

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

27 January 2015

Dear Briege,

Draft Forward Work Programme 2015-16

Power NI welcomes the opportunity to respond to the recent draft Forward Work Programme 2015 - 2016 published by the Utility Regulator (UR).

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

Specific Items

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

- **Power NI Price Control**

The Power NI Price Control is understandably a significant agenda item for Power NI. Early engagement between the UR and the business is critical. Any supply price control review should be set against a backdrop of striking a balance between protecting customers and ensuring that companies are able to finance their activities in a sustainable way. Principles of best practice regulation should be observed including providing regulatory certainty, giving due consideration to all aspects of the market as well as changes in the operating environment. Of particular importance within recent price controls are the capital requirements to support the business's operations and the implications of risk.

To ensure that companies are able to finance their activities is central to the UR's duties. This can only be achieved by the detailed assessment of the capital required to finance supply activity and the cost of that capital. Providing adequate returns on capital ensures ongoing

financeability and maintains investment confidence. The UR therefore must ensure that it carries out robust analysis utilising industry best practice to deliver transparent reasonable decisions.

Power NI strongly believes that the UR should recognise the effect of the margin in this context and that this should be set at a reasonable and appropriate level following a detailed retail related building block approach to analysis. Considering net margin in isolation, while driving opex allowances below an efficient benchmark level represents an unreasonable strategy.

The UR has in past price control determinations, approached opex assessment via a bottom up line by line assessment of the incumbent. Power NI maintains that such an assessment does not holistically assess the efficiency of a supplier but rather arbitrarily accepts or rejects individual line items. Due to such allocation assessments this approach has driven allowances below comparable retail businesses. Power NI would welcome the UR consulting upon the approach to retail price control determinations in advance of the strategic project described in the FWP.

Typically a price control determination has taken in excess of 18 months to complete. Power NI urges the UR to be mindful of this timescale when initiating its project. An approach and strategy should be clearly communicated with affected parties in advance of this timeline. The UR has indicated that it intends to approach all retail determinations as one project. Power NI is unclear of what synergies can be achieved through this approach however understands that the UR may be targeting issues of consistency of methodology within the UR office and may be acknowledging best practice regulatory guidance regarding a more universal retail sector wide approach to price regulation.

The UR should however be mindful that the electricity and gas markets are significantly different. Areas such as the wholesale arrangements, the levels of retail competition and the development of the I-SEM trading arrangements must lead the UR to different conclusions for each fuel. A “*one size fits all*” approach will not be acceptable.

Power NI would also welcome the UR resolving the question of scope of the control as a separate item.

- **The Retail Electricity Market**

Power NI notes the continuation of the 2 flagship projects in relation to the retail electricity market in Northern Ireland – ‘Assessing the effectiveness of competition in retail electricity markets’ and ‘Establishing a Retail Energy Market Monitoring (REMM) Framework’.

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

While the UR has been active in increasing the layers of consumer protection, little has been done in the area of encouraging competition. In 2014 the UR did commission the Cornwall Energy report into the effectiveness of competition and it is critical that phase 2 of that project is a regulatory priority.

Power NI was somewhat surprised that the EU law requirements were not explicitly laid out in the Cornwall Energy Report. The UR should not interpret such an omission as justification for further delay in the area of a competitive framework. The European Commission and ACER

have clearly stated that the Member States should be working towards the removal of price regulation.

Within Northern Ireland a regulatory framework developed in the early 1990's remains in place. Regulation which does not reflect the market characteristics or evolve with the market can inhibit the development of and distort competition. Power NI believes that if a market is demonstrably competitive, the prolonged application of a price control will compromise the proper operation of a competitive market and is in effect counterproductive. This position is consistent with the view at a European level. The UR should be cognisant of potential unintended consequences of continuing and relying upon, frameworks put in place under an entirely different market context.

A number of options exist for how the regulatory framework could be developed. As part of the review of the state of competition in Northern Ireland and the development of tools for retail monitoring, the UR needs to consider the design of its regulatory framework and how it can operate in a competitive market.

This may or may not involve price controls, Power NI urges the UR to consider options which move away from a regulatory approach which focuses solely only on Power NI and instead are based on a framework that regulates the market as a whole.

- **Wholesale Market**

As expected the I-SEM project features heavily in the UR's FWP. Power NI expects that significant regulatory resource will be engaged with this project as the detailed design is finalised through 2015-16.

The I-SEM project will also require participants to commit sizeable levels of resource as industry seeks to engage, influence, understand and implement business and system changes which will result from the project.

As Power NI has stated before securing effective hedges is fundamental to ensuring competition and delivering products that end consumers want. Little consideration was given to the contract market during the SEM design and it has a significant effect on end consumers. The I-SEM workstream focussing on this area must deliver a solution which ensures a liquid forwards market.

While the UR is considering the issue of liquidity and risk mitigation in the context of the European Target Model requirements (I-SEM Project) Power NI would welcome interim measures to address liquidity prior to the new market arrangements.

Power NI believes 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.

- **Smart Metering**

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

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

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

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

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

- **Directive Implementation**

Within the FWP the UR has committed to implementing billing guidance as required under the transposition of the Energy Efficiency Directive. While Power NI fully supports the provision of accurate and understandable information to customers, the UR should be mindful that all suppliers conduct customer research and seek to make their billing and general information as customer friendly as possible. While regulations may demonstrate compliance it is important that such guidance is limited to only the areas within the Directive and is as 'light touch' as possible. Suppliers must be allowed discretion to differentiate themselves in a competitive market; overly prescriptive requirements applied universally will dampen this ability. Additionally, it is again important to recognise that supplier adherence and the required changes to billing and print facilities will come at a cost to the consumer.

Cost considerations should also be assessed in relation to potential requirement to issue bi-annual prepayment statements. Customers have chosen the prepayment arrangement as it provides ease of use, budgeting capability and importantly results in no bills being issued. This 'light touch' approach is both attractive to customers and very importantly, allows supplier to offer discounts for prepayment (unlike GB and RoI). To provide the general information in relation to contact information, fuel mix, energy efficiency etc. an annual statement is issued. The suggestion that this should now become a bi-annual statement means the issuance of an additional 300,000 letters per year at a high level cost estimate of an additional £100,000 per year.

Power NI believes comprehensive information is provided to prepayment customers annually by letter, is available via supplier websites and also via the in home display which accompanies the prepayment meter. The in home display can provide the customer with information in relation to costs, rates, money spent, electricity currently being used, highest consumption points, consumption levels yesterday, last week, last month and total consumption at any time.

Given the cost implications and the alternative sources of information available to prepayment customers, Power NI urges the UR to seek to use such means as the in home display as compliant with the requirement.

- **NISEP**

Power NI would ask that UR provides clarity for suppliers should there be any change in the current decision that NISEP will be ending in 2015/16. Furthermore, we would ask that the UR follow their own published timetable to ensure a prompt completion of NISEP. In relation to future arrangements, it is important that costs of potential energy efficiency obligations are borne equitably across all fuel types.

Conclusion

Power NI is committed to working constructively with the UR across the range of projects references in the Forward Work Plan 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