is that regulation distorts competition by restricting the competitive responses of incumbents. This may best be seen where the regulated incumbent is demonstrably efficient and may be forced to be less so by restrictions on its ability to compete.

The public benefits conferred by retail price regulation are likely to be low to zero. On the other hand, the direct costs of retail price regulation are likely to be substantial while the indirect costs are likely to be even larger. Once the direct and indirect costs of retail price regulation are weighed against the potential public benefits of retail price regulation it becomes clear that it is highly likely that the overall effect of retail price regulation in contestable retail energy markets is not beneficial to customers (i.e. imposing net costs on the community).

Even though it is likely that retail price regulation in contestable retail energy markets imposes net costs, policymakers may not be convinced that the economy-wide consequences of persevering with retail price regulation are significantly detrimental because the retail component of total energy supply costs is relatively small and upstream network service charges (e.g. TUOS and DUOS charges in electricity) would continue to be regulated. Studies have shown however, that the price control review process in competitive markets has become especially and increasingly burdensome. Initially it took about a year to set a five year price control, now it takes about a year - to set a one year control. The process is also unnecessarily intrusive and often a cause of unhealthy tension between companies and regulators.

"There is no rational halfway house between thorough regulation and free competition…. Regulation confronted with competition will have a systematic tendency either to suppress it... or to orchestrate it and control the results it produces."

- Alfred Kahn

Currently, the electricity market is not subject to price control in the >150MWh pa sector. Power NI believes that this threshold is unnecessarily high and is in fact inhibiting competition in the business market. This restriction is illustrated by recent customer frustration regarding the lack of quotes available from suppliers as well as the lack of tailored products.

Harmonisation

Regional harmonisation has long been considered at a pan European level as an aid to market entry and competition. While the UR has initiated a harmonisation project between Northern Ireland and the Republic of Ireland it is important to highlight that this relates to process harmonisation and not retail policy harmonisation. Power NI considers this a significant gap.

The UR's approach to regulatory scope differs considerably from the mechanism adopted by CER. CER have made significant progress in this area for the Republic of Ireland. Their decision paper on a 'Roadmap to Deregulation'[1] identifies the appropriate criteria which would be used to decide on 'deregulation' of a specific market sector, namely:

(i) There are at least three suppliers active in the relevant market; and

(ii) There is a minimum of two independent suppliers[2], each of which has at least 10% share of load(GWh) in the relevant market; and

(iii) ESB PES and ESBIE combined serves or will serve within a specified period a defined percentage of consumption market shares in a relevant market. For each of the business markets, the percentage market share is 50% or less. In the domestic market, the percentage market share is 60% or less

The UR paper by contrast explicitly states that no triggers are going to be set and therefore only serves to create greater regulatory uncertainty with respect to the future of price control regulation.

The example cited by the UR regarding domestic disconnection does not fully explain that this relates to a Power NI policy and not a market rule. Within Northern Ireland other suppliers may chose to disconnect under certain circumstances. The UR must allow certain differentiation between suppliers to develop within the market design and rules, to be excessively prescriptive will only serve to stifle competition and restrict innovation.

[1] Review of the Regulatory Framework for the Retail Electricity Market. Roadmap to Deregulation. Decision Paper. CER/10/058. 21 April 2010

[2] With no common parent company shared with other suppliers.

Pricing

Lower consumer prices will always be a perceived benefit and desired outcome especially in the current economic climate; however service delivery and innovation are also important factors. In restricting the market, new costs of competition are added, the cost of regulation is maintained and diseconomies of scale are forced. Many of these costs would not be incurred in a market without competition or a fully competitive market. It is invitable therefore that the half way house approach taken by the UR in relation to price regulation is in effect adding cost to the consumer.

Relationship between Wholesale and Retail Markets

A successful retail market is contingent upon an effective wholesale market. In 2007 the Regulatory Authorities (RAs) in conjunction with government and the electricity industry established the Single Electricity Market (SEM) to give effect to an all island wholesale market for electricity.

In the design of the SEM the RAs (including the UR) were particularly conscious of the portfolio of supply and generation held by market participants active within the market. In the interests of transparency, competition and both wholesale and retail market development the RAs implemented a range of measures to define market power and mitigate against any possible exploitation of a dominant position.

The Bidding Code of Practice (BCoP), Market Monitoring Unit (MMU), Directed Contracts (DCs) and Economic Purchase Obligations (EPO) are all active measures playing an important role within the SEM. As a supplier, Power NI welcomed the implementation of these measures and continues to believe that the BCoP, MMU and DCs are important controls on the cost of wholesale electricity, while the EPO is intrinsically linked to retail competition and deregulation.

Power NI acknowledges the continuously evolving nature of the wholesale electricity market with increasing competition, investment, divestment, wind capacity and interconnection all potentially changing the current landscape. It is in this context that the UR must be mindful of the effect regulatory measures have on the opportunity for ‘gaming’ both in the spot and contract markets, as well as the availability of reasonable hedging products and volumes especially given the knock on effects into the retail market.

Securing effective hedges is fundamental to ensuring competition and delivering products that end consumers want. While little consideration was given to the contract market during the SEM design and development, the fundamental effect the contracts have on end consumers should prompt the RAs to attach greater importance to this area. The lack of liquidity is of real concern and Power NI would urge the UR to carefully consider any decision in relation to market structure, participant structure or mitigation measures which reduce liquidity. Consequential increased exposure to fluctuating pool price, contract scarcity and a lack of a reasonable contract market will all ultimately manifest in greater costs borne by end consumers and may make certain entities participation in the market untenable.

Power NI believe that the current market already suffers from such a degree of scarcity that contract price premiums have been seen in the NDC market. Reserve prices in many cases are far in excess of DC equivalents leaving suppliers and ultimately customers exposed to these high prices. The lack of visibility and clarity of auction timetables and volumes to be sold also contributes to a price premium. Power NI would urge the UR to mandate greater transparency of the contract auction plans and assist the market in moving away from a reactive hedging approach.

In assessing the effectiveness of the BCoP and MMU in regulating the generation offer price into the SEM, the Cambridge Economic Policy Associates (CEPA) study[3] concluded that the measures have been successful, however clarify that their success should not be interpreted as a reason for their removal. Power NI concurs with this view and would suggest that enhancing the transparency, engagement and proactive nature of the MMU would benefit the operation of the wholesale market.

While the BCoP, MMU and DC measures implemented by the RAs through the SEM design are effective in mitigating against the exercise of market power, there have been few regulatory measures to encourage or enhance any degree of liquidity in the contracting market. DCs, by the RAs own admission, are designed primarily as a market power mitigation measure with their contribution to liquidity a secondary feature.

It is widely acknowledged that the DC product does have a number of flaws such as the contract timing window, type of offer, volume etc however as an active participant in the contracting market, Power NI view the DC provision as essential and would welcome the DC volumes increasing and being offered over a longer time period.

Power NI cannot over emphasise the importance of the contract market and having sufficient volumes available. The contracting outcomes go a significant way to setting the retail price. Power NI believes that as well as assessing the current market arrangements it would benefit the retail market if the RAs actively considered supporting the implementation of an “Electricity Forwards Agreement” type contract structure as an innovative way to circumvent the scarcity issue.

Power NI continues to be extremely concerned with the UR’s inconsistent view of hedging transfers. The approach adopted to date, has prevented Power NI’s participation in sectors of the competitive market and resulted in customers not being able to secure quotations from all active suppliers. This reflects poorly upon the operation of the electricity market, frustrates

[3] Published as part of the Market Power and Liquidity workstream

competition and is contrary to the UR's obligations. The regulatory exclusion of a supplier from the tendering process in effect reduces the choice for a customer, potentially exposing them to the price premium of a limited field.

Additionally, while the UR correctly characterises the all island market as relatively small, the capital requirements for new entrants have been over simplified. Vertically integrated business per se are not damaging to consumers if price and service competition is allowed to develop unhindered by regulatory intervention.

3 Policy Goal

Within the paper the RAs state that in general they pursue regulation as a proxy for effective competition. As described above, regulation can in fact inhibit the development of or distort competition and therefore the UR should be cognisant of potential unintended consequences of continued price controls.

The UR must look to minimise the burden of regulation in terms of unnecessary interference in the market, complexity of rules, rate of change and aim to achieve consistency and clarity of approach.

Power NI believes work on wholesale liquidity is vital and agrees with the characteristics of the "ideal market" set out above and described as a UR policy goal. It is disappointing however, that while it is acknowledged that where demonstrably appropriate the UR would reduce regulation, no transparent criteria are described. Power NI considers this an important prerequisite of any comprehensive policy.

4 Defining Sub-Sectors

The electricity groupings identified in the position paper appear to be limited to sectors defined by use of system (UoS) tariffs. Power NI believes that the market should not be restricted by historic (UoS) tariff groupings but apply a practical customer focussed criteria which enhances rather than restricts the options available to consumers.

Within the domestic sector, distinction should be made between credit and direct debit customers with future sub sectors of on-line and "eco" developing. Customer segmentation is a natural consequence of competition and simply reflects a provision of a greater range of tailored products. It is important to state that these products would not be developed if a customer demand was not present.

Within the commercial sector, Power NI continues to advocate that groups should be considered and demarcation not limited to legacy reporting arrangements. Businesses operate in a dynamic environment and seek to avail of economies of scale by grouping diverse supply points in their portfolio. Simply relying upon existing reporting mechanisms to define important policy decisions ignores the reality of customer requirements and buying behaviours.

The conclusion reached by the UR on sub-sectors is both inconsistent (using consumption for gas and metering arrangement for electricity) and does not adequately reflect market dynamics. The UR should recognise the segmentation above, which describes how the market operates in practice. In the electricity market the UR is allowing legacy systems to drive reporting and not customer requirements, Power NI would urge the UR to rethink this approach.

5 Market Monitoring

Regulatory market monitoring is an essential requirement to ensure the effective operation of the market. Market shares, switching rates and the number of competing suppliers all feed standard reporting. Pricing and tariffs will require the UR to be more active in monitoring and accurately reflect differentials between introductory and standard offers as well as aspects such as terms and conditions. Power NI considers that in a rapidly evolving market, such as in Northern Ireland; quarterly reporting in insufficient and potentially hampers the UR’s responsiveness.

Contestability is a goal of the ideal market and Power NI is disappointed that it continues to be effectively excluded from areas of the business market due to the current regulatory regime. As highlighted in previous price control correspondence and earlier in this paper, Power NI hopes that the UR will take steps to move away from relying on legacy definitions and move to a more customer focussed regulatory regime.

Power NI would encourage the UR to give urgent consideration to an immediate further reduction of the scope of price control in the business sector focused on customers consuming greater than 50MWh and group customers. Power NI believes that there is evidence of active price competition in these sectors.

The removal of the retail price control will allow these consumers to engage with a greater number of suppliers who are able to tailor products, participate in the tendering process, provide quotations and compete for their business on a level playing field. This is a requirement which has been clearly communicated by consumer associations and customers alike as it provides increased ‘real’ competition whilst having the comfort of consumer protection through normal regulatory arrangements.

Power NI believes that this interim step would have a positive effect on the electricity market, is consistent with the UR's statutory objectives[4,] removes a real current competition inhibitor, is consistent with GB and European policy decisions, and facilitates headroom to give further consideration to the regulatory approach. To further delay this proposed next step in order to conduct market reviews assumes that all sectors of the market are at the same level of maturity, which is clearly not the case.

6 Customer Perspective

Power NI concurs with the UR view that consumer benefit should underpin this entire discussion. To transit from a historically monopolistic supply arrangement to a diverse competitive market will take time. This has been illustrated by experience in the electricity market to date.

As competition develops, particularly in the domestic sector, consumer protection becomes increasingly relevant. Power NI welcomes the goals of the IME3 Directive and will continue to actively engage with the UR to seek its successful implementation.

Transparency underpins the IME3 directive. The implementation of information transparency requires a balance to be struck between inundating the customer with data and the simplicity of presentation. The provision of data has cost implications which will ultimately be paid for by the customer. Careful consideration is therefore required of the potential benefits resulting from the information provided. Throughout the IME3 review the UR should be mindful of the additional costs which will arise from placing onerous new requirements on suppliers without a clear cost benefit assessment.

With regard to IME3 and other government energy policy the UR is the conduit for delivery. It is important to recognise that many elements will only be achievable through expenditure and the UR should be aware that significant additional requirements may become a barrier to entry.

Within the consultation paper and during IME3 considerations, the UR appears concerned regarding the percentage of customers who have not switched in GB. While the statistics are useful the UR should be mindful that the goal is an effective market with well informed, protected consumers who are aware of the option to switch. Switching per se will not necessarily achieve greater protection, service or price (particularily post any introductory offer) for a consumer. This is especially the case in a market where the incumbent is an efficient, price competitive supplier providing excellent customer service. To advocate switching suggests that the UR is

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[4] As reaffirmed by the National Audit Office, which states that "the processes used by Ofgem, Ofcom and Postcomm for removing retail price controls were consistent with their statutory duties of protecting consumer interests through the promotion of competition." and "The removal of price controls is an important step in the development of competition"

recommending one supplier over another and therefore seeking to unduly influence the operation of the market.

7 Regulatory Approach

The UR through this paper has taken a useful first step in beginning the debate on the regulatory approach. It does however need tangible outcomes and clear decisions to be truly market effecting. There are some important lessons to be learnt from a more developed market such as in GB however the UR must be mindful that excessive regulation will choke or delay effective competition.

The UR has correctly highlighted door step selling as a negative aspect of the GB market. It is noteworthy that this practice has generated significant bad press and a number of suppliers have moved away from this approach. Power NI would welcome the UR being particularly proactive in clamping down on any negative selling or mis-selling aspects which may develop in the market as this tarnishes the reputation and brand of all industry participants.

Generally the approach to consumer protection through use of licence conditions is the appropriate mechanism. Undue discrimination and cost reflective pricing provide protection while allowing suppliers to develop customer focussed products. Within this space however the UR must require the common services provider (Northern Ireland Electricity) to pursue innovative metering solutions and provide these to the market. Pre-payment meters for small businesses may be a useful option for the business owner in terms of flexibility and cost management. Low cost, SMART metering solutions and the provision of information are future developments which Power NI would like to see Northern Ireland Electricity and the UR proactively developing.

As discussed above, the retention of an incumbent price control in a market which is demonstrably competitive will compromise the effectiveness of competition and is in fact counterproductive. Regulations are rules designed to control certain actions by people. They are a distinctive statement by regulators against a specific industry, often wrongly portrayed as protection for customers. Since the effects of regulation cannot easily be quantified in terms of cost of goods or quality of service, it is difficult to assess whether regulation is causing more harm than good. That is one of the inherent dangers of any form of regulation.

In restricting the market, new costs of competition are added, the cost of regulation is maintained and diseconomies of scale are forced. Many of these costs would not be incurred in a market without competition therefore to derive a “non-competition” reference price as a comparator is unrealistic.

The UR’s discussion of a maximum retail price remains unclear as to the process and implementation of such a principle. To continue to approve the

Power NI regulated tariff portfolio does not set a maximum retail price as it does not require any action from suppliers not subject to price control nor does it ensure that all customers are either paying that price or less (especially following the expiration of introductory offers).

A true maximum retail price therefore would require a series of tariffs to be set by the UR with accompanying licence conditions on all suppliers requiring their adherence to providing a price equal to or below those figures.

In considering the maximum retail price most regulators follow a building block approach. Regulators begin by aggregating allowed retailer costs such as:

- Wholesale energy purchase costs (constantly changing);
- Capacity charges (annual)
- Transmission and distribution use of system charges (annual cycle);
- Market fees as imposed by SEM, costs to meet mandatory renewable requirements (annual) and Levies (annual)
- Operating costs associated with the retail function (including costs relating to, bad debt, billings, call centres and corporate overheads, including regulatory compliance costs); and
- A net margin (return on capital)

As the range of different segments develop, a single incumbent 'standard tariff' reference price becomes reflective of an atypical high risk, high cost, group of customers. This therefore will distort overall market pricing.

Additionally, consideration should be given to the maintenance of such a maximum retail pricing structure, and the monitoring of all retailers offering into the market against those values. This may be complicated by market segmentation and that hedging cycles may take a fixed price offering outside of a maximum retail price limit, even when it is cost reflective.

The maximum retail price therefore would appear to be fraught with difficulties; requiring licence amendments and detailed regulatory monitoring mechanisms. It is unclear if a cost benefit justification could be made for such an approach given the implementations requirements and the potentially distorting effects it may have on the market and its long term development.

8 Conclusion

Power NI welcomes the development of the UR's initial position paper regarding the regulatory approach to competition in the energy supply market. As stated previously the process of defining a regulatory approach is a vital element of any energy markets operation. Visibility of strategy can only encourage engagement, certainty and confidence in the energy markets.

In considering the 5 high level policy principles:

Maintaining an overlay of regulation

On overlay of regulation in terms of licence conditions to give effect to consumer protection is to be welcomed. Specific lessons such as the effect of door step selling as seen in other markets cannot be ignored. The UR must however facilitate supplier innovation and product development and not seek to be overly onerous or restricting. Additionally, a cost benefit analysis should be undertaken to maximise protection while minimising costs. Under such an approach, which places these requirements on all participants, effective competition can flourish.

The retention of incumbent price controls however, in a market which is demonstrably competitive is distorting, disproportionate and will compromise the effectiveness of competition. A lingering feature of a competitive but still price controlled market is the prolonged asymmetrical character of regulation; which historically was required to favour new competitors over the incumbent, when the incumbent was dominant. However, any unnecessary extension of such a regulatory dynamic, when demonstrably the market influence has shifted from the incumbent to the competitor community, introduces suboptimal competitive market conditions and thus could compromise the regulator's ability to comply with its statutory duty of promoting stable and sustainable competition.

The public benefits conferred by retail price regulation are likely to be low to zero. On the other hand, the direct costs of retail price regulation are likely to be substantial while the indirect costs are likely to be even larger. Once the direct and indirect costs of retail price regulation are weighed against the potential public benefits of retail price regulation, it becomes clear that is highly likely that the overall effect of retail price regulation in contestable retail energy markets is not beneficial to customers.

Currently, the electricity market is not subject to price control in the >150MWh pa sector. Power NI believes that this threshold is unnecessarily high and is in fact inhibiting competition in the business market. This restriction is illustrated by recent customer frustration regarding the lack of quotes available from suppliers as well as the lack of tailored products.

Developing effective competition

Power NI supports the principle of effective competition and advocates a strong competitive model characterised by a number of players, low market power (in the supply chain), low barriers to entry and exit, well informed sellers and buyers, independent decision making and product differentiation. Regulatory frameworks assist in the development of such characteristics and provide certainty and confidence to the market. Prolonging the price control mechanism fails to deliver benefits either in the form of price or products for consumers. Nor does it assist in the development of effective competition.

The locking of Power NI out of certain markets (business) remains a fundamental issue which goes right to the heart of the development of efficient competition and contrary to UR objectives. Power NI would encourage the UR to give urgent consideration to an immediate further reduction of the scope of price control in the business sector focused on customers consuming greater than 50MWh and group customers. Power NI believes that there is evidence of active price competition in these sectors.

The reliance upon legacy reporting arrangements which do not reflect customer requirements, is unwelcome and does little to aid the market development.

Transparency between retail and wholesale markets

A successful retail market is contingent upon an effective wholesale market. Transparency of SEM operation as well as low barriers to entry and effective wholesale competition will benefit the retail market.

Securing effective hedges is fundamental to ensuring retail competition and the delivery of products that end consumers want. While little consideration was given to the contract market during the SEM design, the fundamental effect hedging contracts have on end consumers should prompt the RAs to attach greater importance to this area. The lack of liquidity is of real concern as scarcity creates a price premium which could potentially facilitate the manipulation of retail prices to artificially high levels.

Reducing the build up and effect of “k”

“K” is a function of price controls. As stated previously the price controlled incumbent who faces competition is exposed to an asymmetric risk which is potentially of a very large size. While a “K” model already exists within the Power NI regulatory statements movement away from price controls will reduce the level of risk which “k” quantifies.

Given the hedging arrangements within the electricity market mid-year tariff reviews will become an increasing requirement and risk mitigation measure. This approach is consistent with the trigger mechanisms which have been included in Power NI's Hedging Policy and Tariff methodology Statements since 2007

Continuing to set a maximum tariff for 3 years

To prescriptively state that price controls will remain for 3 years for residential and small SMEs is potentially an impediment to the development of efficient competition. As articulated previously, the maintenance of a price control arrangement can be counterproductive to the goal of effective competition. Power NI believes that the UR should develop a detailed roadmap with clear and harmonised criteria following the CER example.

Power NI considers it inappropriate and manifestly inequitable to continue price regulating a sector which is demonstrably competitive. Prolonging a price control in these circumstances is not only inconsistent with the UR's duty to promote stable and sustainable competition, it fundamentally hampers customers getting access to a full range of products, on equal terms, from all suppliers currently operating within the non-domestic sector in Northern Ireland. The 3 year time period also fails to fully acknowledge the pace of change within the electricity market.