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Dear Elena

Draft Forward Work Programme 2013 - 2014

Power NI welcomes the opportunity to respond to the recent Draft Forward Work Programme 2013 - 2014 published by the Utility Regulator (UR).

The Forward Work Plan (FWP) is set at a high level and covers broad ranges of activities. There remain however, a number of key issues outstanding from previous years. Power NI believes these should be addressed. The activities include - a clear retail electricity market roadmap, action to address the lack of liquidity in the wholesale electricity market and a defined best practice approach to retail price controls.

Retail Electricity Competition

With active competition in all sectors of the electricity supply market within Northern Ireland, it remains the reasonable expectation of Power NI that the UR would outline their glide path to full electricity deregulation.

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. Regulation can inhibit the development of or distort competition and therefore the UR should be cognisant of potential unintended consequences of continued price controls, as illustrated by recent customer frustration regarding the lack of quotes available from suppliers as well as the lack of tailored products.

Over recent years extensive competition and switching has taken place within the commercial sector. This has also developed in the domestic market with clear evidence of active price competition. This clearly demonstrates the evolving nature of the electricity market in Northern Ireland, an evolution which will continue.

Power NI acknowledges the recent UR consideration of removing non-domestic groups from the scope of price controlled regulation. It is however incorrect to characterise the frustration felt by group customers as an “anomaly”; it is in fact a failure in the retail electricity regulatory framework and one that should be addressed without further delay.

The removal of the retail price control for groups will allow 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 similar frustration exists in the broader business sector and that given the level of competition, relevant market shares and customer awareness the UR should remove price control regulation for all non-domestic customers.

Wholesale Market Liquidity

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 it has a significant effect on end consumers. 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.

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 also continues to be extremely concerned with the UR’s inconsistent view of hedging transfers. The approach to date, has prevented Power NI’s participation in sectors of the non-price controlled 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 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.

Retail Price Controls

A 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 critical to the UR's duties. This can only be achieved within the current (and foreseeable) economic climate by the detailed assessment of capital requirements to finance a regulated 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 building block approach to analysis. Considering net margin in isolation, while driving opex allowances below an efficient level represents an unreasonable strategy.

The UR has also engaged in a series of short term price controls that are increasingly truncated and have lacked the supporting analysis that a regulated business would have the right to expect. Short price control terms remove the incentive for efficiency and compromises the basic premise of incentive regulation, which is to provide a reasonable return for risks taken in securing savings, with the greater proportion of savings passed to the customer.

In previous work plans a regulatory project focussed on defining best practice was included. While the scope was subsequently changed to look at network companies a defined regulatory approach to retail price controls remains an outstanding requirement.

Additional Items

In addition to the three main issues identified above, the UR should be cognisant of the implications of the IME3 amendments on the regulated tariff review. In recent years submission and approval of the regulated network related components of the end user tariff have slipped to such a degree that Power NI has had little time to announce the regulated customer tariff. Under the new licence amendments the notification period has increased and the method changed. This will require the UR to have concluded the network related elements much earlier. Power NI would also like to engage with the UR notification methodology so as to avoid a high cost, infeasible mailing solution.

As stated in other correspondence, Power NI welcomes the inclusion of a UR action to consult on and implement a new code of practice on marketing. Experience in the GB market has shown that door-step selling generates a high number of customer complaints and general dissatisfaction with the electricity industry. While Power NI does not engage in this practice, customer feedback and calls have made us aware of similar dissatisfaction in the NI market.

The implementation of the European Target Model for the wholesale electricity market is a project which will have a significant impact on the SEM and its participants. Power NI urges the UR to ensure that such participants are fully informed and engaged in the SEM redesign process. The principles behind the European Target Model look to maximise interconnector

usage for cross border trade, and sourcing of the most cost efficient production. While at a high level these are laudable, there is a risk that real benefits to consumers may not be realised should the detailed arrangements not be fully analysed or the solution be costly to implement.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'William Steele', written in a cursive style.

William Steele
Power NI