Response by Energia to the Utility Regulator Information Paper published 26 March 2013

NI Electricity Prices: Data and Comparisons

24 May 2013

1. Introduction

Energia welcomes this opportunity to respond to the Utility Regulator's (UR) Information Paper on Northern Ireland (NI) Electricity Prices: Data and Comparisons ("the information paper"). We note the objective of the information paper to provide the transparency required for interested parties to understand energy price patterns across jurisdictions and more specifically how retail electricity prices in Northern Ireland (NI) compare with those in other EU countries, including the Republic of Ireland (RoI).

Energia is an active member of the Electricity Association of Ireland (EAI) and the Northern Ireland Wind Industry Group (NIRIG). We share their concerns and views in relation to this information paper and would like to fully endorse their responses to it. From Energia's experience of customer reaction to the paper; incomplete analysis, important omissions, and the absence of a meaningful like for like comparison, have led to misinterpretation, misunderstanding and misdiagnosis of a perceived problem over which we as a supplier have no control. Given the complexity of this area and the obvious sensitivities to be considered this is regrettable and potentially damaging to the perceived competitiveness of the Northern Irish economy.

The information paper claims to provide greater transparency and sees this *"as a vital first step to a shared better understanding"* (p.5). From customer feedback and Energia's own reading of the paper we do not share the view that it improves transparency as published or that it serves as a useful vehicle to stimulate debate.

The obvious starting point for analysis aimed at providing transparency on electricity prices is disaggregation of those prices into their component parts. Without this disaggregation, the paper does not further, and potentially hinders, consumer understanding of their energy bills and the issues faced by Northern Ireland. As already mentioned the information paper presents an incomplete analysis, is missing important information, does not compare like with like, and therefore has real potential to misguide the reader. The paper also contains a number of misleading inferences regarding regulated markets versus competition. Whilst we assume these inferences were not deliberate, they serve to further mislead readers who do not possess a good working knowledge of the retail markets on the island of Ireland. In light of the above we strongly caution against using this (incomplete and evidently misleading) information paper to inform policy and regulatory decisions. Section 2 and the concluding section 4 of this response elaborate.

In the context of a common wholesale electricity market and other regulatory, policy and structural similarities, the identified price differential between NI and RoI is of most interest and presents the best opportunity for meaningful comparison and learnings. As a supplier that operates in both jurisdictions we consider this comparison in detail in section 3 of this response and provide analysis to support our conclusions that the differential in electricity prices between NI and RoI can be

explained with reference to the allocation of network charges and related government policy, and to the existence of different taxes & levies.

2. Key concerns

Incomplete analysis and premature conclusions: The analysis and narrative in the information paper of comparative electricity prices is incomplete and provides insufficient evidence to draw any inferences or conclusions. A notable and highly important omission is the need to disaggregate large I&C prices in NI and to benchmark NI prices appropriately, carefully taking into consideration important explanatory factors of price divergence with other jurisdictions. In advance of completing this work it is premature and indeed unhelpful to make certain statements and draw conclusions that are not substantiated by the evidence. Further work is needed, as suggested in this response, to ensure meaningful price transparency and comparison.

Country specific differences not considered: Detailed analysis and country specific understanding is required to make any comparison with other countries meaningful. Due to differences between policy objectives, markets and regulatory structures across Europe, such a comparison is by no means straightforward. Two obvious examples of this are Germany and Great Britain (GB):

- In Germany for example large I&C electricity customers are by law exempted from paying network charges. This exemption is being investigated by the European Commission under State Aid rules with a preliminary view expressed that the exemption is in breach of these rules and distorts competition in the internal market[1].

- In GB, studies indicate that wholesale prices are below the long-run marginal cost of production leading to the significant capacity shortfall identified in Project Discovery[2]. For example an ESRI study published in April 2013[3] compared electricity prices in SEM and BETTA and concluded as follows: *"Our findings suggest that the British wholesale market might be underpricing electricity. With substantial excess generating capacity over the last decade, the market has seen firms "sweating their assets" so that the price has fallen below LRMC. Unless the wholesale price increases to at least LRMC in the near future, the GB market could have difficulties securing replacement investment for the generating capacity to be retired over the coming decade"*.

[1] See http://europa.eu/rapid/press-release_IP-13-191_en.htm
[2] See http://www.ofgem.gov.uk/Markets/WhlMkts/monitoring-energy-security/Discovery/Pages/ProjectDiscovery.aspx
[3] Similar findings are reported in studies published in 2009 by Dieter Helm and the Commission for Energy Regulation. Helm's study called "Infrastructure investment, the cost of capital, and regulation: an assessment", highlights concerns that the prospective returns from investment under the current market rules in GB may not result in adequate investment. The Commission for Energy Regulation study compared spark spreads in the SEM and BETTA and concluded that the wholesale price in GB was probably too low, being insufficient to remunerate the long-run marginal cost of generating electricity.

Regrettably, the information paper presents a crude comparison and makes no attempt to account for these and other country-specific factors. As a result, the key findings highlighted therein have the potential to seriously mislead and, for that reason, are ill advised. We propose that the paper would benefit from revision based on a more detailed analysis of the factors influencing price development across member states.

Absence of true like for like comparison: The approach adopted in the information paper militates against a true like for like comparison despite stated intentions otherwise[4]. This is because it does not disaggregate NI prices for large I&C customers and it does not compare the same customer profile and usage across jurisdictions. It also gives no consideration to important country-specific factors as mentioned above, and as further discussed below in relation to the NI versus RoI distinction. In the context of a common wholesale electricity market and other regulatory, policy and structural similarities a careful comparison with the RoI offers the best prospect for a like for like comparison. Indeed such a comparison, appropriately carried out, can offer important insights into the true driver of price differentials. As a supplier that operates in both jurisdictions we consider this comparison in detail in section 3 of this response and provide analysis to support our conclusions that the observed differential in electricity prices between NI and RoI can be explained with reference to the allocation of network charges and related government policy, and to the existence of different taxes & levies.

3. Comparison of NI versus RoI prices

We note the objective of the information paper to provide the transparency required for interested parties to understand energy price patterns across jurisdictions and more specifically how retail electricity prices in Northern Ireland (NI) compare with those in other EU countries, including the Republic of Ireland (RoI). Referencing other countries without understanding wide-ranging and highly significant country-specific idiosyncrasies can be highly misleading and is therefore inadvisable.

The most appropriate and interesting comparison to make is with RoI, with whom NI shares a common wholesale electricity market and a number of other regulatory, policy and structural[5] similarities. Indeed such a comparison can offer important insights into the true driver of price differentials. As a supplier that operates in both jurisdictions we consider this comparison in detail below and provide analysis to support our conclusions that the differential in electricity prices between NI and RoI can be explained with reference to the allocation of network charges and related government policy, and to the existence of different taxes & levies.

[4] For example, page 13 states that "Throughout the process, we also had to ensure we were always comparing like with like and therefore had to ensure our methodology was consistent with DECC".

[5] Structural similarities exist in terms of size, population density, isolation and dependence on fossil fuels.

The Single Electricity Market (SEM) is the wholesale market on the island of Ireland. The SEM is unusual, if not unique, in terms of the regulatory constraints it imposes upon generators to set prices in a cost reflective manner overseen by a dedicated market monitoring unit. The highly regulated SEM design is frequently heralded as a notable success by the Regulatory Authorities, including the UR, for delivering transparent, cost reflective prices and for promoting competition and new entry, as illustrated below.

SEM Committee Annual Report 2011 (published October 2012):

"The SEMC believes the market has worked well since its introduction in November 2007 and continues to deliver benefits to consumers through the use of efficient generation plant to meet demand across the whole island. The SEM model of setting prices in a transparent and cost reflective manner is not only assisting to promote competition and attract new investment, it has also resulted in improvements in the availability of generation plants".

Utility Regulator Annual Report 2011-12 (published October 2012):

"After over four years, the SEM continues to delivers benefits to consumers. The SEM ensures that the price of electricity charged to consumers is reflective of the costs incurred by the generators to actually produce the electricity".

There is no wholesale price differential between NI and RoI as both jurisdictions belong to the SEM. At a retail level the same companies compete in the LEU sector – suppliers to RoI and NI customers face the same issues regarding competitive forces, market liquidity and wholesale prices. Customers in NI are treated equally with those in RoI.

When it comes to the retail prices that customers pay, the wholesale price is a key component along with network charges, taxes and levies. With a common wholesale price and strong supplier overlap and competition across both jurisdictions, it is this latter group of network, tax and levy costs, independently determined and controlled by the respective authorities, that is the key driver of the price differentials between NI and RoI identified in the information paper. This is confirmed by our own detailed analysis presented below which provides a true like for like comparison and breakdown of large commercial (I&C) and domestic electricity costs in NI versus RoI. Unfortunately this clear explanation is impossible to discern from the analysis or narrative provided in the published information paper. This is principally because:

- No attempt has been made to disaggregate large I&C prices in Northern Ireland, separately identifying network charges, taxes and levies;
- No reference is made to the existence of significant LEU rebates in RoI over the period in question that would have skewed any comparison of large I&C prices between the jurisdictions; and

- There is no mention of Irish government policy calling for the rebalancing of network tariffs in favour of LEUs, and the subsequent delivery of c€50m savings per annum in network charges for RoI LEU customers funded by a rebalancing of domestic tariffs as implemented by the regulator in CER/10/102 and CER/10/206. The following statement from Minister for Communications, Energy and Natural Resources (Deputy Eamon Ryan) in October 2009 is illustrative:

> *"Restoring the competitiveness of Irish industry is a priority concern for Government. In that context proportionate rebalancing of network tariffs in favour of Large Energy Users (LEUs) has been called for, in order to mitigate the cost of energy for industry. Protecting jobs and economic activity is in the interest of every consumer and every citizen as Ireland's industrial electricity prices tend to be above average when compared with other EU Member States as a result of a variety of factors. The Government therefore agreed in July that the Commission for Energy Regulation (CER) be asked to undertake a measure of rebalancing of network tariffs next year in favour of large energy users"*
>
> *http://debates.oireachtas.ie/dail/2009/10/13/00055.asp*

- There is no discussion of important differences in I&C customer size and profile between the jurisdictions. I&C customers in RoI are much larger on average than their NI counterparts and this will skew any blunt price comparisons.

From our experience of customer reaction to the information paper the above omissions have led to misinterpretation, misunderstanding and misdiagnosis of a perceived problem that we as a supplier have no control over. Given the complexity of this area and the obvious sensitivities to be considered this is regrettable and potentially damaging to the perceived competitiveness of the Northern Irish economy.

3.1 Supporting analysis

We chose 45 large half hourly metered I&C customers in NI in the high voltage (T202/T203) category as these customers best matched the category of large I&C customer referenced in the information paper. We then calculated electricity costs for these customers based on outturn SMP & Capacity and for regulated NI and RoI charges. The RoI regulated pass through costs were based on the equivalent DG7 tariff - the same customer profiles were used as notional customers in RoI. An equivalent exercise was carried out for domestic customers in NI versus RoI. The results for 2011 and 2012 are as detailed in tables 1 and 2 below which disaggregates electricity costs as follows[6].

- System Marginal Price (SMP)
- Supplier Capacity Charges (Capacity)
- Market Operator Charges (MO)

[6] Appendix 1 provides a more detailed breakdown of the I&C analysis for 2011 and 2012.

- Imperfection Charges (IMP)
- Transmission Use of Systems (TUoS)
- Distribution Use of Systems (DUoS)
- Public Service Obligation (PSO)
- System Support and Services (SSS)
- The Renewable Obligation (RO)
- Moyle Costs known as Collection Agency Income Requirement (CAIR)
- Large Energy User Rebate (LEU Rebates)

It is important to consider the results in tables 1 and 2 below in the context of a delta of about £20+/MWh shown in the UR information paper between NI and RoI large I&C prices. It is very clear from our analysis that this divergence is driven by network charges and taxes & levies which is no surprise in light of the points discussed above.

Table 1: Analysis of End User Electricity Costs 2011

	2011			
	Domestic		*I/C*	
	NI	*ROI*	*NI*	*ROI*
SMP	64.78	64.78	56.63	56.63
Capacity	16.46	16.46	13.86	13.86
MO	0.64	0.65	0.62	0.62
IMP	3.48	3.57	3.32	3.33
TUoS	4.44	7.97	1.88	3.48
DUoS	26.77	38.71	6.08	3.81
PSO	4.73	7.18	4.68	1.97
SSS	3.30	-	3.05	-
RO	1.98	-	1.98	-
Moyle (CAIR)	-	-	-	-
LEU REBATES	-	-	-	- 8.09
	126.57	139.32	92.09	75.62

Figures in £/MWh

Summary results:

- NI domestic network charges & pass through charges are c£12.50/MWh lower than RoI.
- NI I&C network charges & pass through charges are c£16.50/MWh higher than RoI.
- Taxes and direct renewables support (CCL, Electricity Tax and VAT) increase I&C differentials by c£6/MWh (or greater for VAT exempt RoI customers)

Table 2: Analysis of End User Electricity Costs 2012

	2012			
	Domestic		I/C	
	NI	ROI	NI	ROI
SMP	62.37	62.37	54.22	54.22
Capacity	16.23	16.23	13.78	13.78
MO	0.62	0.62	0.62	0.59
IMP	4.68	4.66	4.72	4.44
TUoS	3.82	8.15	2.97	3.94
DUoS	29.52	38.94	6.96	4.10
PSO	3.55	4.13	3.60	1.68
SSS	3.60	-	3.40	-
ROC	2.98	-	2.98	-
Moyle (CAIR)	0.53	-	0.44	-
LEU REBATES	-	-	-	- 4.05
	127.90	135.10	93.70	78.70

Figures in £/MWh

Summary results:

- NI domestic network charges & pass through charges are c£7/MWh lower than RoI.
- NI I&C network charges & pass through charges are c£14.70/MWh higher than RoI.
- Taxes and direct renewables support (CCL, Electricity Tax and VAT) increase I&C differentials by c£6.30/MWh (or greater for VAT exempt RoI customers)

4. Concluding comments

Energia notes that the information paper, as proclaimed, is *"intend[ed] …to be a catalyst for further debate on the drivers behind electricity costs. [And that the UR is] "already planning some follow up work to th[e] initial paper [to include] projects such as disaggregation of the components of the final price… and review[ing] the allocation of costs across regulated network tariffs"* (p. 32). It is nonetheless disappointing, surprising and potentially damaging that a more complete analysis was not carried out in the first instance, especially given the availability of the required information (notably network tariffs approved by the regulator and taxes & levies which are publicly available) and the evident willingness of energy companies to engage with the Utility Regulator and contribute to the process.

The information paper claims to provide greater transparency and sees this *"as a vital first step to a shared better understanding"* (p.5). From customer feedback and Energia's own reading of the paper we do not share the view that it improves transparency as published or that it serves as a useful vehicle to stimulate debate. Rather it presents an incomplete analysis, is missing important information, does not

compare like with like, and therefore has real potential to misguide the reader. In light of the above we strongly caution against using this (incomplete and evidently misleading) information paper to inform policy and regulatory decisions. These points need to be considered in the context of the key findings underlined in the paper and associated press releases, based on comparative prices for 2011, that:

- *for domestic consumers, prices were around the EU average;*
- *for very small industrial and commercial (I&C) consumers, electricity prices were around the EU average; and*
- *for the remaining 30% of I&C consumers (who are not subject to regulatory price scrutiny) electricity prices were among the highest in Europe.*

With reference to domestic and very small I&C customers the information paper on more than one occasion states that *"These customers can avail of regulated tariffs. Whilst not stating a causal link at this stage, this is a fact, and an issue to be returned to in follow up thinking".* This could be considered an inference (which would be misleading) that retail competition in the I&C market is not working effectively in Northern Ireland and that this is an important driver of the price differentials highlighted in the information paper[8]. This is implausible given the market context and scale of the price differential identified (circa £20/MWh) between NI and RoI, and is clearly not the case as our analysis shows.

In terms of next steps, the UR has identified three priority key work areas for 2013/14. It is worth considering these, as outlined below:

1. A review of the effectiveness of competition in the I&C market;
2. Continue to robustly scrutinise network price control proposals (whilst allowing companies to finance); and
3. Efficient integration of wholesale market with Western Europe (including interconnector arrangements).

These next steps put forward by the Utility Regulator fail to address the difference in network charges, levies and taxes that explains the price gap between large I&C customers in NI versus RoI. With respect to item 1, supplier margin is a small component of the overall charge and this is well understood by customers[9] –Item 2 is effectively a statement of the Utility Regulator's statutory duties, and scrutiny of the network price control is currently the subject of a Competition Commission review.

[8] Such an interpretation would be further reinforced by the 'next steps' set out in the report which include "A *review of the effectiveness of competition in the I&C market".* Informal discussions with Energia's customers have confirmed that their interpretation of the information paper is that the efficacy of competitive versus regulated retail markets is being questioned.

[9] Given the diminutive scale of supplier margins the value added of dedicating valuable resources reviewing this issue further is highly questionable, especially following the in-depth inquiry into business electricity tariffs in Northern Ireland that concluded in March 2010.

Item 3 refers to market reform under regional integration. This has been instigated by a European mandate and is an on-going project involving the SEM Committee and all market participants.

We would also point out the well-known fact that electricity prices on the island of Ireland are higher than some other European counties because of our: (1) high dependency on imported fossil fuels; (2) need for essential network investment; (3) low population density; and (4) inability to realise economies of scale comparable with other countries[11]. Unfortunately there is little that can be done about this apart from reducing our dependence on fossil fuels and maximising the efficiency of interconnector trades, both of which are in hand through government policy on renewables and the regional integration process.

By way of further thoughts:

- Whilst mentioned in the information paper, insufficient prominence is given to the need for further analysis of the bill components and the allocation of costs across regulated network tariffs[12]. We consider it premature and superfluous to identify next steps as proposed or to speculate on price drivers without first completing the required analysis.

- The problems with the paper that have been identified in this response underline the need for 'sense-checks' and pre-publication engagement with industry experts in these and other regulatory matters.

- The issue must be re-analysed prior to any conclusions or actions being taken. We propose that the paper would benefit from revision based on a more detailed analysis of the factors influencing price development across member states.
- The analysis required must also be done on a true like for like basis – this includes using actual NI representative customer profiles as notional customers in other jurisdictions. Not to do this will invariably give misleading results.

[11] Quarterly SEM Price Report, Quarter 4 2012 (published 22 January 2013): "[SEM Prices are] at the upper end of prices across European markets. This is not unexpected given the island's size and reliance on imported fossil fuels."
[12] These steps are certainly not identified as a key work area for 2013/14.

Appendix 1 – Detailed I&C Analysis

Table 3: Detailed I&C Analysis 2011

	January 11-June11			July 11-December 11		
Exchange Rate	1.15			1.15		
Reg. / Govt. Charge	ROI (€/MWH)	ROI (£ equiv/MWH)	NI (£/MWH)	ROI (€/MWH)	ROI (£ equiv/MWH)	NI (£/MWH)
TUoS Energy Charge	€2.88	£2.50	£1.67	€3.08	£2.68	£2.06
TUoS Capacity	€0.95	£0.82		€1.10	£0.95	
DUoS Energy Charge	€2.47	£2.14	£3.29	€2.56	£2.23	£3.72
DUoS Capacity Charge	€1.55	£1.35	£2.07	€1.84	£1.60	£2.37
DUoS Std Charge	€0.16	£0.14	£0.36	€0.17	£0.15	£0.37
PSO Levy	€2.38	£2.07	£4.91	€2.16	£1.88	£4.44
SSS Levy			£2.98		£0.00	£3.11
Market Operator	€0.71	£0.62	£0.61	€0.72	£0.62	£0.62
Imperfections	€3.24	£2.82	£2.79	€4.43	£3.85	£3.87
Moyle (CAIR)			£0.00		£0.00	£0.00
ROC's			£1.86			£2.13
LEU Rebate (Energy)	-€9.03	-£7.86		-€7.37	-£6.41	
LEU Rebate (Capacity)	-€1.15	-£1.00		-€1.05	-£0.91	
TOTALS excl Taxes & VAT	€4.16	£3.62	£20.54	€7.64	£6.64	£22.70
CCL / Electricity Tax	€0.50	£0.43	£1.90	€0.50	£0.43	£2.23
VAT	€0.59	£0.51	£4.49	€1.06	£0.93	£4.99
Totals incl Taxes & VAT	€5.25	£4.56	£26.93	€9.20	£8.00	£29.91

Table 4: Detailed I&C Analysis 2012

	January 12-June 12			July 12-December 12		
Exchange Rate	1.21			1.25		
Reg. / Govt. Charge	ROI (€/MWH	ROI (£ equiv/MWH)	NI (£/MWH)	ROI (€/MWH	ROI (£ equiv/	NI (£/MWH)
TUoS Energy Charge	€3.28	£2.71	£2.55	€3.80	£ 3.04	£ 3.38
TUoS Capacity	€1.22	£1.01		€1.40	£ 1.12	
DUoS Energy Charge	€2.65	£2.19	£3.94	€2.75	£ 2.20	£ 3.91
DUoS Capacity Charge	€2.09	£1.73	£2.61	€2.23	£ 1.79	£ 2.68
DUoS Std Charge	€0.18	£0.15	£0.38	€0.19	£ 0.15	£ 0.40
PSO Levy	€1.86	£1.53	£3.96	€2.28	£ 1.82	£ 3.24
SSS Levy		£0.00	£3.25		£ -	£ 3.56
Market Operator	€0.72	£0.59	£0.63	€0.72	£ 0.58	£ 0.61
Imperfections	€5.64	£4.66	£4.97	€5.27	£ 4.21	£ 4.47
Moyle (CAIR)		£0.00	£0.00		£ -	£ 0.88
ROC's			£2.71		£ -	£ 3.30
LEU Rebate (Energy)	-€5.66	-£4.68		-€2.86	-£ 2.29	
LEU Rebate (Capacity)	-€0.91	-£0.75		-€0.47	-£ 0.37	
TOTALS excl Taxes & VAT	€11.07	£9.15	£25.01	€15.31	£ 12.25	£ 26.44
CCL / Electricity Tax	€0.50	£0.43	£2.26	€0.50	£ 0.43	£ 2.41
VAT	€1.53	£1.33	£5.45	€2.10	£ 1.83	£ 5.77
Totals incl Taxes & VAT	€13.10	£10.91	£32.72	€17.91	£ 14.51	£ 34.62