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NI Electricity Prices: Data and Comparisons, Information Paper

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Dear Elena

Thank you for giving Airtricity the opportunity to provide feedback on the **NI Electricity Price Data and Comparisons** paper published in March. Airtricity supplies over 200,000 electricity customers in Northern Ireland, serving customers in each market segment.

We welcome the additional transparency the report provides in terms of pricing in competitive segments of the market. As more market segments move toward free and fair competition, retail monitoring will play an important role in demonstrating that markets are functioning effectively for final consumers.

However, we would suggest that the overarching EU price comparisons included in the paper do not provide much additional insight, outside of the price dispersions included in **Figure 7**. Each of the cost elements that make up end prices for consumers in Northern Ireland is relatively transparent at wholesale, network and retail level. Benchmarking these complex 'known' costs against simple 'unknown' costs from other EU markets adds little value.

The reasons for the relative price dispersions seen across Europe are complex, but the reasons for price dispersions for medium to large energy users across Ireland are straightforward. Broadly comparable network and other costs¹ have been allocated differently, between different market segments, which, coupled with UK only tax measures like the Climate Change Levy mean larger energy users pay comparatively more in Northern Ireland relative to their competitors in the Republic of Ireland.

If cost reflectiveness and industrial competitiveness are the primary concerns raised by the paper, the Utility Regulator is able to reallocate network and some other costs to address that concern. Taxation or policy issues (such as compliance with European Directives relating to Electricity, Gas or Renewable Energy) are not areas that an economic regulator can effectively influence.

Price components and transparency

Wholesale

¹ The pricing snapshot that the paper focuses on took place during a period in which LEUs were receiving a substantial customer credit, funded by a carbon revenue levy.

One of the advantages of the Single Electricity Market is that the wholesale element of end consumer prices is transparent, and reflects the cost of providing a secure, stable supply of electricity. Benchmarking Irish wholesale prices² against the wholesale prices generated in the hydro-dominated Nordpool, or the cost of electricity produced through a state-funded French nuclear programme doesn't add much in the way of insight or value.

That said, reliable interconnection and efficient capacity allocation through well designed market coupling arrangements will allow Ireland to more effectively access a wider pool of competitive generation from December 2016 onwards. We welcome the commitment within the next steps section of the paper to progress the efficient integration of the wholesale market with Western Europe.

Networks

Network costs can more accurately be compared across the EU, but networks still reflect the geography of individual markets, metal prices at the point at which network investments had taken place and how effectively services by monopoly network providers have been exposed to competition³ among a number of other factors.

These fixed costs are translated into supplier tariffs for different customer types, by allocating them across demand by reference to load, peak demand, shape or some other metric. The allocation of network costs in **CER/10/102** & **CER/10/206** appears to be the primary differential between Northern Ireland and the Republic of Ireland.

Retail

Supplier costs are a relatively small proportion of final prices to consumers. In a efficient, competitive market with low barriers to entry, end retail prices should be self-regulating. Until that point, the incumbent supplier's costs and end tariffs can be regulated, as they currently are for a number of market segments in Northern Ireland where competition is still developing.

Suppliers are also typically required to collect the costs of various obligations or levies from their customers, including charges like the Climate Change Levy, Renewables Obligation and Collection Agency Income Requirement (CAIR).

Transparency and the I&C prices 'Data Gap'

While the information paper states that "*only suppliers have full access to the transparency of price components for their customer sectors*", we would note that wholesale costs are transparent, network costs are effectively set by the Utility Regulator through monopoly price controls and other costs like Climate Change Levy are announced in the annual Budget (Finance Bill).

² NBP gas prices are still the primary driver of the System Marginal Price in the SEM.

³ We would note that the Utility Regulator has still not introduced contestability for connections, despite the item featuring on its Forward Work Programme for 3 consecutive years, and it having the potential to substantially reduce connection costs for consumers and generators.

For the larger customers referenced in the information paper, this leaves a relatively small percentage of the total price paid accruing to electricity suppliers.

Making effective use of comparison

Price formation across the EU

What the information paper is lacking is the transparency of price components for the other EU member states. Without a detailed understanding of price formation for wholesale, network and retail components in other EU member states, no practical conclusions can be drawn from high-level analysis of relative end prices for consumers.

We would suggest that the Utility Regulator would be best served by focusing on more detailed analysis of two different data sets in future work:

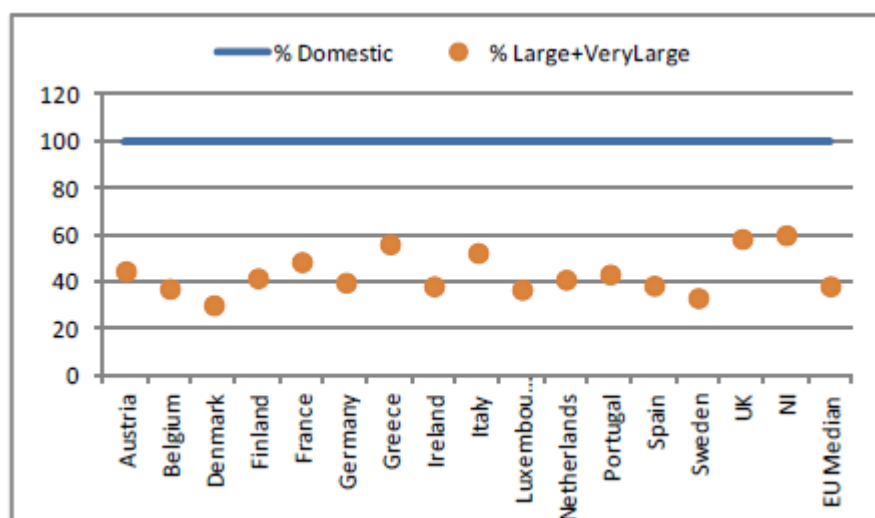
- Relative price comparisons between Ireland and Northern Ireland.
- Relative price dispersions across EU member states, and between Ireland, Northern Ireland and Great Britain.

Price comparisons between Ireland and Northern Ireland

Comparisons between Ireland and Northern Ireland would be the most useful area of further analysis, considering that both jurisdictions share a wholesale market, similar geography and investment conditions. Price formation for each of the components that make up end prices is properly understood, as are the dynamic, technical and allocative effects of competition in most market segments.

Price dispersions across EU member states

Figure 7 in the information paper shows that LEUs in the UK and Northern Ireland pay 60% of the price paid by domestic customers, whereas the EU median (and Irish average) is around 40% of the domestic price paid.



This suggests that pricing is either not cost reflective within the UK, or not cost reflective within other EU member states. There are many examples of LEUs receiving preferential treatment, like LEU customer credits (in place at the time of this snapshot) and LEU network charge reallocations in Ireland, exemptions from network charges for LEUs in Germany⁴ or preferential tariffs offered in Italy, Greece and Romania.

This differential is the primary finding of the report, and represents an issue for business competitiveness in Northern Ireland (which would lie within the Department for Enterprise, Trade and Investment's remit). If pricing for larger customers is not cost reflective, it potentially also represents an economic regulation issue.

Drawing useful conclusions from partial data

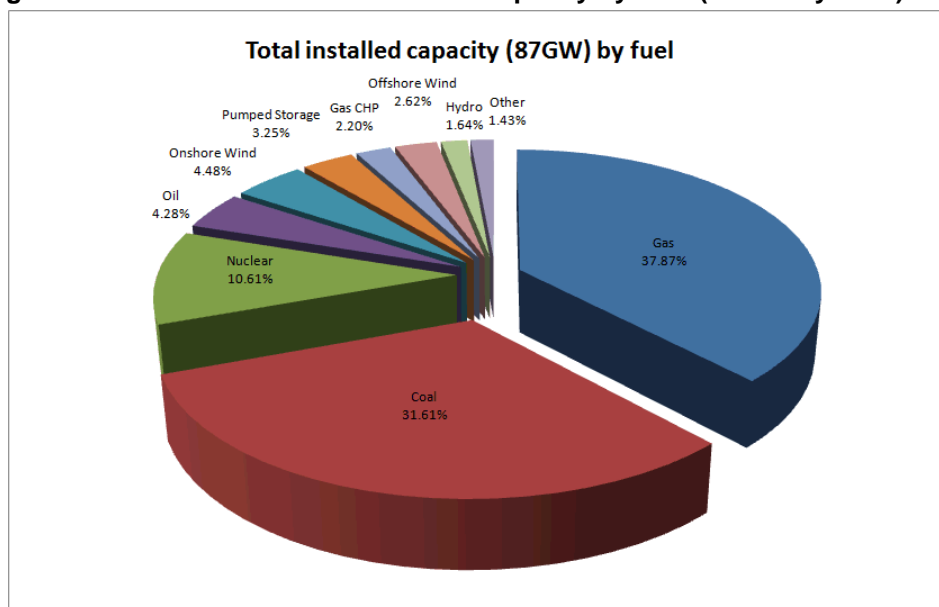
Market size/scale, isolation and consumer dispersion

These factors have a significant impact on end consumer prices, and it is difficult to see the value in broad comparisons across EU member states. Electricity is a physical commodity, and its secure supply has to reflect the fixed and variable costs associated with its physical production and delivery. Many of these costs, and the demand that they are charged to aren't properly comparable across the EU. The complexity of analysing and comparing these additional costs should be better acknowledged in the information paper.

Wholesale energy costs and fuel mix

SEM has a generation portfolio mix that is substantially different from Great Britain. In particular, Great Britain has a more diverse mix of generation capacity (particularly with regards to coal and nuclear), whereas the Irish market is more reliant on gas-fired generation.

Figure 1: Great Britain – Total Installed Capacity by Fuel (as of May 2012)



⁴ This exemption is funded by a surcharge on final electricity customers, which is currently the subject of a European Commission state aid investigation.

The paper states that ***“BETTA has a substantially different portfolio mix compared to SEM, with a greater share of generation derived from coal and nuclear which will tend to reduce the wholesale price as they are cheaper than gas and oil”***.

While it is currently true that nuclear and coal-fired plant operating in GB are cheaper than gas-fired plant, this has not and likely will not always remain the case (recovery of fixed costs in the market, carbon pricing, wholesale energy price trends etc). There is no particular generation mix that will outperform others at all given periods, but a diverse mix is likely to allow a market to capture the benefit of fluctuations in wholesale energy prices and more effectively optimise electricity production at a given point in time, relative to other markets.

Energy policy, taxation and regulation

I. Wholesale Market Design

Absolute levels of generator profitability would be the wrong metric to use for evaluating how effectively a wholesale market is working. Certainly, companies that invest in generation assets would not be using a short term measure like year on year accounting profitability (which tends to reflect current wholesale energy input prices) to evaluate investment opportunities with a lifespan in excess of 20 years. Companies would be looking holistically at:

- Market fundamentals (supply/demand and wholesale price expectations)
- Market access (physical and financial)
- Regulatory stability
- Environmental policy
- New technology expectations

Investors would then be evaluating opportunities against a modified economic rate of return, rather than current profitability levels. A well designed wholesale market should deliver cost-reflective security of supply⁵, with competition driving efficiency, innovation and investment decisions.

II. Network regulation

Effective network regulation means striking a balance between a number of different things:

- Ensuring natural monopoly businesses are incentivised to deliver continuing allocative and technical efficiency.

⁵ We note that the Utility Regulator will shortly be publishing a joint paper with DETI setting out current security of supply issues for Northern Ireland and potential remedies. This suggests that investors are evaluating generation projects against different criteria to those suggested by the Utility Regulator in this paper.

- Opening up areas of natural monopoly to competition where benefits can be delivered, like introducing contestability for connections at distribution and transmission level.
- Facilitating the dynamic aspects of competition such as innovation.

We would suggest that network regulation in Northern Ireland currently prioritises technical efficiency (delivering at least cost) against allocative efficiency, innovation and competition. While the benefits of technical efficiency are easiest to capture in a headline, that does not necessarily mean they are the most valuable for customers in the long or short run.

III. Retail competition

The paper appears to suggest that lack of effective competition is the reason for price differentials seen by Northern Irish large customers relative to larger customers in other EU countries, and particularly those who operate in the Republic of Ireland.

“For domestic and small I&C customers (which represent 70% of all I&C consumers), prices in Northern Ireland in 2011 were around the European average. Customers in this category are able to avail of a regulated tariff. Whilst not stating a causal link at this stage, this is a fact, and an issue to be returned to in follow up thinking. For the remaining 30% of I&C consumers, prices in 2011 were amongst the highest in Europe”

SEM wholesale prices form the majority of retail prices in Northern Ireland and the Republic of Ireland for larger customers, but reallocations of network charges, rebates⁶ and other costs mean that larger customers in the Republic can receive more competitive pricing. The assertions regarding the effectiveness of competition in the I&C market do not appear to be supported by analysis beyond a cursory examination of headline data.

IV. Relative policies towards renewables

Both Northern Ireland and the Republic of Ireland have a target for 40% of electricity consumption to come from renewable sources by 2020, both have a shallow connection charging policy (which is integral to the SEM’s High Level Design) and both have harmonised all-island arrangements for Ancillary Services and Other System Charges.

Despite renewable policies that are very similar, there are still persistent price differentials for different sizes of customer. Relative renewable policies are not driving price differentials between Ireland and Northern Ireland. We would also note that the gross mandatory pool design of the SEM means that low marginal cost renewable

⁶ At the time of the price snapshot in the Information Paper, an LEU customer credit was being given to LEU customers.

energy is maximised, providing market dispatch savings through the merit order effect.

V. Taxation, public policy and regulation

Taxation does have a substantial effect on price patterns, but lies outside the remit of an economic regulator. Analysing complex taxation patterns across Europe for a number of different customer segments would require a substantial amount of work for little benefit.

As the information paper states, taxation and public policy will ultimately be paid for by final consumers and influence relative and absolute price levels. Likewise, regulatory requirements (for information, customer protection measures etc) generally require resources which will be paid for by end consumers.

In order to get value from analysis of these price drivers, we would suggest that the Utility Regulator limits its analysis to costs imposed through regulatory requirements or interventions which lie within its control. As overregulation tends to impose fixed costs which have to be levied against a suppliers' customer base, these can inhibit market entry and effective competition in small markets like Northern Ireland. We could provide some recent examples of regulatory cost burdens introduced at a supplier level, which may be helpful.

Concluding remarks

Analysis of relative price formation in very different markets is necessarily complex. When this analysis is extended to 27 EU member states with widely varying geographies and electricity markets it is difficult to see how practical conclusions can be reached, particularly when comparing areas like taxation, policy and state intervention. Are low absolute prices in Finland a result of factors that can be easily replicated in Northern Ireland⁷?

NIAUR would be better served by concentrating on price comparisons between markets where it does have detailed understanding of the complex components that make up final prices. Noting that end customer prices are high relative to EU member states in some market segments, and suggesting that investment is restricted is overly simplistic. Customers would be better served by an examination of practical questions, such as:

- Could some monopoly activities be exposed to competitive pressures?
- Are Demand Side Response market and licensing arrangements attractive for customers in Northern Ireland, and could they be changed to allow large customers to better respond to scarcity?
- Can the benefits of the North-South Interconnector be more effectively demonstrated in terms of its impact on end consumer prices?
- Are network costs fairly allocated between different customer segments?

⁷ No – they are the result of geography, historic investment and an efficient wholesale market

I hope that you find our detailed comments on the information paper helpful, if you wish to discuss any aspect of our response in more detail, please do not hesitate to contact me.

