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Review of the Effectiveness of Competition in the Northern Ireland Energy Retail Market

For the Utility Regulator

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I Executive summary

I.1 Introduction

This assessment of the effectiveness of the Northern Ireland (NI) retail markets for electricity and gas was commissioned by the Utility Regulator (UR).¹ It is the first phase of a flagship project that is part of a wider programme of interlinking work to deliver the regulator's corporate strategy ambitions for the period 2014-19. The review sits alongside other important initiatives the regulator will undertake this year, including the development of its Retail Energy Market Monitoring (REMM) framework and of its Consumer Protection Strategy.

Cornwall Energy was awarded this project in May 2014. Professor Catherine Waddams of the Centre for Competition Policy, University of East Anglia, has also contributed her expertise in the production of this report. It is our own work and does not necessarily represent the views of the UR.

An Information Paper² was published by the UR in July 2014 that set out more detail on the approach to this review, as well as formally launching the assessment, and the factual background. The Information Paper also set out the context, including relevant energy industry background, customer metrics and market share.

While the markets for larger non-domestic electricity customers opened to competition in 2002, markets for households and smaller business customers were only opened in 2007 (but with no competitor entry occurring until 2010), and the incumbent supplier Power NI is still subject to price control outside of the larger business market. Total connections are less than 850,000, which makes NI very small compared with other member states of the European Union (EU).

The gas market is smaller and was initially opened to competition in the Greater Belfast area for larger consumers in 2006, and domestic consumers in 2010. As with the electricity markets, households and smaller business gas customers of the incumbent supplier SSE Airtricity are still subject to a regulated price. Total connections in the Greater Belfast area are less than 200,000.

Cornwall Energy has also developed a market segmentation that divides both markets into four subsets. In both cases, the domestic markets represent a single category. For the business markets we have banded them essentially to groupings that manifest similar characteristics, and these broadly map across to micro-businesses, other SME businesses and larger I&C businesses respectively.

We gathered quantitative and qualitative data and information from a wide range of sources to provide the evidence base for this review. The quantitative data provides insights on various metrics. These include switching trends, prices, levels of market concentration, and consumer satisfaction and complaint levels.

To assist the review, we undertook an omnibus survey of customer views on relevant issues and the state of competition in the energy markets. Field work took place during August 2014, comprising 20 questions put to 1,322 interviewees.

We also undertook structured interviews and some participants submitted written responses. The wide range of views, from entities in Republic of Ireland (RoI), Great Britain (GB), as well as NI, and across the market spectrum, including consumers (and their representatives), suppliers and trade associations, gave invaluable insight to contextualise the quantitative trends.

It should be stressed that our review of the NI retail energy markets at this stage does not seek to propose remedies. The issue of remedies, if necessary, will be addressed in the second stage of this process. The expectation is that the second phase of the review will commence after the publication of this assessment and after the UR has considered the scope and nature of the work for stage 2.

¹ In this report we use the term UR to refer to the executive and supporting team. The term NIAUR, which is the board of the regulator, is not specifically referenced.

² [Review of the Effectiveness of Competition in the Northern Ireland Retail Market—An Information Paper](#), July 2014.

1.2 Approach

We took as our starting point for the evaluation used in the review the five market characteristics used by the GB regulator Ofgem (working with the Competition Markets Authority (CMA) and the Office of Fair Trading (OFT)) in its recent *State of the Market Assessment*.

The five characteristics are:

- weak customer response;
- weak competition;
- vertical integration;
- barriers to entry and expansion; and
- tacit coordination.

Where relevant, we have tried to link in the various issues and comments flagged to us during the course of the review.

We have also placed emphasis on what we see as the important differentiating factors pertinent to the NI energy markets. In this context we have made a number of comparisons with neighbouring markets, especially GB and RoI, though for reasons we explain in this report these have limited validity.

Consequently, a range of other comparisons have been made in this report with a variety of smaller markets in the EU that seem to us to hold closer parallels to NI. In this context we specifically try to address issues faced by smaller markets and their regulators in the development of competition.

1.3 NI differentiators

We identified during the course of the review a range of factors that we believe have constrained the development of competition in NI. These are:

- the relatively short period compared with some European markets over which the energy markets in NI have been fully deregulated combined with the recent late entry of competitors into the domestic markets;
- the very small size of the NI energy markets, which are among the smallest in the EU, and which are bounded by neighbouring markets with very different trading systems and rules. This limits both the number of suppliers and the profits they can make;
- the hybrid nature of the current market framework, given that the large majority of domestic and small I&C volumes delivered in NI are still subject to price regulation. Price controls have been set to put pressure on supplier prices and this has consequential impacts for profitable offerings by new entrant suppliers, especially given the similar costs faced by all suppliers; and
- the limitations on access to dual fuel offers, which in turn reduces the cost savings realisable to drive the competitive process.

For the reasons we explain in more detail below, we do not expect these constraints to diminish significantly in the near to medium term.

1.4 Overall conclusions

The energy markets in NI are maturing with new entrants continuing to win market share from the two incumbents, Power NI in electricity and SSE Airtricity in gas³. Market shares are now pegged at 72% in terms of domestic electricity customers (69% market share by consumption) and 72% in terms of domestic and small I&C gas connections⁴ (69% market share by consumption). The figures are 71% of customers

³ For gas, figures are for Greater Belfast only.

⁴ We discuss below the different reporting classifications.

(37% by consumption) in electricity and 71% (56% by consumption) in gas in the Greater Belfast area for total markets.⁵ However, the rate of attrition in the market share of the incumbents has declined since Q2 2013.

We believe that overall NI has achieved reasonable levels of switching given its context of deregulation. Indeed rates in the period following the emergence of competition in the domestic and smaller business markets once new entry occurred from 2010 were good. These have slowed as the pool of active switchers has diminished and in the absence of the emergence of further alternative providers. There has also been steady erosion of the incumbent's market share in both the electricity and gas sectors. Indeed switching levels and loss of market share by the incumbents do not compare unfavourably to other small markets with a similar length of experience of liberalisation within the EU.

The incumbent's market share in both sectors remains high, and with few active suppliers conditions exist that are conducive to tacit coordination. In this context we have noted the discount approach to pricing adopted by competing suppliers, where they specifically price their offerings relative to the regulated prices applied to the incumbents. However, this is a rational approach to price setting that we would expect to see in relatively immature markets, and we have not identified any customer detriment arising from it.

Furthermore, market size will continue to limit the number of suppliers who can viably compete given the obvious limits on customer acquisition and the high level of fixed costs associated with market entry. These constraints are greater in gas than electricity markets given very low existing levels of gas penetration.

It is likely that most price sensitive customers will already have switched. Switching rates in both electricity and gas are unlikely to recover and might even continue to tail off. All suppliers face similar costs and achievable customer savings from switching are unlikely to change dramatically. Technology change is unlikely to be a significant factor over the near term, and indeed could raise entry costs. There is little scope for domestic customers to switch back to the incumbents given that all new entrants price at a discount to the incumbents in both gas sectors. Aggressive competition in other jurisdictions has been enabled by falling commodity prices and the ability to make dual fuel offerings, but these conditions are absent from NI.

Against this background, we find the UR's "ideal vision" set out in its May 2014 *Strategic Approach Information Paper*⁶ an appropriate set of objectives for small energy markets with the hybrid features present in NI, where liberalisation is progressing but with a high level of residual regulation. These features are based on a mix of measures to promote competition, with residual consumer protection through price controls and non-discrimination licence conditions. Consequently the blend of the two is, and will continue to be, somewhat different from regulatory policies exhibited in larger, more established markets with multiple competitors.

We also believe the NI experience strongly suggests that regulation and competition can usefully co-exist. Some form of direct price regulation is often necessary to deliver and sustain competitive entry until it is well-established. Even in an effectively competitive market consumers cannot be protected in all respects at all times. As we have seen in the GB market, the removal of price control does not invalidate regulatory intervention. Indeed in the case of GB the rate and degree of interventions has increased dramatically since 2008. Thus we believe a hybrid market can provide the dual benefits of competitive offering and regulated prices to ensure excessive profits are avoided, and there is transparency with regards pricing for regulators, government and customers.

Furthermore, in a small market with clear limits on the number of viable players, we see real risks of oligopolistic pricing and associated customer detriment if price controls are removed too quickly. In such circumstances it is a moot point whether sufficient suppliers are likely to emerge that will enable regulated pricing to be removed altogether. Consequently we would expect that this co-existence of competition with price regulation of the incumbents in NI will continue for some time. Competition could be stimulated by increasing the allowed profit (increasing "headroom") in the price controls, but we believe this will tend

⁵ http://www.uregni.gov.uk/uploads/publications/TransparencyReport_2014_AUG.pdf

⁶ [UR Strategic Approach to Energy Retail Markets and Consumer Protection An Information Paper](#), May 2014.

to create customer detriment as costs to customers will increase. At the same time new entry will continue to be limited by the size of the market and relatively high costs of entry.

Through the review we and stakeholders who we interviewed identified a number of measures that could or should be considered to improve the functioning of the energy markets in NI. These warrant consideration as part of the follow-up to this report and as the scope of stage 2 is considered. We note these in sections 1.6 and 4.4. While these measures might improve some aspects of the competitive process, for instance, improving customer access to information or improving predictability of costs, it is important to emphasise that they are unlikely to fundamentally change the competitive dynamic, and we would expect to see continuing price regulation being a feature of the market for some time to come.

1.5 Findings by customer segments

At a lower level we have reached a number of conclusions on the individual market segments. These are summarised at Tables ESI (electricity) and ES2 (gas) below.

Table ESI: Main findings on NI electricity market segments

Customer category (electricity)	Definition	Summary of findings
Household	A household in Northern Ireland.	<ul style="list-style-type: none"> Customers report relatively high levels of satisfaction and trust with current arrangements. Greatest concern is inability to easily access tariff comparisons. New entrants have taken significant market share from incumbent—although the incumbent is still dominant. Moderate savings to be gained from switching, especially as large parts of the market lack potential economies of scope in predominantly single fuel market. Customer proficiency, poor access to tariff comparisons and lack of switching culture dampens customer response. Price regulation currently creates the conditions for coordinated behaviour among suppliers. Switching levels are moderate but have declined. If this persists new entrants will struggle to grow customer numbers and prospective new entrants will be less likely to appear. Competition initially moderate but tending towards weak.
Very small I&C or micro-business	Any business that has an annual consumption below 20MWh/yr.	<ul style="list-style-type: none"> The market is less concentrated than the household market but currently exhibits very low (and declining) levels of switching. Customers have no comparison service to use—although brokers are appearing in the market. These services could improve consumer response (by proxy) and strengthen competition—but there is a desire from the majority of the market for accreditation to ensure fair treatment of customers and suppliers and to drive “honest broker” behaviour. Switching statistics indicate annual contracting.
Small I&C	Any business that has an annual consumption between 20MWh/yr and 50MWh/yr.	<ul style="list-style-type: none"> The market is less concentrated than the household and micro-business markets and currently exhibits low (and declining) levels of switching. Customers have no comparison service to use—although brokers are appearing in the market (more so than in the micro sector). These services could improve consumer response (by proxy) and strengthen competition—but there is a desire from the majority of the market for accreditation to ensure fair treatment of customers and suppliers and to drive “honest broker” behaviour. Switching statistics indicate annual contracting.
Larger I&C (Sometimes known as LEU)	Any business that has an annual consumption above 50MWh/yr.	<ul style="list-style-type: none"> This segment is less concentrated than the other segments and customers are sufficiently proficient to drive supplier behaviour, particularly at the larger end of the market, indicating strong customer response. Competition is robust, but some improvements to market processes (transparency and predictability of regulated charges) could reduce risks currently in the market and benefit suppliers and customers. Concerns were raised by suppliers regarding the ability to hedge along the trading curve under the current SEM arrangements; with some of the view the I-SEM would not improve conditions for suppliers. Wholesale and retail market interactions should be kept under review.

Table ES2: Main findings on NI gas market segments

Customer category (gas)	Definition	Rationale
Household	A household in the “Greater Belfast” gas market area.	<ul style="list-style-type: none"> Customers report relatively high levels of satisfaction and trust with current arrangements. Greatest concern is inability to easily access tariff comparisons. New entrants have taken significant market share from incumbent—although incumbent still dominant. Small savings to be gained from switching, especially as large parts of the market lack potential economies of scope in predominantly single fuel market Consumer proficiency, poor access to tariff comparisons and lack of switching culture dampens customer response. Price regulation currently creates the conditions for coordinated behaviour among suppliers. Competition initially moderate but tending towards weak.
Very small I&C or micro-business	Any business that has an annual consumption below 73.2MWh ⁷ /yr.	<ul style="list-style-type: none"> The market is less concentrated than the household market but currently exhibits very low (and declining) levels of switching. Customers have no comparison service to use—although brokers are appearing in the market (more so than in the micro sector). These services could improve consumer response (by proxy) and strengthen competition—but there is a desire from majority of the market for accreditation to ensure fair treatment of customers and suppliers and to drive “honest broker” behaviour. Switching statistics indicate annual contracting.
Small I&C	Any business that has an annual consumption between 72.3MWh/yr and 732MWh/yr ⁸ .	<ul style="list-style-type: none"> The market is less concentrated than the household and micro-business markets and currently exhibits low (and declining) levels of switching. Customers have no comparison service to use—although brokers are appearing in the market. These services could improve consumer response (by proxy) and strengthen competition—but there is a desire from majority of the market for accreditation to ensure fair treatment of customers and suppliers and to drive “honest broker” behaviour. Switching statistics indicate annual contracting.
Larger I&C (Sometimes known as LEU)	Any business that has an annual consumption above 732MWh/yr.	<ul style="list-style-type: none"> Customers are driving supplier behaviour, particularly at the larger end of the market, indicating strong customer response. Competition is robust, but some improvements to market processes (transparency and predictability of regulated network charges) could reduce risks currently in the market and benefits suppliers and customers.

⁷ 2,500 therms/yr

⁸ 25,000 therms/yr

1.6 Issues for consideration

It should be stressed that our review of the NI retail energy markets at this stage does not seek to propose remedies. The issue of remedies, if necessary, will be addressed in the second stage of this process. We have nevertheless identified some possible measures based around the various comments and suggestions put to us during the course of the review. In general these focus on steps that might improve information and thus help support switching and enable market participants to better understand industry cost trends going forward. They should form the basis of further consideration by the UR as it gears up for stage 2.

These areas for further consideration include:

- the UR should review its customer segmentation for both electricity and gas and how it is published. In this context we consider the approach we have adopted, which focuses on customers rather than consumption, has merit;
- assessing the appetite for a centrally administered comparison and switching site for both fuels that is independently accredited;
- assessing the gas switching process, and a review of the objections process for both fuels, which would verify the scale of concerns reported and determine if action is appropriate;
- there should be further consideration of longer notice periods for changes to uncontrollable third party charges. This would elicit to what degree any such change would be beneficial to the energy retail markets, against the potential detriment caused to the regulated companies in terms of reduced revenue recovery certainty;
- in this context the communication of how price regulation changes have been or will be derived could assist new entrant suppliers in hedging their own costs and pricing tariffs;
- the UR should consider whether market entry processes support efficient operation of the market;
- the household and smaller I&C market requires continued education on the process for taking advantage of the competitive retail market;
- an accreditation and suitable regulatory framework for brokers operating in the I&C market should be considered against existing legal and regulatory protection;
- the UR should consider how it might better fulfil the role of “critical friend” for prospective new entrants, including establishing a “road-map” for them in both electricity and gas, but also the resource implications of taking on such a role;
- as a minimum, the UR should nominate an individual to deal with market entry questions and concerns and ensure this role is visible to stakeholders;
- where regulatory changes are proposed they should also be assessed against the impact they could have on entry.

We also note and support the intention of the UR to keep under review:

- the relationship between wholesale and retail prices, and how these might be impacted by implementation of the I-SEM; and
- the impact of the allowed supply margins in regulated price controls on competitor pricing.

The expectation is that the second phase of the review will commence after the publication of this assessment and after the UR has considered the scope and nature of the work for stage 2.

2 Introduction and background

This assessment of the effectiveness of the Northern Ireland (NI) retail markets for electricity and gas was commissioned by the Utility Regulator (UR). It is the first phase of a flagship project that is part of a wider programme of interlinking work to deliver the regulator's corporate strategy ambitions for the period 2014-19.

Following a competitive tender Cornwall Energy was awarded this project in May 2014. Professor Catherine Waddams of the Centre for Competition Policy, University of East Anglia, has also contributed her expertise in the production of this report.

This report is all our own work and does not necessarily represent the view of the UR. A glossary of terms is at Appendix A.

2.1 Purpose of this review

The UR committed in its *2014-15 Forward Work Programme*⁹ to review the effectiveness of competition in the retail energy markets in NI.

The review sits alongside other important initiatives the UR will complete this year, including the development of its Retail Energy Market Monitoring (REMM) framework and of its Consumer Protection Strategy.

2.2 Approach

An Information Paper¹⁰ was published by the UR in July 2014 that set out more detail on the approach to this review, as well as formally launching the assessment, and the factual background. The Information Paper also set out context, including relevant energy industry background, customer metrics and market share and should be read in conjunction with this paper. A summary of key facts from the Information Paper is at Appendix B.

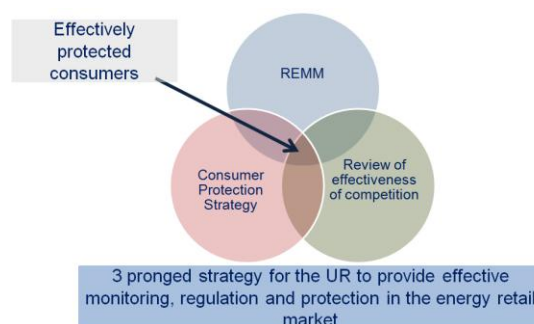
Cornwall Energy gathered quantitative and qualitative data and information from a wide range of sources to provide the evidence base for this review. A detailed listing of these can be found at Appendix C.

The quantitative data provides insights on various metrics. These include switching trends, prices, levels of market concentration, and consumer satisfaction and complaint levels.

To assist the review an omnibus survey of customer views on the state of competition in the energy markets was undertaken. A list of questions can be found in Appendix D.

We are grateful to the market participants that took part in structured interviews. A list of the questions and participants are at Appendix E and F respectively. The wide range of views from entities in Republic of Ireland (RoI), Great Britain (GB), as well as NI, and across the market spectrum, including consumers (and their representatives), suppliers and trade associations, gave invaluable insight to contextualise the quantitative trends.

Figure 2: UR's flagship projects, 2014-15



Source: UR workshop. 6 August 14

⁹ http://www.uregni.gov.uk/uploads/publications/FWP_201415_final.pdf

¹⁰ [Review of the Effectiveness of Competition in the Northern Ireland Retail Market—An Information Paper](#), July 2014

The evidence gathered has been used to assess the effectiveness of competition across five key market characteristics that are commonly regarded as accepted and understood indicators of features of imperfect markets.

This review did not assess the Ten Towns gas market area as the market will not open to retail competition for household and smaller I&C customers until April 2015.

2.3 GB parallels

The commencement of this review coincided with the beginning of the Competition and Markets Authority (CMA) review of GB energy markets¹¹. That review stemmed from a recommendation by the GB energy regulator Ofgem¹², following its *State of the Market Assessment*, which was commissioned in response to growing stakeholder concerns that wholesale and retail markets may not be working in the best interests of customers in the areas of its jurisdiction.

For the avoidance of doubt, our review is a bottom up health-check on the competitive state of the NI retail energy markets; it has no relationship with the CMA investigation, and it is not an “off-shoot” of it. Furthermore, we do not presuppose that the NI markets have in the past, or will in the future, follow a similar path as the GB markets.

Comparison with GB markets shows distinct differences, particularly in terms of context (especially size and history). Even now, following market opening, regulatory policies have important differences. For example, price caps in the early days of GB market opening were set explicitly to leave headroom for new entrants and to stimulate regional competition before they were removed. The changes occurred against a background of a 40% drop in wholesale markets between 1999 and 2002. In contrast the NI price caps have been applied in very different circumstances, and wholesale prices in the NI have not exhibited – or are not expected to exhibit – such a decline.

Moreover some of the issues that have arisen in GB, especially in the 2008 Energy Supply Probe¹³ and the subsequent Retail Market Review¹⁴ that commenced in 2011 – and which have had an important bearing on the CMA investigation – are not relevant to NI. This position has arisen partly because of the different development path of the markets and partly because the UR has observed developments in GB and other markets and taken steps to stop similar issues arising in NI.

For example, rules on customer transparency, marketing codes of practice and the presentation of bills in standardised form have been adopted in NI, to help avoid some of the difficulties that had been observed in the GB market despite its record of longer and deeper competition. Similarly, European competition law imposes particular constraints on discrimination on undertakings which are dominant, as remains the case with the incumbents in NI; consequently the UR has emphasised this requirement within the price cap regulation, so that it does not arise as a separate issue.

The GB experience should not of course be disregarded. While both reviews are separate, have different aims and are being conducted over different timeframes, they are addressing similar questions. We have conducted this assessment by reviewing the same characteristics identified by the *State of the Market Assessment*; carried out jointly by Ofgem / CMA / OFT.

These characteristics focus on the existence and implications of:

- weak customer response;
- weak competition;
- vertical integration;
- barriers to entry and expansion; and
- tacit coordination.

¹¹ <https://www.gov.uk/cma-cases/energy-market-investigation>

¹² <https://www.ofgem.gov.uk/publications-and-updates/state-market-assessment>

¹³ <https://www.ofgem.gov.uk/electricity/retail-market/market-review-and-reform/retail-market-review/energy-supply-probe>

¹⁴ <https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/retail-market-review>

We ask if these characteristics are evident in the current NI market and, if so, what they show both in isolation and combination.

2.4 Differentiators

We were aware throughout the review that NI is significantly different from the neighbouring GB and RoI retail markets. There are at least four important differentiators, all of which have implications for competition in NI energy markets.

2.4.1 Time since deregulation

Firstly, the markets in NI are not as mature as those in GB or even in RoI—although, looking farther afield across Europe, the market is at a similar stage of liberalisation to many others. Maturity in this context is not a rigid definition. Retail markets in NI have been progressively opened up only since 2002 in the case of electricity (2006 for domestic consumers) and more recently since 2006 in the case of gas (2010 for domestic consumers).¹⁵

A background note on the Third Energy Package is at Appendix G. This has been a key driver of regulatory measures to stimulate competition across Europe.

2.4.2 Market size

Secondly, the NI retail markets are physically much smaller than the neighbouring markets. There are around 785,000 household electricity customers, 60,000 electricity business customers, 168,000 household and small business gas customers, and just over 3,200 larger gas business customers (in the Greater Belfast area¹⁶). In customer number terms the NI electricity market is just over a third of the size of the RoI market and around 3% of the GB market. In gas, the NI market is just under one third of the size of the RoI market but around 1% of the GB market.

Indeed NI has one of the smallest gas and electricity markets in the European Union. In population terms it is on a par with Estonia, and only Cyprus, Luxembourg and Malta have fewer inhabitants. For the purpose of this review, comparison with similar sized markets can only provide a high-level indication of how those jurisdictions have approached retail competition. Nevertheless we consider these markets, specifically the five characteristics listed above.

Data on other smaller markets and other relevant European trends is at Appendix H.

The context of market opening is very different to the GB market. For instance in GB there were fourteen different geographical electricity retail zones each of which started with a different incumbent and aggressive “out of area” and cross fuel competition. NI is a single zone, and much smaller than the smallest in GB.

2.4.3 “Hybrid” competition

A third differentiator is the regulatory approach in NI, notably the existence of supply price controls across a large part of the incumbents’ business.

Power NI has a 37% share of the total electricity market by consumption and retains around 69% of the domestic market by consumption¹⁷. Domestic electricity customers and smaller non-domestic industrial and commercial (I&C) customers are protected by a regulated tariff set out in Power NI’s supply licence (99.8% of its consumers; 87.5% of its consumption). Larger I&C customers of Power NI, and customers of other electricity suppliers in NI, are currently not covered by the price control regime. These provisions are backed up by comprehensive non-discrimination licence obligations.

¹⁵ The ACER Market Monitoring Report 2013 reported that as of the end of 2012 Estonia, France, Greece, Malta, Romania and Spain all had regulated prices for domestic and small business consumers.

¹⁶ The Ten Towns area is out of scope for this review. As of Q2 2014 there were 21,167 household and 2,201 business customers.

¹⁷ http://www.uregni.gov.uk/uploads/publications/TransparencyReport_2014_AUG.pdf

The situation is similar in the gas supply market. In Greater Belfast, SSE Airtricity (formerly Phoenix Supply Limited) is the incumbent supplier. It has a 56% share of the total gas market by consumption and retains 69% of the domestic and small I&C market by consumption. The company's domestic and smaller non-domestic I&C gas customers are protected by a maximum average price approved by the UR (98.6% of its consumers; 62.2% of its consumption). Larger I&C customers of SSE Airtricity using above this threshold, and customers of other gas suppliers in the Greater Belfast area, are not covered by the UR's supply price control regime.

The European Court of Justice¹⁸ clarified in a case in 2008 the criteria under which regulated prices could be compatible with internal energy market legislation. These were where the measure is: in the general economic interest; compliant with the principle of proportionality; clearly defined, transparent, non-discriminatory and verifiable; and guarantees equality of access for EU energy companies to national consumers.

This position provides important practical questions for national regulators. The legislation is, for instance, silent on what a member state should do in a "hybrid" market, that is, if it has competition in its retail market but still a supplier who has a market share that indicates by any conventional measure that it has market power and is a dominant player.¹⁹

NI is a good example of such a hybrid market, a large part of which is still price regulated.

2.4.4 Dual fuel capability

A fourth important feature is that there is not a dual fuel market in NI at present. This is important as it means that economies of scope from cross-selling gas into electricity, and vice versa, are absent.

This position is in contrast to several energy markets that have experienced high switching levels, such as GB and Netherlands. In those markets, electricity supply is universally accessible, gas penetration is also widespread, and dual fuel competition is the norm, especially in domestic markets.

2.4.5 Implications

Due to these differences, the comparisons we have made of market metrics between NI and neighbouring markets are points of reference rather than specific measures of performance.

Furthermore, timing of liberalisation, concentration and size considerations, as well as similarities in the economic regulatory structures, suggest that of the two neighbouring markets the RoI is a more relevant proxy market than GB for the purposes of comparison, though even this comparison should be used sparingly.

Ultimately, however, the NI path of opening retail markets shows distinct differences to that followed in neighbouring markets, and there is no expectation that these paths should converge now or in the future. We consider it is more helpful to compare the development of competition in NI retail markets with experiences at a similar stage of market opening in other EU jurisdictions, especially those that are small, to obtain a sense of expected progress.

2.5 NI market segmentation

Most energy consumers will want the same outcomes from the market. These can be loosely defined as having fair access to safe, sustainable and secure supplies of energy at a reasonable price. They will also want availability of relevant information to make informed choices regarding their consumption and choice of supplier(s).

Specific groups of consumers though have differing needs and desires regarding the quality and quantity of their energy and their ability to pay for it. These differences in turn will drive how they choose to interact

¹⁸ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:161:0006:0006:EN:PDF>

¹⁹ Furthermore, it does not address how price regulation might apply to sub-sets of consumers (for instance vulnerable customers on social tariffs, which remain commonplace throughout Europe).

with the retail market (or choose not to as the case may be) and motivate competing retailers to innovate around service, price or products.

In conjunction with the UR we have assessed consumer segmentation in the retail markets. These categories are split by access to fuel for the domestic (or household) retail market and by consumption levels in the non-domestic (industrial and commercial or I&C) markets.

As well as for domestic customers, regulated tariffs provided by the gas and electricity incumbents are in place for smaller business customers, with customers having choice between these and new entrant offers. Above defined consumption thresholds covering these market segments, prices are not regulated.

Within the smaller non-domestic market, the large majority of customers have relatively low consumption levels. Given the characteristics of these “micro” business consumers and as the NI economy features many smaller businesses, the review therefore further segmented non-domestic markets where regulated prices exist to include a category for low consuming businesses.

The non-domestic markets in our analysis therefore segment into three parts.

The segmentation is shown at Table 1 for electricity and Table 2 for gas. All figures are taken from the UR’s *Annual Energy Retail Report 2014*²⁰, with the exception of the market shares for Power NI that are taken from *The 2014 Power NI Supply Price Control Decision Paper*²¹. It should be noted that for reporting purposes the UR employs different consumer segmentation for I&C customers in electricity. This is to ensure commercially sensitive data cannot be gleaned from published sources.

2.5.1 Comments on general market segmentation

With regard to the information on customer segmentation and how it is gathered and published, the following points emerged during the course of the review.

A number of interviewees said they believed that there would be benefits in aligning how the market is segmented by customer type in NI with how it was segmented in RoI and/or GB, despite these jurisdictions each having their own different classifications. The reasons given were that it would assist new entrants, particularly those already present in a neighbouring market, with their assessment of the NI market, prior to committing whether to enter and, if so, how.

Others commented that, if alignment were possible, it would better help understand if non-competitive costs (that is regulated or mandated elements of the customer bill such as network charges, government policy programme costs and taxes) were apportioned on a similar basis to comparable consumer segments in neighbouring markets.

2.5.2 Domestic consumers

We were not asked to review specifically whether markets may or may not be working in the interests of vulnerable consumers, but this issue came up in a number of interviews. We recognise that defining and measuring vulnerability is fraught with difficulties and can include income, health, age, and rurality.

As the UR’s REMM programme is developed, the regulator will want to include metrics that adequately capture where specific market outcomes may be to the detriment or benefit of vulnerable household customers. The regulator’s office is also reviewing its Consumer Protection Strategy, which can also be expected to address fuel poverty issues and their interaction with economic regulation in more detail.

Others commented on the possible benefits of being able to distinguish between different consumption levels at the household level. Data available on different consumption types and social classification in NI is limited.

²⁰ http://www.uregni.gov.uk/uploads/publications/ERR_2014.pdf

²¹ http://www.uregni.gov.uk/uploads/publications/Power_NI_Price_Control_Decision_paper_v20.pdf

Table 1: Consumer segmentation—electricity

Customer category	Definition	Scope and scale
Household	A household in Northern Ireland.	<p>40.2% of total electricity market by volume.</p> <p>27% of the domestic market is now supplied by new entrants (by customer number).</p> <p>Power NI customers have a regulated price.</p>
Very small I&C	Any business that has an annual consumption below 20MWh/yr.	<p>4.2% of total electricity market by volume.</p> <p>Around 64% of the I&C electricity market, by meter numbers, comprises businesses that fall within this consumption band.</p> <p>Power NI (combined with its sister affiliate, Energia) retain 57% of market share in the 0-50MWh/yr market.</p> <p>Power NI customers have a regulated price.</p>
Small I&C	Any business that has an annual consumption between 20MWh/yr and 50MWh/yr.	<p>Volume market share data for this definition is not publically available.</p> <p>Around 19% of the I&C electricity market, by meter numbers, comprises businesses that fall within this consumption band.</p> <p>Power NI (combined with its sister affiliate, Energia) retain 57% of market share in the 0-50MWh/yr market.</p> <p>Power NI customers have a regulated price.</p>
Larger I&C (Sometimes known as LEU)	Any business that has an annual consumption above 50MWh/yr.	<p>Volume market share data for this definition is not publically available.</p> <p>Larger businesses, by meter numbers, account for the remaining 17% of the electricity I&C market.</p> <p>I&C businesses are not price regulated.</p>

2.5.3 Business consumers

We received comments that segmentation in the business markets should consider looking at meter measurement frequency (e.g. half hourly or other), as this can be used as a proxy by suppliers for the cost to serve different types of customer. Moreover, definitions using consumption levels mask those sites that are part of a group, such as a retail chain.

The small gas customer market (<73,200kWh/yr) was difficult to differentiate as meters could be household or business. A proposed solution was for industry processes to “flag” a meter as being either domestic or non-domestic. However, we understand from the UR that suppliers already hold this information, and make it available to the regulator, and we see no reason why this cannot be made publicly available.

A number of very large business customers (and suppliers) noted that the “larger I&C” definitions used for this review embraced relatively small consumption levels. This approach nevertheless follows the classifications used by suppliers.

For comparison the RoI regulator segments electricity consumers (for the purposes of its most recent *Annual Report*²²), by distribution connection voltage level and gas consumers through a combination of supply point capacity and annual consumption levels. Ofgem, in its most recent *Great Britain and Northern Ireland National Reports to the European Commission*²³, variously defined by metering type (half hourly or non-half hourly for electricity and non-daily metered or daily metered for gas) or domestic, micro-business, SME, or larger business by consumption and/or employee numbers.

²² <http://www.cer.ie/docs/000876/CER14134%20Electricity%20&%20Gas%20Retail%20Markets%20Annual%20Report%202013.pdf>

²³ <https://www.ofgem.gov.uk/ofgem-publications/89147/nationalreport2014updated.pdf>

Table 2: Consumer segmentation—gas

Customer category	Definition	Scope and scale
Household	A household in the “Greater Belfast” gas market area.	<p>The domestic and very small I&C market accounts for 49.1% of total gas market by volume.</p> <p>SSE Airtricity customers have a regulated maximum average price. 27% of customers with an annual consumption below 73.2MWh/yr are now supplied by new entrants.</p>
Very small I&C	Any business that has an annual consumption below 73.2MWh ²⁴ /yr.	<p>The domestic and very small I&C market accounts for 49.1% of total gas market by volume.</p> <p>Around 57% of the I&C gas market comprises businesses that fall within this consumption band.</p> <p>27% of customers with an annual consumption below 73.2MWh/yr are now supplied by new entrants.</p> <p>SSE Airtricity customers have a regulated maximum average price.</p>
Small I&C	Any business that has an annual consumption between 73.2MWh/yr and 732MWh/yr ²⁵ .	<p>15.2% of total gas market by volume.</p> <p>Around 36% of the I&C gas market comprises businesses that fall within this consumption band.</p> <p>SSE Airtricity has 52.8% market share (by consumption) of all customers consuming in excess of 732,000MWh/yr.</p> <p>SSE Airtricity customers have a regulated maximum average price.</p>
Larger I&C (Sometimes known as LEU)	Any business that has an annual consumption above 732MWh/yr.	<p>35.8% of total gas market by volume.</p> <p>SSE Airtricity has 52.8% market share (by consumption) of all customers consuming in excess of 732,000MWh/yr.</p> <p>I&C businesses are not price regulated.</p>

2.5.4 Conclusions

The segmentation we have used allows a sensible decomposition of the NI markets. We are nevertheless sympathetic to many of the points raised with us. The UR may wish to consider how it segments the market in the light of this review and through its related REMM work. It should have particular regard to the definition and composition of vulnerable customers.

Consistency for consistency’s sake with neighbouring markets would not, however, seem appropriate. Further rationalisation across markets would appear to be a matter for ACER.

2.6 Next steps

It should be stressed that our review of the NI retail energy markets at this stage does not seek to propose remedies. The issue of remedies, if necessary, will be addressed in the second stage of this process.

The expectation is that the second phase of the review will commence after the publication of this assessment and after the UR has considered the scope and nature of the work for stage 2.

²⁴ 2,500 therms/yr

²⁵ 25,000 therms/yr

3 Review assessment and findings

To assess the five market characteristics described in section 2, we were mindful of the guidance²⁶ issued by the CMA (originally developed by the Competition Commission) and the *State of the Market Assessment* on the GB energy markets by Ofgem²⁷. The CMA guidance is primarily there to explain how it may conduct market investigations (as it is doing in the GB energy markets at present) within a framework to identify and propose remedies for adverse effects on competition.

We have used the guidance to ensure that the assessment of aspects of the NI energy markets are undertaken by reference to accepted and understood principles, but taking into account the specific circumstances on the ground.

We have also referenced the UR's "ideal visions" from its strategic approach published earlier this year, and previous work by the UR, which we summarise in the box below.²⁸

Box 1: UR's "ideal visions" for future energy customer environment

1. Well-informed consumers should have clear and easily understood information and awareness of different suppliers, products and tariff/service choices resulting in uncomplicated, high-quality decision-making by consumers. Consumers should be able to easily weigh up their options and switch supplier if they wish to.
2. All consumers should benefit from competition as much as possible, but they should also be protected by ongoing regulatory action when competition remains weak. This regulatory action is transparent, proportionate and developed through appropriate analysis and consultation.
3. The UR should build on existing work to effectively monitor supplier and customer activity in the energy retail markets to ensure the market is operating effectively, and to provide information to the regulator, stakeholders and importantly to customers themselves, to allow transparent and effective decision making.
4. Customers, especially vulnerable ones, should be adequately protected in the NI energy markets. There is much evidence that vulnerable customers may not be able to benefit as much as others from the benefits of competition, and may need an extra layer of regulatory protection.

Source: [UR Strategic Approach to Energy Retail Markets and Consumer Protection An Information Paper May 2014](#).

The five characteristics are assessed individually below. In each case we define what the characteristic is, comment on it in the specific context of the NI retail energy markets and then state our conclusions. Their impacts on the effectiveness of NI energy markets cannot be considered in isolation; inevitably there are linkages and overlaps.

3.1 Weak customer response

3.1.1 What it is

The full benefits of competition will not be realised if customers do not actively respond to offers in the market or engage with suppliers. In this context, the OFT has developed its "3 A's" framework—this considers whether the demand-side is effective when consumers are able to access, assess and act on information. In turn the existence of such a situation may enable suppliers to avoid pricing keenly, discourage innovation, improve service levels or otherwise react to consumer wants.

There are numerous circumstances in isolation or combination that can result in weak consumer response. These include:

- low levels of consumer proficiency to engage with markets because information is difficult to find or understand;

²⁶ [Guidelines for Market Investigations: Their Role, Procedures, Assessment and Remedies](#), April 2013. CMA.

²⁷ <https://www.ofgem.gov.uk/publications-and-updates/state-market-assessment>

²⁸ Various reports, including price control settlements, vision for competition etc.

- poorly functioning market processes, such as the mechanisms to switch providers; and
- perceptions (or the reality) that engagement would not deliver benefits that outweigh the effort to engage.

Information asymmetries between suppliers and customers might also have adverse effects on competition, such as the detrimental effect of presenting suppliers pricing for a single product in a complex manner. In the case of energy where the product is homogenous (in the case of electricity and gas separately, it is uniform and undifferentiated) energy suppliers are only able to compete on price and service. However actual consumer spend can be very sensitive to consumption levels. Typically different combinations of fixed and variable charges are applied to different consumption levels, making meaningful comparisons difficult for all but the most informed customers.

In this context it is relevant that, as part of its RMR²⁹ in 2011, Ofgem found in GB that large numbers of tariffs with complex structures and discounts made it difficult for consumers to engage in the market. It concluded that suppliers were able to behave in a manner that resulted in customers being exposed to unnecessarily costly and/or complex means to compare offers. This in turn drove lower levels of engagement.

Furthermore, switching from one supplier to another may be made difficult for customers by the costs of doing so or onerous market processes (such as the switching systems or processes associated with debt-blocking and erroneous transfers). Previous customer experience of engaging in switching could also be relevant.

Where information is unhelpful or where dissymmetries are present, the time cost of switching can be high or the process unpredictable and not in line with the customer's expectation. This situation is likely to result in a greater number of "sticky" customers remaining with their supplier. In this context regulated tariffs can provide reassurance that costs are being priced in appropriately by the incumbents and also provide a suitable basis for comparison for competitors and new entrants.

3.1.2 How it was assessed

We examined the number of suppliers and switching rates as well as the opportunities consumers have to access information on supply offerings and services levels, using data available in the UR's *Quarterly Transparency Reports* (QTRs). We also considered reported satisfaction levels, complaint numbers and results from periodic "omnibus" consumer attitude surveys. This data was augmented with the responses provided during the interviews.

We sought to understand levels of engagement represented by switching levels and also awareness levels of the ability to switch, we then looked at how these differed for the consumer segments, and where possible reasons for this. High switching rates could be interpreted as a sign of adequate consumer awareness and competition. Conversely low switching rates may point to the levels of competition or regulation equalising prices. Switching data therefore needs to be read in conjunction with other indicators and analysis, for instance whether switching rates change where a supplier changes its pricing.

Satisfaction levels can also be used to measure customer response. There are other, less visible consumer responses that can increase competition—for example, a customer changing tariff to another offered by the same supplier, electing to change payment methods, and tariff enquiries/seeking quotes that do not result in switching. It should be noted that the evidence gathered and its analysis can only indicate customer response levels. There are many other aspects that influence consumers decisions to engage with markets, including behavioural biases, which themselves can be driven by the media, peers, and market participants, which we have not been able to measure.

As we have already indicated, we also believe access by customers to both gas and electricity is an important factor that can impact the scope of competition.

²⁹ <https://www.ofgem.gov.uk/publications-and-updates/retail-market-review-findings-and-initial-proposals>, p19.

3.1.3 Findings

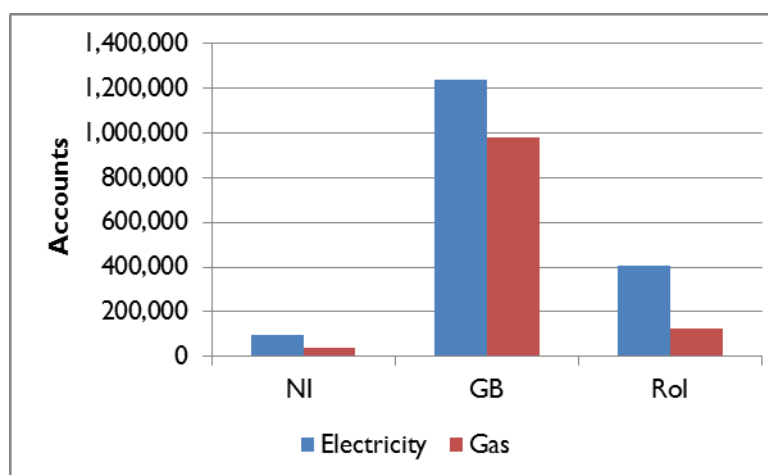
In assessing the level of customer response we have segmented our analysis under the following headings:

- number of suppliers;
- switching rates;
- awareness of switching;
- dual fuel penetration;
- marketing channels;
- switching process and objections; and
- interaction with price regulation

Number of suppliers

The pool of energy suppliers in NI is small, across all market segments. The latest QTR shows eight active electricity suppliers and four active gas suppliers—it should be noted though that not all suppliers are active in all market segments. This must in part be explained by the smallness of the market, which limits the opportunities to grow and the associated economies of scale that can reduce supplier costs and therefore their prices.

Chart 1: Average accounts/supplier in NI, GB and Rol



Source: Regulatory data assessed by Cornwall Energy

One consequence of NI's limited market size is the low ratio of accounts per supplier; there may be a small number of suppliers but the total number of accounts in both fuels probably cannot viably support many more. There simply are not enough customers to be acquired to cover high fixed costs and permit a reasonable profit margin. Chart 1 shows this information for NI and the two neighbouring markets.

Related to this, there is no metric we are aware of that measures new entry into domestic energy markets on a consistent basis. ACER considers entry and exit combined, and suggests that expressed as a percentage of the average number of active suppliers in the market activity in

NI over the period 2009-12 is higher than in all other members states other than two (being Greece and Belgium).^{30,31}

However, the same source shows that NI is one of only three jurisdictions where it says the number of active suppliers has decreased over the period (the other two are Greece but also Romania).³²

In conclusion we believe the size of the NI energy markets places real limits on the number of suppliers that might operate viably. This is a fundamental factor limiting the competitive potential in NI energy markets that we return to later in the report.

Switching

³⁰

http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202013.pdf

³¹ ACER attributes the high level of activity in Belgium to a very intensive campaign to better inform consumers about prices and the possibility of switching, against the backdrop of an imminent price freeze.

³² It is unclear why ACER thinks the number of suppliers in NI has declined.

Chart 2 shows the number of domestic electricity switches in NI averaged around 5,000 switches per month in 2013-14, which represents over 7% of domestic consumers annually.³³ This represents a halving from record levels experienced over the winter of 2012-13. Both historic and current levels have been lower than GB³⁴ and Rol³⁵, who both averaged about 12% domestic electricity switching per year in 2013-14, but where there have also been reductions over recent years.

Chart 3 shows gas switching rates in the domestic sector (Greater Belfast) have been decreasing over the last year, and averaged over 1,000 switches per month for 2013-14. This also represents about 7% of consumers, but which prior to this year were running at an annualised rate of twice this level.³⁶ Again the current level is less than GB³⁷ and Rol³⁸, whose domestic gas switching was around 11% and 12% per year respectively in 2013-14.

Annual average data, including annualised year to date data for the domestic markets is shown at Chart 4. After over two years of generally increasing switching numbers, there has been a sustained slow-down in churn since the beginning of 2013. Despite the differences in scale, the switching trends are similar.

Chart 2: Domestic switching—electricity

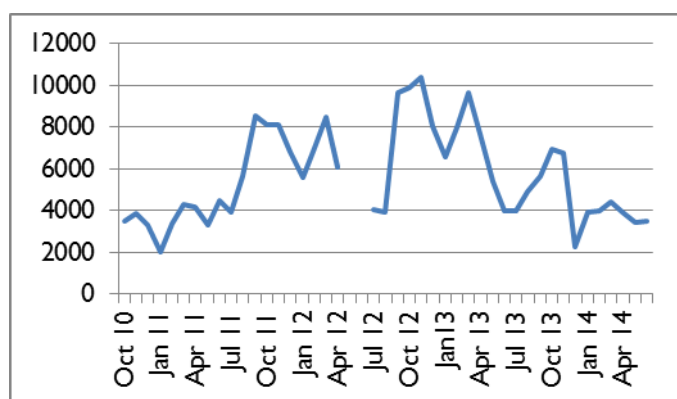
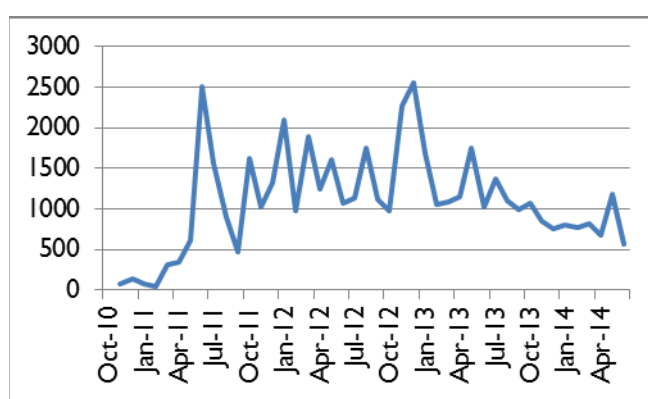


Chart 3: Domestic switching—gas



Source: Utility Regulator

SME electricity switches³⁹ averaged around 305 switches per month in 2013-14, which represents a switching rate of about 6% per year. Again, neighbouring markets have displayed higher rates of switching. We recently estimated that 30% of SMEs have switched energy suppliers over the previous six months in GB⁴⁰. Rol has a SME electricity switching rate of 22% per year⁴¹, according to CER.

Total gas I&C switches have averaged 16 per month over the last year, which is 6% of applicable businesses per year. This is again below levels in neighbouring markets, such as Rol where SME gas switching is 23% per year, according to CER.

The results of the 2014 August omnibus survey indicated that a large proportion of respondents were not engaged in energy switching, with 60% of electricity consumers and 63% of gas consumers in Greater Belfast saying they had never switched. This position is comparable to GB where 58% of domestic electricity energy consumers said recently they had never switched or didn't know whether they had switched and

³³ Chart 2 does not include May 2012 and June 2012 results, as a cap on switching caused a substantial dip and spike. The figures from the August QTR are 1.4% quarterly for electricity and 1.5% quarterly for gas, suggesting the annualised rate is currently running at around 6% in both domestic markets.

³⁴ <https://www.ofgem.gov.uk/ofgem-publications/86804/assessmentdocumentpublished.pdf>

³⁵ <http://www.cer.ie/docs/000971/CER14136%20Consumer%20Survey%202014%20Report.pdf>

³⁶ A similar phenomenon has been observed in other markets partly explained by tighter regulation on direct marketing.

³⁷ <https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-switching-statistics>

³⁸ <http://www.cer.ie/docs/000971/CER14136%20Consumer%20Survey%202014%20Report.pdf>

³⁹ SME < 70KvA and SME > 70KvA

⁴⁰ Cornwall Energy: *Third Party Intermediaries in the Business and Industrial Energy Supply Markets, 2014*, p16. Subscription report only, but made available to the UR.

⁴¹ <http://www.cer.ie/docs/000971/CER14136%20Consumer%20Survey%202014%20Report.pdf>

61% of domestic gas customers⁴², although the actual number is known to be lower in GB (based on retained market shares of incumbents).

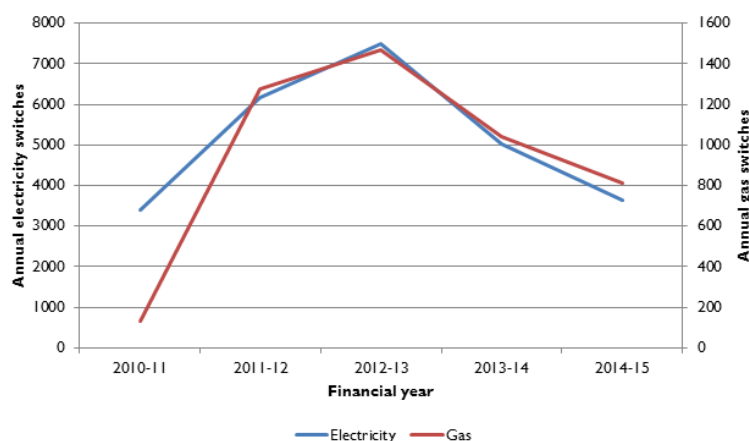
Respondents who had previously switched said they were more likely to switch again; 53% of electricity consumers and 66% of gas consumers who had switched once said they would do so again. However, the proportion of consumers unwilling to switch again was found to be higher in NI than GB. 42% of electricity consumers and 29% gas consumers were unwilling to switch again, compared with 26% of energy consumers in GB.⁴³

It is clear that switching levels in NI are low in absolute terms but not relative to other markets. A number of smaller jurisdictions have seen no competitive entry, and other markets - some considerably bigger than NI with many more suppliers - have experienced lower switching rates in both electricity and gas. Notably markets such as Poland, Slovenia, the Czech Republic and Denmark in electricity and Slovenia, Slovakia and Portugal in gas, which have more suppliers, have achieved lower switching levels.

In both electricity and gas there is, however, a deteriorating trend since 2013. Low and deteriorating switching rates are not unique to NI. ACER in a survey of national regulated authorities conducted in early 2013, identified the difficulties and reluctance associated with switching as one of the main barriers to entry across Europe⁴⁴. A summary of ACER findings can be found in Appendix H.

Based on data from 2011 and 2012, Northern Ireland was grouped with a number of other jurisdictions including Austria, France, Denmark, Greece, Hungary and Poland that were described as “countries with low switching rates”. Bulgaria, Cyprus, the Baltic States, Luxemburg and Romania had minimal or no switching in the household sector. The average switching rate in member states with at least partial household price regulation was 6.5%, so NI ranking was above the average in this respect at the time of the survey.⁴⁵ Furthermore, markets with high switching rates either had a much longer history of deregulation, high levels of dual fuel access or both.

Chart 4: Average monthly annualised switching rates for electricity and gas



Source: Utility Regulator

We think the ACER data and commentary from the 2012 review does not set out the full picture, as it does not note that some countries with regulated prices also achieve much higher switching rates. It also fails to observe that the countries with the highest churn are also those with the longest legacy of market opening and in most cases are considerably larger. Indeed NI would seem to have performed well when compared against competitive markets at a similar state of evolution.

High churn rates require careful interpretation. There is evidence that customers can make poor switching decisions based on erroneous or inappropriate consumption data. The data also does not pick up on switches

between offerings of the same supplier, for instance, between variable and fixed tariffs, or between payment method.

⁴² [Customer Engagement in the Energy Market-Tracking Survey 2014](#), Ipsos MORI, June 2014, p12-13.

⁴³ [Switched on? Consumer Experiences of Energy Switching](#), Consumer Futures, Jan 2013 p.23-25. Polling was carried out with 4,154 adults across Great Britain.

⁴⁴ *The ACER Review 2012*, p9.

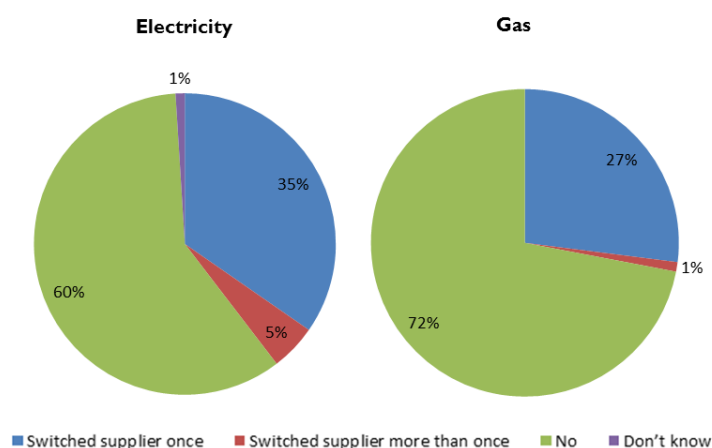
⁴⁵ As above, p33.

There have also been a rising number of regulatory interventions in several markets, and some of these interventions are much wider in scope than those in NI. For instance, in GB all of the Big Six suppliers have been subject to mis-selling inquiries resulting in fines and payments to consumer groups in excess of £30mn. All suppliers are now subject to standards of conduct and a high level of prescription as to what is permissible marketing and how they should engage with customers, and these restrictions are set to remain in place at least until 2017.⁴⁶

Awareness of switching

Awareness of switching remains high in NI. The omnibus survey found that 83% of all electricity consumers and 89% of gas consumers in Greater Belfast knew they have a choice of providers. These figures are higher than Ofgem's 2014 tracker survey carried out by Ipsos MORI at about the same time where 80% were aware they could switch electricity suppliers and 81% gas suppliers.⁴⁷

Chart 5: Domestic switching activity for electricity and gas



Customers of incumbent suppliers in NI were found to be less informed on switching; with only just over two-thirds of Power NI customers (68%) aware of their ability to switch. Those on lower incomes were also found to be less likely to switch, with 65% of electricity consumers and 60% of gas consumers saying they would not consider it. However, this trend could be linked to debt restrictions, which are more likely to apply to low income households.

Chart 5 shows that there is a low level of recurring switching in NI, with only 5% of electricity consumers and 1% of gas consumers having switched more than once.

More generally, a number of interviewees commented that NI does not have a strong switching culture. It is hard to evaluate this view, which is clearly based on opinion, but superficially the available data and views on switching in NI relative to other markets suggest churn levels are not unreasonable given local conditions and despite the existence of a regulated tariff.

Dual fuel penetration

We consider a further important factor affecting the development of competition in the NI energy markets is the absence of a significant dual fuel capability.

A supplier's cost to serve can fall significantly in such circumstances as the supplier is serving two customers in effect for the costs of serving one. These reduced costs can translate into lower prices, encouraging switching. In the GB market for instance dual fuel discounts are explicitly applied, and are typically worth £15-20/dual fuel customer.⁴⁸

In the GB market dual fuel supply accounts for over 75% of the combined domestic market, with over 85% of households requiring electricity and gas being supplied on a dual fuel basis. In Rol it is about 30%. The

⁴⁶ The UR itself introduced a mandatory Marketing Code of Practice earlier in 2014. To date there have been no investigations or enforcement actions under it.

⁴⁷ Ipsos MORI, *Customer Engagement with the Energy Market - Tracking Survey 2014*, p19. The sample size was 4,004 adults. GB data is ambiguous as it suggests that back in 2008 when the first Ipsos MORI survey was carried out for Ofgem that awareness was much higher at 97%.

⁴⁸ This characteristic of the GB retail market also helped high levels of switching in the early days of domestic market liberalisation. Dual fuel capability resulted in competition between the incumbent regional electricity supplier (offering existing customers cheaper gas) and the incumbent national gas supplier (offering existing customers cheaper electricity). Customers could avail themselves of a single provider for two fuels in the expectation of lower overall bills.

scope for economies of scale and cost savings from shared functions that these levels of penetration bring are virtually absent in NI, dampening the savings available from switching.

Marketing channel and switching sites

It emerged from our interviews that a number of suppliers had withdrawn from doorstep sales activity due to reputational risks but also limited marketing budgets. This reduction in direct sales activity mirrors similar developments in other jurisdictions following regulatory and company responses to high profile instances of mis-selling.

We would also observe that there appears to be in NI limited easily accessible information on offers in the market for household and especially small business customers. This would seem to reflect the absence of switching sites in the domestic markets and the relative paucity of brokers who normally fulfil this role in the micro-business and SME markets (although even here in markets with higher switching rates it is usual for businesses to have to seek this information out). The Consumer Council for Northern Ireland (CCNI) does publish basic tariff pricing information.⁴⁹

An online comparison site⁵⁰ was launched in Northern Ireland in early 2014 for household electricity tariffs. The service is provided at no cost (i.e. the provider does not charge commission or advertising fees). In contrast to services in neighbouring markets, it does not currently have the capacity to allow customers to complete a switch, but it does allow customers to be directed to their preferred supplier based on the comparison to effect a switch.

We approached two well-known online comparison sites based in GB for their views on the NI market. One established player had committed some effort to establish a presence in NI but ultimately felt the market was too small and there were insufficient benefits in doing so. Another said they did not consider the NI markets as an area for expansion and were unlikely to do so given their size.

In the business markets it was suggested during the interviews that around 70+ brokers were active in the market, up from around 15 in 2012. While we believe this is a strong sign of increasing competition in these market segments, brokerage itself elicited strong views. On the one hand some participants were of the view that an honest broker could improve the competitive landscape by offering customers independent advice, education and range of supply options. On the other many, particularly suppliers in the larger I&C market, stated that while there had been an increase in brokers over the last 12-18 months the customer and supplier were often not told about commissions, which concerned them.

The majority of interviewees suggested that the introduction of comparison sites (for tariff comparison and switching at the household/small I&C end of the market) would be beneficial, provided consumers were presented with all offers and any commission clearly displayed. Similarly with brokers (acting in the I&C contract market), there was a consensus that activity should be accredited and transparent. Despite this sentiment, we cannot see how comparison services can be offered outside of the tariff markets, and note that business switching sites do not exist as far as we are aware in other jurisdictions.⁵¹

Towards the larger I&C end of the market, the dynamic appears to be different. Where customers tender for supply the offers presented were unanimously perceived to be competitive—not least as the customer often insisted on suppliers displaying their margin. Many customers and suppliers mentioned that more new entry would be beneficial to expand customer choice, but most were of the opinion that significant entry was unlikely given the small size of the NI market and the number of suppliers already active across the various market segments.

Suppliers and customers both stated that the larger I&C market had evolved considerably over the last few years with customers “becoming more savvy since the economic downturn” resulting in customers migrating towards “flexi” type contracts (where the customer has degrees of choice on how the commodity element of the contract is procured) and away from fixed prices.

⁴⁹ <http://www.consumer council.org.uk/energy/electricity-gas-price-comparison/>

⁵⁰ <http://www.enirgy.info/>

⁵¹ There are competitive procurement platforms and service providers in some jurisdictions, but these usually work through closed tenders on a site-specific basis given individual consumption patterns.

At the very large end of the market, which appears to be dominated by the public sector, some customers had seen a decline in the number of responses to supply contract tenders. The anecdotal evidence from the structured interviews indicated that the customer was thought to be “too big” for some suppliers—although one customer had split their supply contracts into a number of separate tenders in an attempt to receive a higher number of responses.

Other anecdotal evidence from the interviews suggested that larger I&C customers would also look to dictate how contracts were invoiced, which some suppliers may not be able to accommodate. This may also explain the apparent lack of differing products (compared to neighbouring markets) available to larger customers. It was suggested that in many instances savings to be gained by switching were very small and could outweigh the cost of tendering and/or changing invoicing flows/systems.

We also received feedback from suppliers and larger I&C consumers and their representatives that customers were seeking quotes from suppliers to use as a negotiating tool with their existing supplier.

The above was more pertinent in the electricity market than gas, though nevertheless still relevant in both.

Switching process and objections

In electricity, household customers can generally switch supplier within a few days, whereas gas can take 15 or so days. In both cases this is less than or comparable to experience in neighbouring markets.⁵² Nevertheless given the differences in the switching times and processes for the two fuels, it is likely that, unless improved and aligned, these differences could fetter the emergence of a dual fuel market at the household and smaller business end of the market, although the scope of that potential market presently remains small.

There were concerns raised in the interviews that the switching and objections processes may not be working in the best interests of customers.

To illustrate:

- it was not clear to some customers what their rights were if they sought to switch and had outstanding debt; and
- some were of the view that the objections process could be open to abuse as it was not possible for the gaining supplier to validate the reasons for the objection.

A number of comments were also received that the gas switching process was cumbersome and particularly awkward for Pas As You Go (PAYG) customers where payment top-ups had to be undertaken within a limited period or the switch would not be completed. In these circumstances the customer and suppliers have difficulty unpicking the transfer, billing correctly and communicating to the customer the situation. A number of suppliers at the smaller end of the market also stated that the governance arrangements around the switching process, especially in gas, meant they felt they had little opportunity to propose improvements.

Larger I&C customers and their representatives were less concerned with the switching process *per se* but did express frustration with accessing consumption/meter reading information across multiple sites for the purposes of issuing tenders for supply contracts. Switching statistics for this sector indicate a cyclic switching pattern (annual contract rounds) with little discernible trend in activity, although this is primarily due to the low number of customers in this segment of the market.

These are all legitimate concerns but they are all examples of types of issues we have come across in many retail energy markets. They are the type of issues that all ought to be soluble through industry governance.

Engagement

There were mixed views on the benefits or otherwise of initiatives to raise public awareness. Participants suggested that, particularly at the household and smaller I&C level, greater levels of awareness on how to

⁵² Switching times with GB must be completed within three weeks, following the end of the mandatory cooling off period (household only). Ofgem and the industry are developing plans to shorten switching time. In RoI households also have a 14 day cooling off period, after which switches are generally completed within two weeks.

switch (and that energy provision would not be interrupted) could deliver benefits. There were also suggestions that the UR, CCNI or other public authority could present information on the typical breakdown of energy bills and deliver “positive messages” about the market and competition in general.

Contrary to this were views that public authorities were not best placed to deliver messages about engagement, and that this should be left to the market. It was also highlighted that NI media often reports stories of the GB energy retail markets, which are overwhelmingly negative. It was felt that this could “pollute” the general consumer mind-set and damage consumer engagement in NI, although we did not find any evidence that this was happening during our review.

Overall, however, those that commented were generally supportive of the UR’s consumer protection approach (codes of practice backed up by licence conditions) and recognised that greater proportionate monitoring by the regulator should allow it to ensure compliance and regularly comment on the state of the market.

Supply price controls

Power NI is currently subject to price control regulation in the entire domestic market and in the non-domestic market for customers consuming up to 50MWh per annum, as set out in its supply licence.⁵³ This price control sets allowances for Power NI’s operating costs and profit margin. The UR allows a supply margin of 2.2%, which it believes to be a fair and reasonable allowance for the margin given the change in risk profile that Power NI has experienced as a result of the emergence of a competitive market.⁵⁴ The allowed margin appears low enough to protect customers and maintain low prices.

Power NI’s regulated tariff is usually re-set and verified at the start of each October for the following 12 months. The UR compares the forecast revenue requirement for the year ahead along with the under-/over-recovery in the previous period. The components of the tariff from its latest tariff review⁵⁵ are detailed in Table 3.

Table 3: Power NI price control

Cost/ Tariff	Regulatory scrutiny
Generation costs	Competitive and regulated wholesale market; approval of Power NI hedging methodology by UR; annual approval of Gt statement (forecast of Power NI wholesale costs).
Supplier charge	Application of Power NI Supply Price Control 2012-14 and any other costs approved on a pass-through basis.
NIRO costs	Audited on behalf of the UR by Ofgem as part of its UK-wide audit.
Correction factors	Analysis by the UR of variances between forecasts used for setting tariffs and out-turn costs; agreement to the “first year effect”.

In Greater Belfast customers of SSE Airtricity are also protected by a maximum average price as set out in its supply licence.⁵⁶ The Airtricity tariff is reviewed biannually in April and October and the price control also contains provision to review the tariff if the price of gas changes significantly. A margin of 1.5% is applied in determining allowed revenues.

In both cases the prevailing price controls could be considered to be tight, and below the range of 3-6% that we have seen targeted by non-regulated entities for supply profits in fully competitive markets. In practical terms, this means that the “price to beat” for competing suppliers is lower than might otherwise be expected. Against this however, it is evident from the level of tariff differentials, that suppliers can and

⁵³ http://www.uregni.gov.uk/uploads/publications/NIE_Energy_Ltd_-_Supply_Licence_-_28_March_and_1_April_2014.pdf

⁵⁴ http://www.uregni.gov.uk/uploads/publications/Power_NI_Price_Control_Decision_paper_v20.pdf

⁵⁵ http://www.uregni.gov.uk/uploads/publications/Retail_Tariff_Background_Briefing_May_2013.pdf

⁵⁶ http://www.uregni.gov.uk/uploads/licenses/2014-03-28_Airtricity_Gas_Supply_NI_Ltd_%28PSL%29_Supply_Licence.pdf

do differentiate their offers, and we have seen no evidence that the existence of price controls has constrained competition.

3.1.4 Weak consumer response –conclusions

Household and small I&C customer response to competition has been adequate but could be improved. The level of engagement is reasonable given the length of time the NI markets have been open, but it has fallen when measured solely by switching activity between suppliers. The latest ACER Annual Report⁵⁷ to give comparable information on a wide range of jurisdictions that included NI shows annual switching rates in 2012 in markets where householders have choice ranging from 0.6% to 14.8%. Only Luxembourg, Austria and Poland had lower rates than NI (which in 2012 was reported by ACER as 2%, a figure we know to be significantly understated).

We conclude that overall consumer response in the smaller markets has been moderate. Market size is undoubtedly a factor in dampening rates.

The average accounts/supplier metric is a blunt metric that does not take account the different market positions of the individual suppliers in each market segment, nor the scope for niche offerings. However it does bring home the basic problems of building scale for new entrants unless they compete across jurisdictions.

This position is reinforced by the exposure of all businesses to similar costs. Other factors include the lack of online comparison sites that also act as brokers. Another factor, which we discuss later, may be of course that consumers are generally happy with their current provider. This is evidenced by high levels of trust and customer satisfaction. Moreover a significant majority of consumers that have switched provider have stated that they are unlikely to switch again. However, having switched, there is little obvious choice for consumers but to switch back to the higher priced incumbent, which limits serial switchers, although savings are available to switchers who have not already moved to direct debit and on-line offerings.

Despite this finding, the option to shop around for most customers is relatively new and the market is therefore still immature. Real choice for the households has only been available in both fuels since 2010.

Another feature that is not currently present in the smaller consumer end of the market is the availability of dual fuel offers, reflecting limited access to gas in NI. This access was a key driver of competition in GB and the Netherlands (as well as other jurisdictions) that has seen incumbent market share erode significantly and allowed suppliers to offer bundled products that delivered savings over single accounts for each fuel. It is unlikely that such a market would proliferate in NI to the same extent due to the size of the market (there are no regional electricity suppliers to compete against a national gas incumbent which has been a feature of the GB markets) and physical (gas penetration is relatively low) differences. Nonetheless suppliers who offer both fuels, and are not restricted via retail price control rules, may be able to provide cheaper offers through lower costs to serve.⁵⁸

Finally, raising prices to allow “headroom” is not a feature of regulated prices in NI. This approach purposefully sets the regulated price higher than cost (plus a reasonable margin) where the regulator is confident that new entrants can and will enter markets and rapidly erode market share from incumbents. It is sometimes used as a temporary measure that can accelerate competition. It was used in GB during the early years of market liberalisation where regional markets were apt for such an approach.

Moreover, the supply price controls set for the incumbents in NI are tight, though accepted by the regulated suppliers at their most recent settlements, and appropriate for the risk and capital employed in the regulated suppliers’ businesses. During the period that competition has been emerging, the permitted return has been between 1.5% - 2.2%, placing real pressure on the regulated price to beat. While we do not believe these price controls have constrained competition, it could in theory be stimulated by

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http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202013.pdf

⁵⁸ In GB, new research has indicated that consumers can save an average of £55 by opting for the cheapest single fuels rather than dual fuel. <http://www.makeitcheaper.com/press/2014/single-out-your-energy-supplier-as-dual-fuel-deals-fall-short.aspx>

increasing headroom in the price controls. However, we believe using this mechanism in NI would actually tend perversely to create customer detriment, as costs will increase but new entry will continue to be limited by the size of the market and relatively high costs of entry.

Although general awareness of the competitive market among households in NI would appear to be on a par with neighbouring markets at the same stage in development, the propensity to switch is lower. As noted above, this may be due to high consumer satisfaction levels combined with perceptions that the potential savings are not sufficient. Looking to the neighbouring markets of GB and RoI, the evidence shows that significant portions of the customer base are “disengaged”, even after longer exposure of retail competition. Data also suggests that there is a very small number of customers who are serial switchers in NI⁵⁹. These factors make comparative statements across markets difficult.

A key facilitator in these neighbouring markets has been the emergence of online switching sites in GB and RoI, especially since suppliers have turned away from direct sales approaches. These services allow proactive consumers to compare offers and switch at the time and location of their choosing. The fact that there has been no apparent entry into the NI market of online brokers is most likely driven by a combination of low switching rates in a small market (where scale is necessary for online businesses to charge reasonable commission) and the low number of suppliers present (reducing the number of options to present to consumers).

The conclusions we have reached for the non-domestic markets differ, although, evidence regarding the prices, propositions and switching in small and medium I&C market is far patchier, which is a feature of many energy markets.

While it is an over-simplification to deem all smaller businesses as exhibiting the same interactions and issues with the markets as household customers, the statistics do show similar trends. Switching levels are low and there currently exists no central resource for such consumers to independently compare or contrast offers and prices.⁶⁰

The last point though is not unique to NI and is a reflection of the way suppliers everywhere construct offers to smaller businesses. Despite many smaller I&C customers having annual consumption levels only a few times higher than that of the typical household, it is their consumption patterns that make it difficult (or more precisely risky and therefore probably more expensive than the industry average) for suppliers to publish tariffs, particularly making available fixed price offers. This is why it is unusual to see regulatory requirements in competitive markets for suppliers to publish tariffs to non-domestic customers.

For the larger I&C market we conclude that in contrast the market shows signs of strong consumer response. At this end of the market we found consumers are generally very well informed and often had a detailed understanding of the cost elements of their contracts. Moreover the consumption of volumes typically at a single customer, coupled with the relatively low margins that are usually transparent, lends itself to a different business operation from a supplier’s perspective. The trend is for customers to move towards named account management with a personal relationship between customer and supplier.

The response at this end of the market could also manifest itself as the customer choosing not to switch supplier, but engage with the market to gain a number of quotes/tender responses to keep their current supplier’s prices and services keen. Indeed there were indications that some customers may actively choose not to go to the market as costs (specifically procurement costs and/or potentially their own costs to change back office validation and payment processes) outweigh the perceived benefits.

This should be viewed as a rational competitive response.

⁵⁹ [Ofgem’s Retail Market Review – Findings and Initial Proposals](#), March 2011.

⁶⁰ Under licence the price regulated suppliers (Power NI for electricity, SSE Airtricity, Belfast Gas and Firmus for gas in their regulated areas) must have standard tariffs for regulated I&C customers (of any size). Also Firmus (as the competing supplier in Belfast) does publish standard tariffs for customers up to 732k therms/yr.

3.2 Weak competition

3.2.1 *What it is*

Where one or more suppliers have significant market power, competition can be undermined through the ability of the players with significant market power to influence or direct outcomes to their benefit. Where this feature exists, it is often referred to as “unilateral market power”, which is different from the market power that arises as a result of coordinated conduct (see section 3.5 “tacit coordination” below).

Significant market power may also exist where a market is dominated by a small number of suppliers—an oligopoly. In this instance of oligopoly, coupled with the ability and opportunity to act in a coordinated fashion, incentives to compete are lessened as there are benefits to companies not “breaking from the pack”.

Where a supplier has a high market share (and is not subject to price control regulation), it might have less incentive to compete vigorously (especially where barriers to entry are evident). These factors are amplified in energy markets where demand, as is the case for energy at the household and smaller business level, is relatively unresponsive to price changes.

Weak competition can result in adverse effects including high prices, poor service levels, limited choice and high profits. It can also prevent or stifle the incentive to innovate (for example the introduction of increased payment methods and/or tariff structures, and a widening of a supplier’s own business operations).

3.2.2 *How it was assessed*

Analysis of market shares and concentration metrics provide an obvious overview of levels of competition in the market and the extent to which market power exists, and therefore the opportunity for a supplier or suppliers to exercise market power.

A further dimension is to assess how market shares have changed over time as it can be deduced that where market shares remain stable for long periods, especially where costs are known to have moved, concentration may indicate that competition within the market is weak. However, a highly concentrated market may be competitive if market shares fluctuate over short periods in response to changes in competitive offers. Such volatility may also indicate the existence of effective competitive constraints, such as successful entry and innovative developments.

We also looked at customer satisfaction and complaints data as an indicator of whether competition might be weak.

3.2.3 *Findings*

Below we present our analysis on whether the market displays characteristics of weak competition under the following headings:

- market concentration;
- erosion of incumbents’ market share;
- price levels;
- price decomposition;
- supplier pricing;
- satisfaction ratings; and
- complaints.

Market concentration

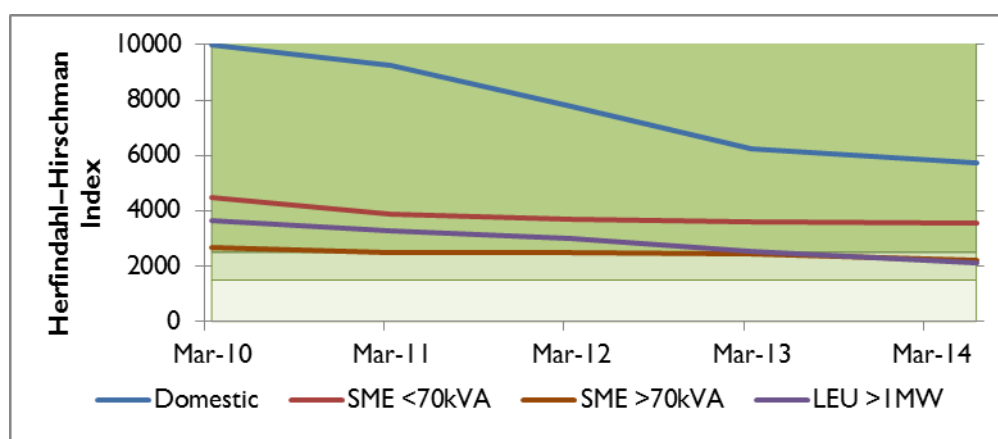
Across both the NI gas and electricity markets new entrants have emerged that have introduced choice of providers. This applies across all customer segments. The electricity retail markets have a higher number of suppliers, which is almost certainly due to the larger number of customers and the relatively much smaller size of the gas market.

The Herfindahl-Hirschman Index (HHI) is a widely used measure of market concentration. The index is calculated by finding the sum of the squares of the market shares of companies active in the market. An index of 10,000 denotes a monopoly market; an index above 1,800 is considered to be a highly concentrated market; and an index between 1,000 and 1,800 a moderately concentrated market. An index below 1,000 represents an un-concentrated market with many participants, of which none holds large market share.

It is to be expected for markets to show high levels of concentration where the opening up of competition is recent and the number of entrants remains small. ACER does not routinely publish HHI (or similar concentration) measures for member states. Nevertheless, looking at other indicators such as number of suppliers, levels of incumbent market shares and switching rates, we would expect to find similar high HHI levels across all market segments in the benchmark jurisdictions.

Experience from other energy markets also suggests we will usually see more entry in the larger end of the market because the cost to serve/market/enter is low compared to serving and setting up a domestic supply business with many customers consuming small amounts. This is borne out by the HHI in the NI household and smaller I&C markets in NI, as demonstrated by Chart 6 (electricity) and Chart 7 (gas).

Chart 6: HHI—NI electricity



>2500	High concentration
1500-2500	Moderate concentration
<1500	Low concentration

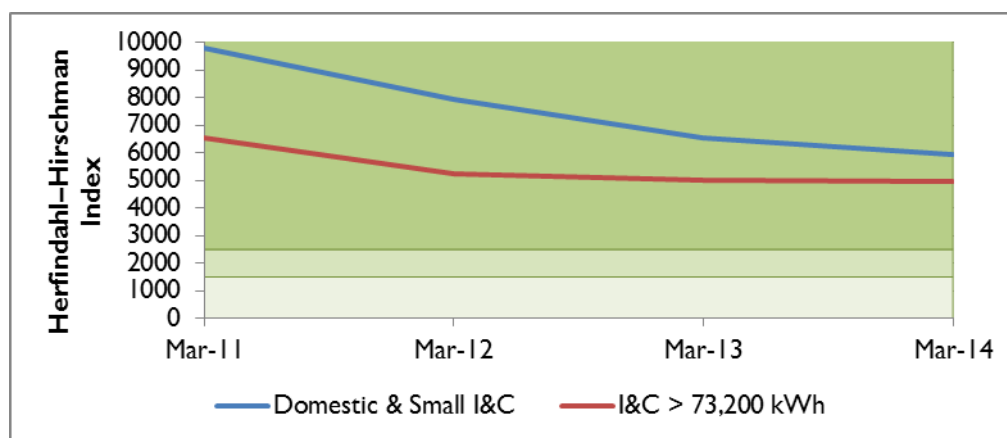
Source: Utility Regulator

For electricity, as Chart 6 shows, the domestic market HHI has decreased gradually since new suppliers began to enter the market in 2010, but at 5,724 is still highly concentrated due to the high market share of Power NI, as well as the small number of suppliers active in the market. The <70kVA market is also highly concentrated at 3,530. In contrast the SME >70KVA and LEU >1MW market segments have demonstrated decreased concentration levels, at 2,205 and 2,099 respectively are moderately concentrated.

Similarly, Chart 7 shows that the HHI of domestic and small I&C gas has also decreased in Greater Belfast, but at 5,933 still remains highly concentrated due to the market dominance of SSE Airtricity. The I&C

>73,200 kWh market segment has remained fairly steady over the last two years but at 4,976 is well above the threshold defining highly concentrated.⁶¹

Chart 7: HHI—gas



>2500	High concentration
1500-2500	Moderate concentration
<1500	Low concentration

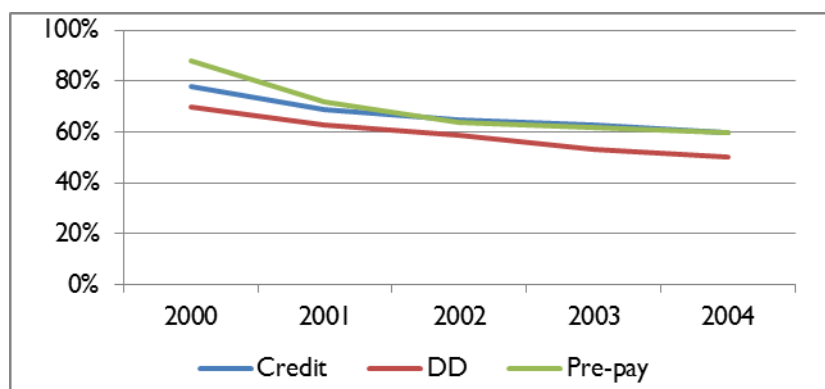
Source: Utility Regulator

Erosion of incumbents' market shares

High HHI indicators in both the electricity and gas markets reflect the high levels of incumbent market share. We therefore looked at the rate at which incumbent suppliers are losing market share.

Within five years of market opening, between 40-50% of consumers had left their incumbent electricity supplier in GB, as Chart 8 illustrates.⁶² For gas, within five years of market opening between 18-38% of consumers had left their incumbent supplier.⁶³

Chart 8: Incumbent share of total number of electricity accounts in GB after market opening



Source: DECC

NI has not achieved as high a level of incumbent market share degradation. Looking at a comparable time frame for electricity in NI, Power NI at the end of Q2 2014 still had a 72% share of domestic electricity customers (70% of total electricity customers).^{64,65}

In relation to gas, SSE Airtricity also at end Q2 2014 also still had a 72% share of domestic and small I&C customers (71% of total gas customers in the Greater Belfast area).^{66,67}

⁶¹ For comparison, the smallest of the supply regions in GB has just over 1mn domestic accounts (685,000 electricity and 380,000 gas). We estimate the following HHI values: electricity: 4,399, gas: 2,756, dual fuel: 2,719.

⁶² <https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-switching-statistics>. Data is

⁶³ <https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-price-stastics>

⁶⁴ http://www.uregni.gov.uk/uploads/publications/TransparencyReport_2014_AUG.pdf

⁶⁵ The corresponding volume shares are 69% of domestic electricity volumes and 37% of total volumes. We have used customers in the comparison (not volumes as previously) for the purpose of making the comparison with available GB data.

⁶⁶ Winbacks and organic growth from new connections are included in the numbers.

⁶⁷ The corresponding volume shares are 69% of domestic and small I&C volumes and 56% of total volumes.

The difference between NI and GB possibly stems from the choice available and level of savings offered. Immediately after deregulation GB consumers had the choice of numerous established suppliers whereas NI consumers had to wait for the new suppliers to enter the market.

In this context, we also explored whether the absence of dual fuel capability might be a significant factor. In its *State of the Market Assessment*, Ofgem said that in GB dual fuel customers may be more likely to switch away from their incumbent supplier. However, this comparison is distorted by the fact that all dual fuel customers must have switched at least one fuel once.

Similarly, in RoI, CER's research of consumer attitudes found perception of greater savings associated with dual fuel offers remains the primary driver for the move to those offers.

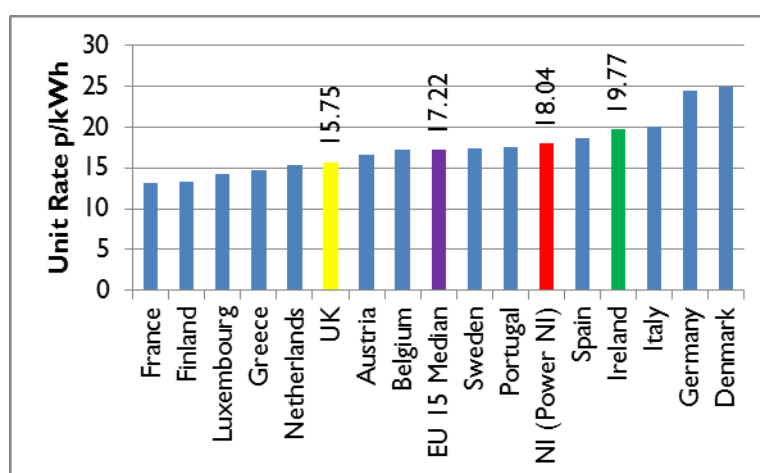
Price levels

The majority of market participants we interviewed were of the view that the market could be more competitive, although some suggested that for the size of the market there were already several active suppliers. Indeed, energy prices in NI were often quoted as being higher than many other markets, which in turn had a detrimental effect on the customer's international competitiveness.

We also received several comments from suppliers regarding low supplier margins in contracts and in the regulated tariffs, which would indicate that price disparity between NI and other markets is primarily due to differences in wholesale price levels and the non-discretionary costs that are being passed through.⁶⁸

Historically, in NI electricity prices have been higher than in GB.⁶⁹ This is mainly due to higher energy transport costs, higher costs of supply in NI as a result of the small size of the market that reduces chances of developing economies of scale, and a difference in fuel mix. Chart 9 shows that NI's current regulated electricity tariff is nearly 15% more expensive than the UK average tariff for a medium user based on latest published data, nearly 5% higher than the EU 15 median, but nearly 9% lower than comparable RoI prices.^{70,71}

Chart 9: Domestic electricity prices in the EU15 for medium consumers (including tax), January 14 – June 14



Source: DECC

In the case of gas similar concerns regarding the issue of international competitiveness were voiced, although the comment was focussed on I&C users. Most respondents put this down to the additional transport cost of moving gas from GB. However, as Chart 10 shows, the average price for medium

⁶⁸ These views align with recent analysis carried out for the UR on the reasons for price differentials for larger customers in NI relative to neighbouring markets. http://www.uregni.gov.uk/uploads/publications/NI_electricity_network_pricing_5_Aug.pdf

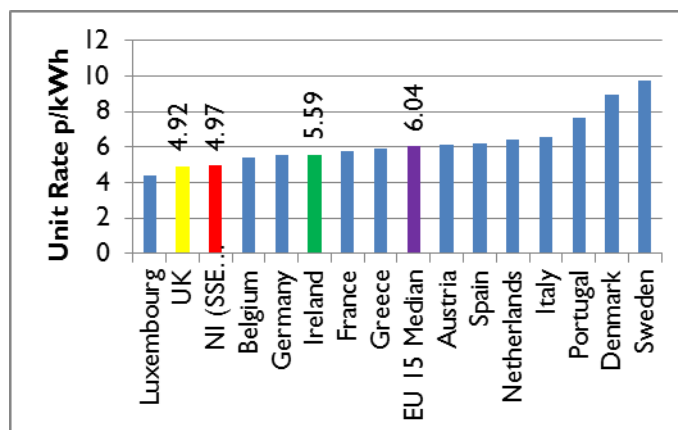
⁶⁹ <https://www.gov.uk/government/collections/quarterly-energy-prices>

⁷⁰ The difference between GB fluctuates and the NI price has been lower.

⁷¹ It should be noted that suppliers in the three markets face different levels of third party charges, including costs of government programmes and levies.

customers is less than 2% higher than the average UK price⁷², and is over 10% lower than the comparable Rol price. All these prices are below the EU 15 median price.

Chart 10: Domestic gas prices in the EU15 for medium consumers (including tax), January 14 – June 14

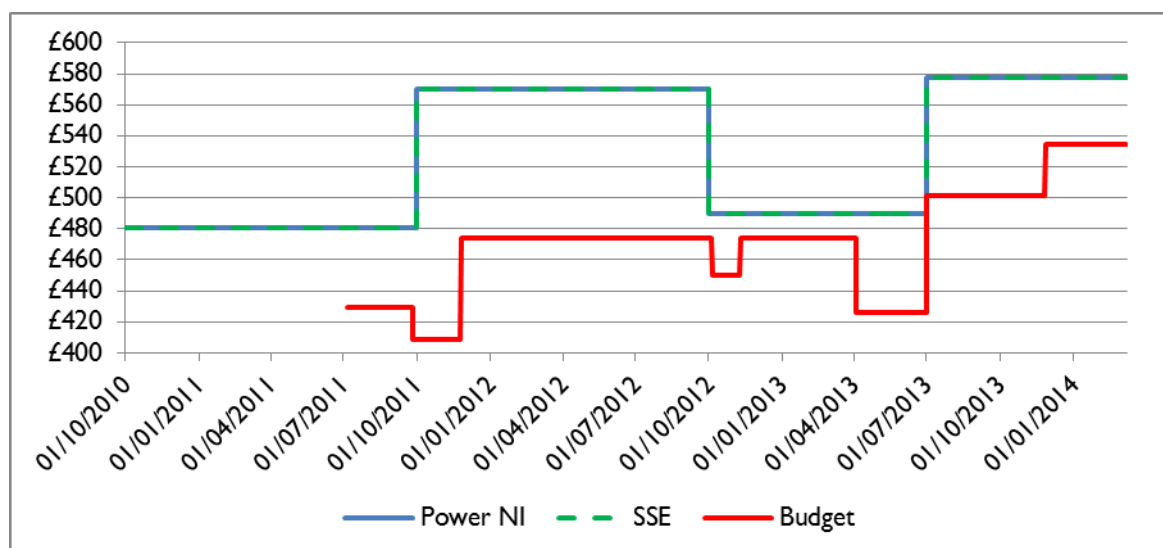


Source: DECC

Each supplier active in the NI market tracks the movement of the regulated tariffs and prices relative to them.

In electricity, the regulated tariff is priced to allow Power NI to make a 2.2% profit margin (on forecast regulated turnover). As Chart 11 shows SSE Airtricity's standard tariff based on typical domestic consumption values is priced the same, although it does offer fixed one and two year discounts standard tariff. Budget Energy aims to undercut the regulated tariff by around 10%, though the differential has varied from time to time.

Chart 11: Domestic electricity supplier tariff changes (3,200kWh)



Source: Utility Regulator

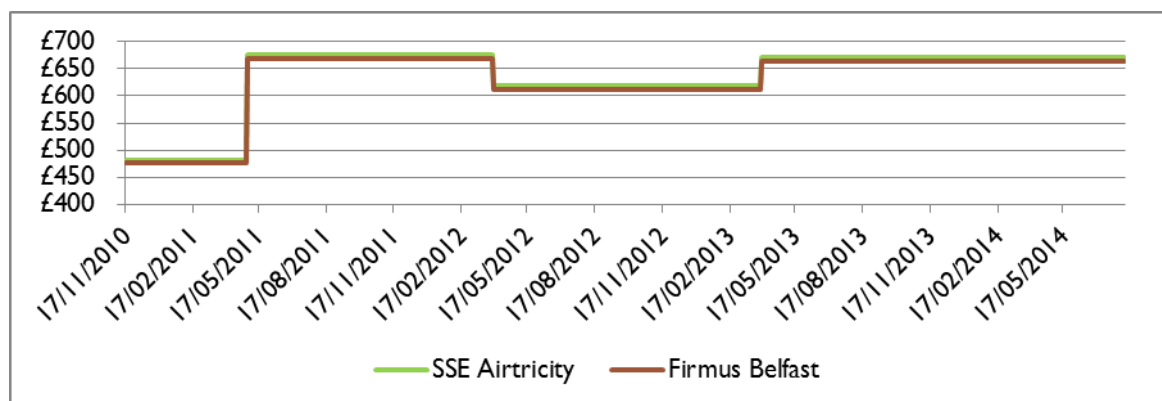
Tariffs shown are the companies' standard tariffs before discounts.

Please note the lines for Power NI and SSE Airtricity overlay each other in this chart.

⁷² Standard domestic gas tariffs in NI are lower than comparable Big Six offers.

In gas, as Chart 12 shows, Firmus tracks the price of SSE Airtricity's regulated tariff, which has been set to achieve a 1.5% profit margin—marginally undercutting it. The typical differential is about £6 based again on typical domestic consumption values.

Chart 12: Domestic gas supplier tariff changes (16,500kWh)



Source: Utility Regulator

Tariffs shown are the companies' standard tariffs before discounts.

Savings available

The existence of price differentials are especially important considering 97% of consumers said in response to the omnibus survey that price was the main reason they would consider switching.

There is a good spread of prices in electricity, with the cheapest domestic tariff costing £56 less than the average tariff of £545 per year.⁷³ The difference between the regulated electricity tariff and the cheapest alternative is higher with a potential saving of £88 per year. These savings compare favourably with those available in other markets on a single fuel basis.

It is noticeable that the pricing strategies of the two entrants differ. SSE Airtricity's approach is to offer discounts from its standard published tariff. Budget Energy has chosen a different pricing strategy that is not based on a non-fixed term discount on Power NI's standard tariff.⁷⁴

Differentials in the domestic gas market appear much narrower based on a comparison of SSE Airtricity's and Firmus' standard tariffs, and have been since competition began, averaging around the £6/year, which they currently sit at. ACER does not give data for NI but £6 savings (or €8 a year) would place it at the lower end of achievable savings for other markets during 2013.⁷⁵

However, whilst the savings on standard tariffs for gas have been historically low, these reflect differences in the two gas suppliers' standard tariffs only. Firmus, like SSE Airtricity presently in electricity, has in the past offered substantial discounts for fixed 1 and 2 year periods. It seems to have been these discount offerings that have triggered the comparable level of switches we have seen.

⁷³ Annual cost including VAT at 5%. Calculated with supplier unit rates and the typical electricity consumption of households in Northern Ireland of 3,200kWh of electricity per year.

⁷⁴ The ACER Review 2013, p72, shows 21 member states with available savings in electricity at €50 or less. There appears to be no obvious correlation with switching rates.

⁷⁵ As above. Seven jurisdictions are reported as having savings at around or close to zero.

Price composition

The UR does not publish detailed cost breakdowns of typical supplier prices, although it has published a breakdown of Power NI's regulated electricity tariff as of July 2013⁷⁶ and of SSE Airtricity's regulated gas tariff as of April 2013.⁷⁷

An element of concern during the interviews focussed on the regulated third party elements of the consumer bill. Large customers (who typically see these elements invoiced as separate line items) and suppliers were critical of the process for notifying the market of changes to network and other administered charges (e.g. for electricity these include: Public Service Obligation⁷⁸, Distribution Use of System⁷⁹, Supplier Transmission Use of System⁸⁰, Collection Agency Income Requirement tariff⁸¹, System Support Services⁸²). Almost all were of the view that the notice period given of input charge changes was too short and insufficient to either allow them to budget adequately (larger I&C customers) or adequately price through to tariff customers (suppliers).

A number of rule changes have been proposed in the GB market to reduce the risk to suppliers of having to assimilate network tariff changes into end prices at short notice. Governance arrangements in GB have evolved so that network charging methodologies are now contained in industry codes, meaning code signatories can propose changes that would benefit competition. An example midway through the change process is a modification to the GB distribution code that proposes that distribution network charges should be issued with 15 months' notice rather than the current eight weeks⁸³.

Increased transparency and predictability would support the competitive process. However, it would also raise issues for the incumbents in NI where the notice period straddles two price control periods.

Customer satisfaction

Turning to other measures of weak competition, consumer satisfaction is considerably higher in NI than in GB. In its *State of the Market Assessment*, Ofgem found that in GB only 30% of customers trust or tend to trust, and 44% of customers distrust or tend to distrust their energy provider(s). In the omnibus survey, for which summary results are shown at Table 4, 74% of NI electricity customers trust or tend to trust and only 7% distrust or tend to distrust their energy provider(s). The results for gas were similar, with 69% trusting and 10% distrusting their supplier(s).

Table 4: Omnibus survey satisfaction results

Satisfaction	Electricity			Gas		
	Positive	Negative	Neutral	Positive	Negative	Neutral
Price	64%	20%	16%	70%	17%	13%
Flexibility of payment options	89%	1%	10%	90%	3%	7%
Customer Service	70%	3%	27%	66%	5%	29%
Comparing tariff offers	39%	26%	35%	34%	27%	39%
Trust in suppliers	74%	7%	19%	69%	10%	21%
Overall	89%	2%	9%	89%	3%	8%

Source: Omnibus survey

⁷⁶ http://www.uregni.gov.uk/uploads/publications/Retail_Tariff_Background_Briefing_May_2013.pdf

⁷⁷ www.uregni.gov.uk/uploads/publications/Airtricity_Gas_Supply_NI_pricing_announcement_Q_and_A.pdf

⁷⁸ <http://www.nie.co.uk/documents/PSO-Schedule-of-Charges-Oct14-Sept15.aspx>

⁷⁹ <http://www.nie.co.uk/documents/Regulatory-documents/DUoS-Statement-Oct14-Sept15.aspx>

⁸⁰ <http://www.soni.ltd.uk/Customers/TUOSTariffsandBilling/TUoSCharges/NetworkCharges/>

⁸¹ <http://www.soni.ltd.uk/Customers/TUOSTariffsandBilling/TUoSCharges/CollectionAgencyIncomeRequirement/>

⁸² <http://www.soni.ltd.uk/Customers/TUOSTariffsandBilling/TUoSCharges/SystemSupportServices/>

⁸³ Other changes have also required network owners to provide prior year forecasts of charges to aid predictability.

Only 3% of electricity consumers and 5% of gas consumers were unhappy with the customer service from suppliers.

The majority of respondents also said they were happy with energy prices, with a 64% satisfaction score in electricity and a 70% score in gas.

The area of the market with the highest level of satisfaction is the flexibility of payment options with 89% of electricity and 90% of gas consumers saying they were satisfied. This position possibly reflects the fact that this sector arguably displays the most innovation in the market, as can be seen with the emergence of “pay-as-you-go” or PAYG.

Almost nine in 10 consumers were found to be satisfied with the overall performance of energy suppliers in NI. This exceeds levels found in RoI where satisfaction ratings ranged from 75% to 84%. Ratings are considerably higher than GB, where Ofgem’s *State of the Market Assessment* found 51-52% of customers said they were satisfied with their supplier.

Some lesser concerns were highlighted in the omnibus survey, notably the ease with which consumers could compare offers between suppliers: only 39% of electricity consumers and 34% of gas consumers were happy with this aspect of the market. Ofgem research has shown that in GB customers find and/or perceive this issue as a barrier to market engagement.⁸⁴

Overall these results imply remarkably high satisfaction ratings for utility services that are in many jurisdictions usually considered poor performers. However, despite the high NI satisfaction ratings, 27% of respondents listed NIE as their electricity supplier, and 31% listed Phoenix as their gas supplier—entities that no longer exist in energy supply. This could be regarded as a symptom of disengagement, but we conclude that the high levels of satisfaction seem much more significant to our review.

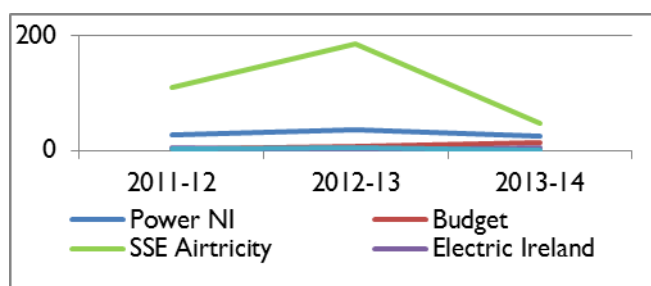
Complaints

Turning to complaints, these have fluctuated in both the electricity and gas markets over the last few years.⁸⁵

Chart 13 shows that SSE Airtricity saw an increase in electricity complaints from 2012 to 2013, before decreasing again. Complaints to other suppliers have remained stable.

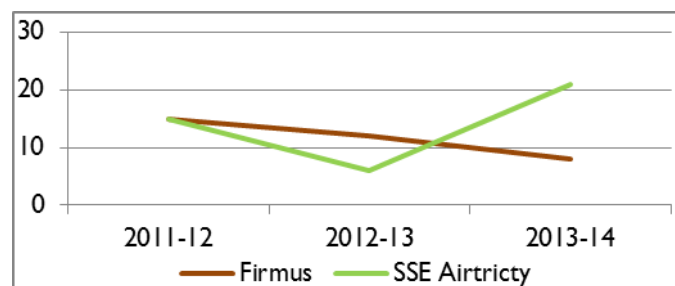
SSE Airtricity’s recorded complaints for gas also increased in 2013-14 over the prior year, with Firmus’ numbers decreasing as Chart 14 shows.

Chart 13: Electricity investigations, complaints and referrals, 2011-14



Source: CCNI

Chart 14: Gas investigations, complaints and referrals, 2011-2014 (all market segments)



Source: CCNI

⁸⁴ For example, successive qualitative research from the Ofgem Consumer First Panel—reports dating from 2008 available here: <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/our-consumer-research-and-publications>

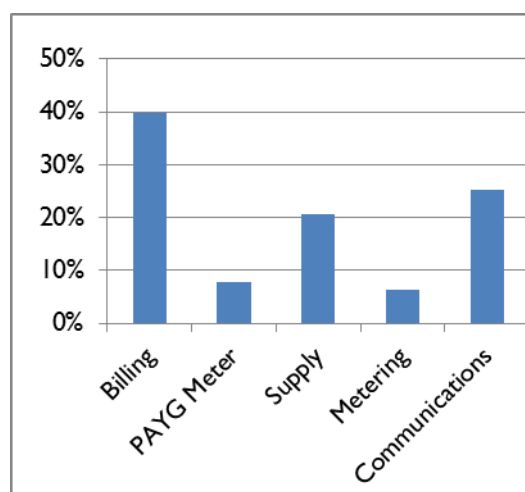
⁸⁵ <http://www.consumerCouncil.org.uk/search/?search=complaints&x=0&y=0>

Data in both cases is for complaints made to NICC, and the ratio of complaints/thousand customers is therefore very low compared to GB indicators, which are for all complaints.⁸⁶ The UR has indicated that as part its REMM work, it will be establishing a more complete and robust data set in relation to customer complaints.

Complaint categories (Chart 15 for electricity and Chart 16 for gas) show similar trends for both gas and electricity. Billing issues were the most common complaint amongst consumers in 2013-14—a third of which were about disputed bills. Problems with supply also led to a higher level of customer complaints, with customers unhappy about the initial application for supply, as well as unplanned interruptions. There is a larger spread of complaints among categories in NI compared to GB, where 82% of energy complaints were found to be about billing issues in 2013-14.

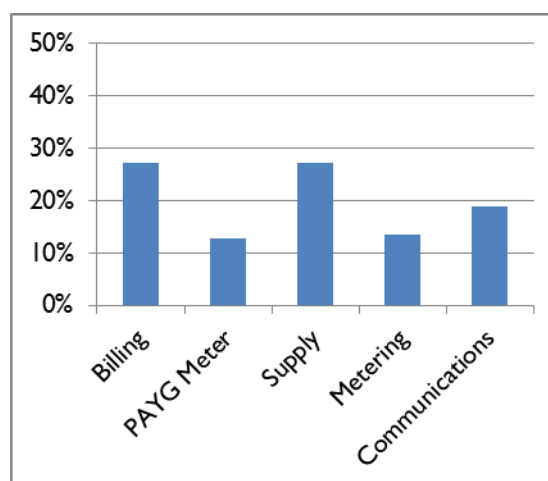
The complaint numbers for each supplier though are too low for deriving statistically robust comparisons with neighbouring markets.

Chart 15: Category of electricity investigations, complaints and referrals, 2013-14 (all market segments)



Source: CCNI

Chart 16: Category of gas investigations, complaints and referrals, 2013-14



Source: CCNI

The Which? customer survey from January 2014 identified Budget Energy as the supplier who provided the best customer experience, although the sample size for the three NI suppliers noted in the survey was small.⁸⁷ Nonetheless compared with GB, NI suppliers were moderately placed, performing slightly better

Table 5: Which? customer service survey 2014

	Customer Service	Value for Money	Bills	Customer Score
Budget Energy	60%	80%	60%	63%
Airtricity	60%	60%	60%	54%
Power NI	60%	60%	60%	45%

Source: Which?

⁸⁶ <http://www.cer.ie/docs/000971/CER14136%20Consumer%20Survey%202014%20Report.pdf>

⁸⁷ <http://www.which.co.uk/energy/saving-money/reviews-ns/energy-companies-reviewed/best-and-worst-energy-companies/>. Sample size: Budget Energy (39), Airtricity (94), Power NI (147).

than the Big Six. The results of the survey are shown in Table 5.

Overall there is no evidence from complaints data to suggest poor service by NI suppliers.

Innovation

Products available in neighbouring markets such as social and green tariffs, as well as dual fuel offerings are absent from the NI market. All tariffs are variable⁸⁸, which is in contrast to the proliferation of fixed tariffs in GB.⁸⁹

Product innovation in NI is primarily focussed on payment methods. The emergence of a pre-payment option as a lifestyle choice rather than solely as a debt management solution has developed over the last few years. The August 2014 *Quarterly Transparency Report* states that 40% of electricity and 64% (Greater Belfast area) of gas customers pay via a PAYG meter. The successful implementation of keypad meters has created a PAYG market that appears to be viewed by a significant section of customers as a facility to assist with budgeting and for convenience.

However, similar to GB, there is still a correlation between income and payment. As can be seen in Chart 17, at low incomes prepayment meters are the most common method of payment, whereas at higher incomes it is direct debit.

We believe that the small number of suppliers and the existence of little variety between products is linked. In turn this may be dampening switching.

3.2.4 Weak competition – conclusions

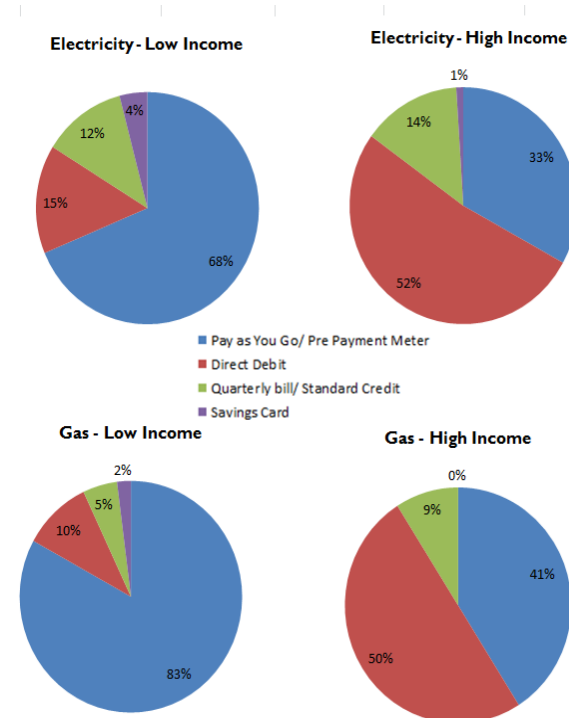
All energy retail markets in NI are concentrated, but become less so towards the higher consuming end of the market. This is to be expected as the larger business markets have been open somewhat longer and, as we have already noted, these markets are simpler to enter. The market share of the incumbents outside of the larger I&C markets remains very high.

ACER does not routinely publish HHI, or other concentration, measures for member states. Nevertheless looking at other indicators such as number of suppliers, levels of incumbent market shares and switching rates, we would expect to find similar high concentration levels across all market segments in the benchmark jurisdictions.

Comparison with neighbouring markets, and markets across Europe, indicates that there is nothing peculiar to the NI markets at this stage of liberalisation. This situation though should not be taken to mean that the NI retail markets will necessarily develop along the lines of any other market, especially given their small size.

In market segments with higher incumbent market shares, price regulation acts as a proxy to competition. This means that there is a “price to beat” that new entrants use to benchmark their own offers, and it is clear the competitive dynamic in NI is driven by newer entrants seeking to match or undercut the incumbents’ prices. Price regulation does not necessarily indicate concentrated markets—it can exist, for

Chart 17: Percentage of consumers on payment options across income levels



Source: Omnibus survey

⁸⁸ SSE Airtricity offer two “fixed” tariffs, but it is the discount that is fixed, not the unit rate.

⁸⁹ On average, one in four customers in GB with the Big Six suppliers is on fixed tariffs. However, 90% of customers with independent suppliers are on fixed tariffs. The Rol tariff landscape has more similarities with GB than NI, with the cheapest tariffs offered being primarily one year fixed deals.

example, as a means to provide “backstop” tariffs for vulnerable consumers—but with high concentration levels price regulation would be expected.

The fact that both the gas and electricity markets are separate in the minds of consumers and products offered to consumers will also contribute to higher concentration levels (on the assumption that market power is more difficult to achieve in two markets simultaneously).

Energy retail markets differ from many consumer markets insofar as significant elements of the value chain are subject to regulated prices—network costs and policy programmes. Moreover the sale of a homogenous product means there is limited opportunity for retailers to differentiate the content of the product they offer. Linked to this is the reality that the products are delivered, via special purpose networks (as opposed to e.g. road or rail), in such a way that the overall supply and demand is centrally managed (more so in electricity because of storage costs) and cannot drift beyond tolerances put in place to maintain wider system safety.

The design of the wholesale market is also critical as it will determine how easy it is for suppliers to access the products they seek (size and duration) and allow some differentiation in final prices to customers—which is a function of the hedging strategy employed. In the NI context, all suppliers are dependent on the SEM for electricity and the NBP for gas.

As a consequence, a significant proportion of the costs incurred by a supplier are the same when selling to the same customer (assuming that costs are passed on in the same way). An underlying premise of most competitive markets is that, where they are functioning efficiently, companies can assess the costs they face and forecast how they will change over time. In turn those businesses that are effective will thrive as they can offer the lowest price to customers and maintain a viable and profitable enterprise.

Where suppliers have more time to reflect regulated charges into existing supply contracts and tariffs, offers should enable more efficient pass through of costs to customers and a lower risk premium for the uncertainty around changes in regulated charges. Secondary to this, the rationale for the basis on which the charges are derived and how they may change could allow (although only in limited instances) customers to adapt their consumption patterns where it is cost efficient to do so (for example larger consumers, which see the charge, could move consumption away from peak.)

There is scope for a wider discussion between market participants and the UR around increasing predictability and transparency of pass-through costs, and possibly fixing some of these with longer notice periods.. This move should elicit to what degree any such change would be beneficial to the energy retail markets, against the potential detriment caused to the regulated companies in terms of reduced revenue recovery certainty. Aside from the opportunity to reduce the risk, and therefore premia in tariffs, suppliers face, a move to longer notice periods for regulated charges should help facilitate the emergence of fixed priced products, were suppliers and consumers to see these as desirable.

Household customers appear to be highly satisfied with the retail market compared with customers in neighbouring markets. A relatively high proportion of domestic customers are also satisfied with prices. However, consumer sentiment, or biases, are complex and are difficult to assess and explain in terms of the effectiveness of competition. The fact that a number of surveys would point to well above average satisfaction levels with the market is not necessarily a by-product of effective competition. But there is insufficient data to ascertain satisfaction levels prior to market opening. One interviewee noted that despite 15 years of retail competition in GB satisfaction levels had declined. Other commentators and research point to consumer biases (and the subsequent willingness to engage in markets to drive the engine of competition) being the result of a myriad of factors including perception, branding, peer group behaviour.

Overall, the NI energy markets are still characterised by high levels of market concentration (which in turn reflects limited numbers of suppliers, high incumbent market shares and modest switching rates). However, levels of competition do not compare unfavourably with proxy markets of similar size and at similar stages of development elsewhere in the EU and internationally. A combination of regulated tariffs available to customers of the incumbent with market based tariffs for customers who choose to switch seems to have resulted in a wider market environment where satisfaction levels are very high. Savings can be made from switching, especially in electricity, but the available savings are limited, particularly compared with dual fuel markets.

We conclude that competition is established and the strength of market competition increases with customer size. However the market share of the incumbents remains high.

3.3 Vertical integration

Below we present our conclusions on vertical integration.

3.3.1 *What it is*

In the energy market suppliers are often under common ownership with upstream production (i.e. gas production and electricity generation). This vertical integration of the supply chain can result in trading and business organisation arrangements between the two entities that are more efficient than standalone entities, with benefits passed onto consumers.

However, the integrated structure can also harm competition and ultimately consumer welfare where it forecloses one-sided participant's access to the market (for example wholesale products). In turn it may reduce appetite for market entry, as costs would be higher as the new entrant would also need to organise itself in a similar structure to operate in that market. Opportunities for new entrants or one-sided players to compete on an equal basis could be reduced thereby weakening competition.

The impact of vertical integration on energy market effectiveness is a topic that is presently the subject of much debate. The European Commission's programme to liberalise markets, as defined by the three energy packages, has not ruled one way or another on whether a vertically integrated structure should or should not be a feature of markets. The issue is being looked at in greater detail by the CMA in its review of GB energy markets.

3.3.1 *How it was assessed*

As both energy markets in NI are still relatively young, much of the recent regulation and restructuring of the sectors has been to unbundle the industry. This activity has focused on separating retail from distribution.⁹⁰ It has also concentrated on separation of the retail and generation functions of the ex-nationalised companies. We therefore look at ownership relationships.

A further issue for consideration is whether suppliers can exert similar pressure on generation companies. We therefore briefly consider energy import opportunities and any limitations on access to product in the unbundled NI structure.

3.3.2 *Findings*

On vertical integration we have split our findings by:

- ownership;
- interconnection; and
- access to product.

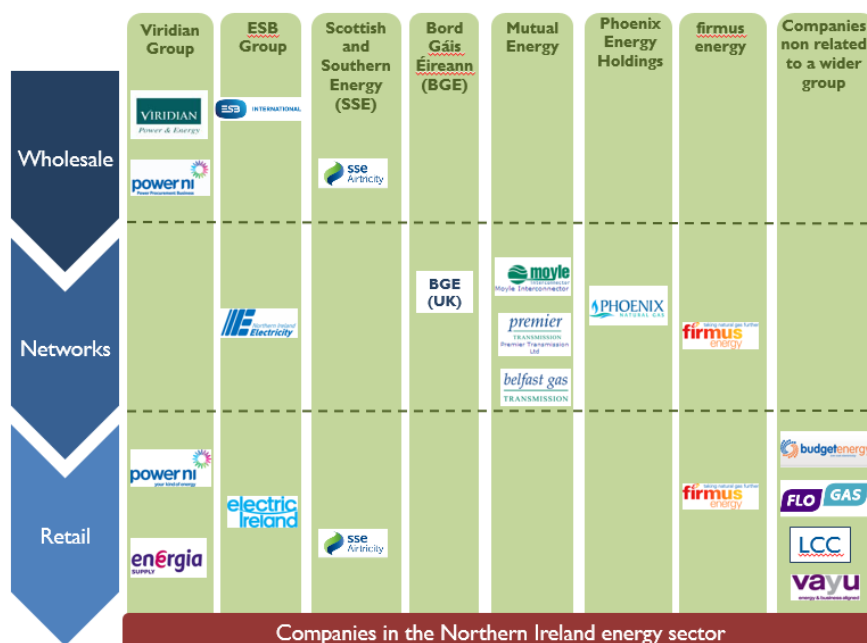
Ownership

The main suppliers of electricity and gas in NI are vertically integrated, or benefit from affiliated generation. In contrast, none of the NI suppliers have significant gas interests, as shown in Chart 18.

In 2007 Northern Ireland Electricity (NIE) Energy and Procurement business (now known as Power NI) transferred to a separate Viridian subsidiary company – to ensure independence of distribution system operation under the EU Electricity Directive 2003. NIE retained the transmission and distribution businesses. NIE was subsequently divested from the Viridian Group and is no longer affiliated to Power NI in any way. Power NI is required under its electricity supply licence to maintain its

⁹⁰ This is not the case in the Ten Towns gas area, where Firmus has a derogation from unbundling requirements until the network exceeds 100,000 connections.

Chart I8: Structure of the energy sector in Northern Ireland



Source: UR

business separate from the other Viridian NI supply business and is required to be compliant with very tight ring-fencing provisions in this respect. Viridian supply businesses in NI must also keep separate regulatory accounts for the separate licensed businesses. Power NI must also submit an energy hedging policy statement to the UR for approval, which permits scrutiny of its contracting activity for the acquisition of electricity.

There is no evidence to suggest that Power NI organises itself in a vertically integrated structure, or that it being a part of the Viridian Group results in wider market detriment.

SSE Airtricity acquired the Phoenix gas supply business in 2012 and took over its operating licence on 28 June of that year. The company is 100% owned by the SSE Group. It also holds an electricity supply licence. It owns wind farms in NI with a combined installed capacity of 143MW, and its parent has extensive generation assets throughout GB. SSE Airtricity does not have to produce an annual hedging strategy for approval by the UR, but all power supplied in NI must be bought and sold through the SEM.

We see nothing to suggest that SSE Airtricity or its parent company is able to operate in a manner that is detrimental to the market and consumers.

Electric Ireland is owned by the ESB Group but is separated (and rebranded) from ESB. The supplier as yet has minimal presence in the NI domestic market retail (<1% by customer numbers), but it did supply 13% of volumes in Q2 2014 to the non-domestic market. ESB are major owners of power plants in RoI.

Again there is no evidence to suggest that Electric Ireland organises itself in a vertically integrated structure, or that it being a part of the ESB group results in wider market detriment.

Interconnection

NI has electricity interconnection with GB. The 500MW Moyle Interconnector links the NI and Scottish electricity systems. Power flows are usually into NI and exports are anyway heavily constrained.

Viridian was the largest importer of electricity via the Moyle interconnector in 2013-14. It imported 455GWh from GB, but it does not own any assets in that market.

In 2013-14 SSE imported 436GWh of electricity from GB to NI via the interconnector (364GWh net export). This is the equivalent of around 20% of the suppliers annual supply volume, which over the same period was 2.2TWh. ESB imported 136GWh from GB in 2013-14. It has a small GB generation portfolio

comprising the 350MW Corby gas-fired power station and the 25MW West Durham wind farm, as well as a 50% interest in the Marchwood gas-fired power station. It also has extensive generation assets in RoI.

The SEM rules ensure that all power sold to customers in NI through licensed retail businesses, including imports over interconnectors, are purchased on a proper arm's-length basis.

Access to product

All suppliers have ready access to wholesale electricity through the SEM.

However, several suppliers during the structured interviews indicated they were dissatisfied with liquidity under the SEM, which should be a major focus when moving to the I-SEM. The dominance of ESB in the generation market was also highlighted as a reason for liquidity issues. These are matters we consider further in the next section. All gas used in NI is transported from the GB system via the Scotland to Northern Ireland Pipeline. The five year historic range of annual gas demand is 14,288GWh to 16,500GWh.⁹¹ No supplier complained to us of problems with accessing gas product.

3.3.3 *Vertical integration - conclusions*

While three suppliers in NI are part of corporate groups that include generation companies (none for gas production), there is no evidence of these relationships harming competition. Power NI is subject to explicit regulatory limitations that mean it must be operationally and commercially independent, and its ability to sign trading agreements is in effect regulated by the UR. We did not hear of concerns over the exercise of market power by integrated companies during any of the interviews.

It is also the case that one-sided players have acted as disruptors and are gaining market share.

Moreover the SEM is a mandatory market. Suppliers are exposed to the same price for all power (including imports). The SEM is a very transparent trading mechanism, and one which prevents market foreclosure by integrated players.

The emergence of the I-SEM and any changes in corporate structure/market shares could in the future result in market behaviour that might be detrimental to customers. Although vertical integration will probably save costs, should it occur on any scale it may lead to leverage of market power across the separate businesses. These are issues the UR will wish to keep under review.

3.4 Barriers to entry and expansion

Below we present our analysis under on barriers to entry and expansion.

3.4.1 *What it is*

If prospective suppliers struggle to enter the market, then the chance for new players to exert competitive pressure on existing players is diminished, potentially resulting in weak competition and/or weak customer response. Even without actual entry, the threat of it can keep existing players "on their toes".

Where significant barriers to market entry do exist, these can deter new entities and active players introducing new business models (e.g. operational and financial structures) that could result in more efficient practices (that can be passed onto customers as improved service or lower prices) and innovative products, offers or simply just greater choice.

Linked to the ease of entering the supply market are the opportunities for new players to expand at a rate and to a scale that instils competitive discipline on existing participants. If new entrants can threaten existing suppliers, this can also address other market defects, except weak consumer response, which reduces the incentive to enter.

In markets being opened up to competition, barriers to entry and expansion have the effect of reinforcing the incumbent firms' advantage, albeit these can be ameliorated where price regulation is in place.

⁹¹ http://www.premier-transmission.com/media/PremierTransmission_WinterOutlook2013-14.pdf

There are start-up costs that new entrants must incur before they can recover these from customer revenues. While these are inevitable in any market, some of these may be “sunk” costs (those incurred that cannot be recovered where the company exits the market). These may also be such that, unless a new entrant has a realistic opportunity to build scale, then entry will be unattractive and unlikely.

In the context of the NI energy retail markets, the fixed and sunk costs of entry are typically IT systems related. These require a degree of critical mass for recovery to occur and often over a minimum period of time that can last years. While the existence of these costs is not necessarily an impediment to competition, if many new entrants do appear then the recovery of a greater sum of fixed and sunk costs from consumers will have to be outweighed by the competitive discipline numerous participants potentially deliver.

Other barriers can take the form of regulatory impediments, such as the entry process itself, which could place onerous requirements on participants that are deemed necessary for wider consumer protection or market integrity. Participation in policy or regulatory programmes (including, for example delivering environmental and social welfare programmes where fixed costs can be more easily absorbed by incumbents with larger customer bases) can create market entry barriers. Moreover, market processes may be inefficient and cumbersome and deter entry (e.g. if switching is complicated or prone to errors).

Prospective new entrants will also take a view on the non-commercial risks in the market. In a relatively immature market such as NI, these can be characterised as: the presence (or not) of a “roadmap” that provides a degree of certainty on the future balance between competition and regulation to allow businesses to plan over a time horizon of a number of years (recognising that regulators need to be able to react to changing conditions too); political risks, in terms of market interventions to deliver wider policy aspirations and/or gain political capital; and pan-national initiatives that must be accommodated into local market arrangements—for example European Commission regulations to harmonise markets.

It is possible that, even where no significant barriers to entry exist, new players may not be present or seek to enter as the commercial rewards such as profits and margins may not be sufficient to risk entry.

3.4.2 *How it was assessed*

Trends in market share changes for new entrants were analysed, and we also sought to understand from our interviews the reasons for entry and the views of new participants on the entry process itself and on their ability to expand.

We also sought to understand why suppliers present in neighbouring markets (RoI and GB) were not present in NI and if they had considered entry.

It was also important to consider the possibility that, whilst there has been new entry, the market may not be able to support any additional suppliers due to constraints of market size.

Another aspect that can indicate appetite for entry is the expected profitability to be accrued once a supplier is established, which is linked to the minimum efficient scale necessary to achieve a reasonably competitive level of costs.

As the NI energy market is relatively young, it is not possible to take a view on characteristics such as new entrant survival rates nor growth rates particularly in the smaller consumer end of the markets where market opening is more recent.

Although it was not possible to substantiate the comments received from stakeholders, there were a number of messages that were repeated and pertinent to prospects for new entry, particularly in the gas market. We summarise these views.

3.4.3 Findings

We present our findings on barriers to entry and expansion under the following headings:

- entry levels;
- network charges;
- policy costs;
- market entry processes;
- regulated prices and margins;
- regulatory certainty;
- wholesale market reform; and
- impact of market harmonisation.

Entry levels

There are four active electricity suppliers in the household market, and eight in the I&C market. For the Greater Belfast gas market there are two active domestic and four active I&C suppliers. We have already demonstrated in the previous section that new entrants have secured meaningful market share at the expense of the incumbent suppliers in both electricity and gas sectors. Incumbent market share is not out of line with that achieved in other markets opened up over similar timescales, although as we saw previously it lags larger markets and several of those that have been open for longer (e.g. GB). We have already also seen that, given the size of the NI markets, the ratio of suppliers to customers in the domestic market is comparable to several small markets and better than others.

Most of the suppliers we spoke to present in neighbouring markets stated that they had not seriously considered entering the NI market (with the reason being that the market was too small to bother, and in the case of GB suppliers bounded by different wholesale and retail rules). Where they had entered, they had pulled back on activity due to uncertainty on the future direction of retail price regulation or had only entered as customers in their existing home market sought group contracts that included sites in NI.

The notion that the size of the NI market was a natural impediment to entry was stated by numerous parties. For suppliers operational in neighbouring markets (some of whom were also present in NI), many stated that the fixed costs of entry and different processes and rules would inevitably lead to higher costs for NI customers. Given the perceived need to price against the incumbent tariffs, this had reduced the incentive for entry.

Network charges

Some participants were of the view that the “regulatory black box” that determined network charges (and the price control process, although to a lesser degree) was too opaque to understand the basis on which network charges are levied (e.g. cost-reflective, one customer segment cross-subsidising another), and could act as a barrier to efficient operation. This made it difficult to communicate to customers (particularly in the larger I&C segment) the rationale for why significant elements of their bill changed annually (particularly where the customer consumption remained the same) and frustrated some tariff suppliers who were of the view that they received the bad publicity and customer ire for an element of cost they had no control over.

Some were also of the view that aligning the timing of regulated charge changes (between fuels and with neighbouring markets) would benefit the retail market primarily through reduced risk premia being added to tariffs and allowing larger customers to budget more effectively.

A number of consumer representatives and suppliers believed there could be benefit to the wider market if a forum were established to allow the UR, suppliers and customers to raise issues regularly in an informal environment.

Policy costs

Market participants were less concerned with the impact of policy costs (e.g. the Renewables Obligation Northern Ireland⁹² and, in the household retail market, the Northern Ireland Sustainable Energy Programme (NISEP)⁹³) on the effectiveness of the retail markets.

Where views were expressed, these included the potential benefit of the UR and DETI to work together to understand the impacts of regulated and policy costs (and their transparency) on retail markets and with the recently announced intention to extend the gas network⁹⁴ whether programmes (including NISEP) were sufficient to encourage fuel switching by subsidising boiler installations⁹⁵.

Market entry processes

None of the existing suppliers complained to us that market entry processes were too complex. There were concerns with the process for entering the two gas markets due to differences that we were told introduced unnecessary cost and complexity for new entrants. This appears to be a perception issue as entry arrangements seem to be largely identical for the two gas areas, with a few minor differences related to the rules for accession to network codes.

Linked to this is the perception that the gas switching process undermines the rationale for entering (as new suppliers are concerned that they may not be able to grow their customer numbers sufficiently). It was also noted that it is the supplier that is responsible for reading gas meters, whereas in electricity and both markets in the RoI meters were read by the respective network companies.

It was suggested by suppliers, particularly those without experience in other jurisdictions, that the UR could in future act as a “critical friend” in assisting new entrants, either directly with advice where appropriate or making available more information to help prospective suppliers gain a clearer picture of the contestability of the market (such as breakdown of the market by profile class/end user category).

It was also mentioned that for new entrants with no energy heritage or experience that training or information to help with the validation of industry charges would be beneficial. This was tempered by a number of other players that held the UR’s QTRs in high regard, noting they already provide significant relevant information for prospective new entrants, which they felt went far enough.

Regulated prices and margins

It was noted by suppliers during the interviews that in the regulated parts of the market the margins allowed to the incumbents in their price controls were low, which made it difficult for competitors to price more profitably and grow. This inability to make acceptable returns could be construed also as a barrier to entry.

As we have already noted, the UR has not sought to introduce “headroom” in regulated prices as a means of promoting increased switching away from the incumbent. This is an explicit policy, primarily due to there being just one ex-nationalised supplier (as opposed to GB where regional companies were created at electricity market opening) and no similar sized players to the regional incumbent to “make the market” in both sectors.

This issue of the permitted margins and their impact on the competitive market is something the UR already keeps under review. As new entrants are operating in the market and undercutting the incumbent, the notion of introducing a greater margin runs the risk that prices and profits would increase without the competitive pressure exerted from greater consumer engagement. This is a particular concern given the high knowledge of switching but the stated intention of many respondents not to consider switching during

⁹² http://www.detini.gov.uk/northern_ireland_renewables_obligation

⁹³ http://www.uregni.gov.uk/uploads/publications/NISEP_List_of_Schemes_2014-15_2.pdf

⁹⁴ http://www.uregni.gov.uk/publications/gas_to_the_west_consultation_120814

⁹⁵ New gas connections are currently provided to customers free of charge (it is provided for under the distribution price control within defined a distance from the existing network). The price control also provides allowances under a connection incentive mechanism. Customers are required to invest in appropriate heating systems.

the omnibus survey. Given the existence of significant price discounts, we do not however believe that the existence of these controls in their current form has constrained competition.

A related matter is whether the price controls could or should be lifted altogether. We do not think this is feasible at least for the present. In such an instance the effect would be identical to increasing headroom, and prices and margins would slowly increase as the incumbents in the regulated parts of both sectors still have considerable market power.

Regulatory uncertainty

A number of comments were made to us with regard to the medium-term regulatory “road-map” for the retail market, specifically on whether there would be regulated prices and in what market segments for the foreseeable future or indeed as a permanent feature of the market. Views were polarised on the advantages of retaining regulated retail prices, with no discernible market participant groupings. Suppliers, including the incumbents, were generally more likely to favour their removal.

Many participants stated that the regulatory uncertainty undermined the ability for existing and potential entrants to develop business plans, which typically look over a three-year or longer time horizon.

Wholesale market reform

There were also comments during the interviews on the wholesale electricity market. The market design is being remodelled (in the form of the Integrated Single Electricity Market (I-SEM)), with its planned introduction scheduled for 2016. Those participants that had a view stated that they feared the new arrangements would not improve or could worsen suppliers’ ability to hedge their retail position adequately. In turn this could mean suppliers view offering fixed term tariffs as too risky.

Related to this, a number of suppliers stated that the current SEM market did not deliver forward curve trading liquidity to allow suppliers to offer longer-term fixed products. The current product availability would appear to bear this out. Beyond this, respondents were generally positive about their access to wholesale product through the SEM.

Fewer comments were received regarding the GB gas wholesale market, and again access to product was considered to be generally good in a market that is considered to be accessible and liquid. In general no problems were raised, in terms of accessing products, although some interviewees did comment that prices were inevitably higher than those in GB due to the additional transport costs.

Impact of market harmonisation

Looking to the future, there were mixed views on the wider European market harmonisation programme (which the move to I-SEM is one element of). Some feared that closer alignment and greater cross-border trading could create conditions that would ultimately favour pan-European utility companies and push out smaller players. One participant commented that the “one size fits all” approach to market design had not been properly assessed in the context of Ireland (wholesale) and NI (retail). At the other end of the spectrum, participants favoured the programme, provided it increased security and could result in fairer (or even lower) energy prices.

At a more local level, many players commented on the likely benefits to be realised in the retail markets if rules and processes could be more closely aligned to neighbouring markets (especially RoI). Comments were overwhelmingly focussed on possible reductions in costs to supply. It was noted that there were proposals to align a number of activities (such as harmonised market messages and market processes) between NI and RoI. We note also that the UR has previously commented that “we believe there may be enhanced opportunities (market scale, supplier business opportunities, efficiencies in operation, dual fuel potential) if energy retail developments were better harmonised between the two jurisdictions.”⁹⁶ Concerns were also raised that final plans to roll-out smart meters differed between the two jurisdictions, and this could result in greater divergence.

It is important to note that it is not within the UR’s power to align the policy of two separate jurisdictions.

⁹⁶ http://www.uregni.gov.uk/uploads/publications/Retail_markets_-_Policy_Paper.pdf, p8.

3.4.4 Barriers to entry and expansion - conclusions

There is a proven level of entry into both electricity and gas retail sectors in NI across market segments. This number seems to have been naturally capped by real limitations on the economies of scope and scale available to new entrants.

The issues raised with us over uncertainty going forward with regulated charges and policy costs and the operation of detailed market rules are not out of line with experiences we have come across in other markets, and accession processes in NI do not appear onerous or exceptional. In contrast to other local markets, we did not hear of any particular concerns over credit and collateral issues, which can be problematic in the energy sector acting as a drain on working capital.

At the wholesale level, existing and potential suppliers have good access to product. The SEM provides guaranteed access to electricity at centrally set prices, and the GB gas market is considered to be very liquid. Whilst the SEM does provide access to wholesale product at fair market prices, it does have some issues with liquidity. In particular suppliers can be exposed to volatility of system prices (especially peak prices) due to a lack of contracts in the secondary market. This issue applies to all electricity suppliers, not just the competitors, but it could be a particular concern for prospective new entrants who have less scope for dealing with the risk exposure.

It may be prudent for the UR to assess if entry processes within the NI rules are restricting further entry. While this does not appear to be a major concern (given the level of entry that has occurred in what is a small market), it may be that aligning the entry processes where practical for gas and electricity will encourage greater entry. The UR might also consider developing materials, including a route map, on market entry.

The reality of the situation is that from a retail perspective the NI markets have a single wholesale market for the whole island of Ireland, but a GB based wholesale gas market. This is further complicated by different approaches to network regulation within the neighbouring jurisdictions and that energy policy is UK based. This unique position is unlikely to change in the foreseeable future.

3.5 Tacit coordination

In this section we outline our assessment of whether conditions exist that do, or might, support tacit coordination.

3.5.1 What it is

Behaviour by companies that results in coordinated actions that dampen competitive pressures can result in consumer detriment. This can arise as a result of interactions that increases or maintains profits or lessens innovation in products or firms' efforts to become more efficient. Furthermore, where barriers to entry are present, sustained tacit coordination can weaken competition and result in weak customer response. Tacit coordination can result in actions that, for example, include not lowering prices where opportunity exists or not introducing innovations.

More positively, if barriers to entry are not present and the market can sustain more competitors, tacit coordination will be undermined by new entrants.

Tacit coordination can occur where competitors have good knowledge of each other's customer bases and costs, and how and when they change, and can therefore anticipate each other's likely actions. This is more easily achieved in concentrated markets.

When conditions are right, the behaviour can benefit all or the majority of market participants to the detriment of customers. Generally there are usually short-term benefits of deviating from the status quo through gaining market share, but over the longer term the costs of triggering very intense competition from former coordinators would be viewed as too risky.

3.5.2 How it was assessed

Energy retail markets feature significant elements of costs that are the same for all participants and known in advance. These include regulated network costs and to a large degree other programme costs (PSO, NISEP, NIRO etc.). Moreover, the wholesale markets give rise to costs that will differ to some degree, but which are dependent on the supplier's ability to hedge their retail position and their cost of collateral/credit—which is likely to be well understood by rivals.

In the segments of the markets where retail price controls are in place, there is also a greater degree of visibility between competitors of the incumbents' own costs and its regulated margin.

Feedback from interviews, coupled with analysis of the timings and scale of price changes in the retail markets, also shed light on coordination or whether these are a rational response by a supplier moving prices in line with costs.

3.5.3 Findings

Below we present our analysis on tacit coordination under the following headings:

- tariffs;
- new entrant pricing; and
- contracts markets.

Tariffs

With the exception of regulated retail prices, it was not easy to access historic tariff information for NI⁹⁷. The observable trends are that the sectors still subject to regulated prices see prices generally move in line with the price of the incumbent—indeed some products are sold on the basis that they will always be at a discount to the regulated price. This pricing approach is seen in many other markets where new entrants will price against the dominant player irrespective of whether it is price regulated and/or where the number of competing suppliers is small. While, on the surface, this discount pricing may be an attractive proposition to customers and increase engagement, feedback from suppliers stated that it was not necessarily their preferred pricing strategy.

Suppliers told us that it is not possible to understand or predict by how much regulated prices would change looking forward. Nevertheless the allowed costs the regulated suppliers can recover (as agreed in the price control settlement with the UR) mitigates their risk. New suppliers have no such protection if their own costs increase. Similarly, where there is an under- or over-recovery of revenue in one period (typically a year, but not necessarily so), the regulated entity will have their future allowed prices adjusted to correct this (within certain tolerances).⁹⁸

Whatever the effect at the individual supplier level, the regulatory driven changes have the impact of encouraging all suppliers to adjust their tariffs at the same time and to the same degree.

New entrant pricing

New entrants looking to build market share have stated that it is difficult to price their tariffs purely on a cost-reflective basis. Indeed there are undoubtedly clear incentives and pressures that emerge from the system with the incumbents subject to price regulation over a large part of their customer bases but new entrants who are not.

Again, this is because the incumbents are permitted to change their prices under regulatory formulas. Their competitors therefore face risks of putting products in the market that are, even if only temporarily, more expensive than the incumbent's price. They are also exposed to different levels of costs as new entrants have to recover fixed costs from much smaller customer bases, and the incumbents may even have already recovered their sunk costs. Furthermore, under the current system, the incumbent can over-recover in

⁹⁷ We are very grateful for Airtricity for providing us with their pricing information.

⁹⁸ In regulatory parlance, this adjusting of allowed revenues to compensate for differences in collection in earlier periods is often known as the "k-factor".

one year and see its tariffs reduced accordingly the next year, whereas the non-regulated supplier would face costs in the year that they arise.

New entrants can only realistically win market share where they can beat the incumbent price. In general as a result of these incentives and pressures and based on what we observe, suppliers in NI adjust tariffs around the same time and by the same amounts. However, setting aside the differential timing issues and risks, the behaviour is rational if the new entrants wish to protect or grow their market share.

Contracts market

There is insufficient evidence on prices in the larger business markets; end consumer prices are not visible to consumers or competing suppliers. They also differ depending on the *terms* of the contract. Despite this, contract customers, and specifically well informed larger consumers, know very well the costs stack that makes up the final bill. The negotiation at this end of the market tends to revolve around supplier margin and flexibility in terms of servicing the accounts (such as, invoicing, additional energy management/advice, access to wholesale market products).

This characteristic is not present in the smaller business market or the household market, where consumers more typically desire stable prices that they are confident are competitive and, in addition, perhaps a number of payment options.

3.5.4 *Tacit co-ordination—conclusions*

Conditions exist in NI that are conducive to tacit coordination in the domestic and smaller business tariff markets. At its simplest, tariffs move together as new entrants seek to mimic the pricing behaviour of the dominant player. This is a characteristic of other markets that have the largest players subject to price regulation. However in the household and smaller I&C markets, it is not only possible, but entirely rational, for new entrants to follow incumbent pricing. It is not a necessary condition, but would require a new entrant to break from the pack where it believed it could secure market share.

There was insufficient empirical evidence to draw any conclusion on tacit coordination in the larger business markets. Anecdotally the negotiation in these market segments tend to revolve around supplier margin and flexibility in terms of servicing the accounts, which is what one would expect to observe in a market with new entrants as competitors strive to differentiate their offers.

3.6 Competition in small economies

For the purpose of this review, comparison with similar sized markets can provide a high-level indication of how those jurisdictions have approached retail competition. In this section we have looked primarily at electricity markets, as gas penetration differs significantly across Europe, though the commentary and implications extend to gas markets as well. Data on other smaller markets and other relevant European trends is at Appendix H.

3.6.1 *Market size—conclusions*

Market size is clearly an important consideration when considering the transitional path to competition but also where it might lead. As we have already noted, Northern Ireland is one of the smallest electricity and markets in the European Union. In population terms it is on a par with Estonia and only Cyprus, Luxembourg and Malta having fewer inhabitants. Care is clearly needed in terms of cross-reading conventional metrics such as the number of new entrants, switching rates and the rate at which new entrants can build scale and erode the market share of the incumbent(s).

The ability to build scale in any markets is particularly important. If there are sunk costs (i.e. costs of a company entering a market which cannot be recovered on exit), these will limit the number of firms who can profitably serve a market. Energy retail does involve some such costs, for example investment in consumer record systems, so that questions arise over how many providers can be supported in a small market such as NI.

Market size itself depends on the size of the population (including its energy usage), its dispersion and the openness of the economy to trade. This latter factor is not relevant to the current NI market, but there are obvious possibilities to extend the market to the whole of Ireland, although it could be argued that this is already a fact as suppliers can operate in NI and RoI and the retail market arrangements are harmonised and run by ESB and NIE which are part of the same ESB group.

Furthermore, there is one wholesale electricity market for the entire island, making entering the retail markets in both jurisdictions easier. If the population is very dispersed, effective regional markets may develop, which would restrict the market size still further. This is often a characteristic of energy markets. Conversely, if the market is open to trade with other economies, this has a similar effect to having a larger geographical scale. Small economies are thus often defined by other features, such as the island natures of Malta and Cyprus, or the political isolation of Israel. In small economies all industries are likely to be highly concentrated, so this will be a feature of the general competition jurisdiction, as well as of particular regulated sectors.

The most obvious restriction of a small economy is that there may be insufficient demand for suppliers to grow to the most efficient scale, i.e. the one with lowest average costs. If this is true for even a single supplier, it defines that sector as a natural monopoly, with familiar implications for discouraging competition and imposing economic regulation to curb monopoly power. Such a situation in retail energy would also mean that average costs of the operation would be higher in such economies than in those with sufficiently large markets to realise the lower minimum cost levels, potentially affecting the competitiveness of industry and commerce, and the costs for households.

This context raises issues unique to small economies in the balance between allowing individual companies to be large enough to reap the benefits of scale economies and encouraging sufficient competitors for competition to be effective. Michal Gal, a legal scholar and expert in this area, argues that it is important to recognise the different implications in not importing competition policies that are designed for larger economies without adapting them to the special circumstances of the country concerned. Because there are likely to be fewer players in a small economy, it is particularly important to ensure that the rules are designed to reflect the particular trade-offs relevant for the circumstances. Accordingly Gal questions the benefits of competition law convergence or harmonisation for such economies, arguing instead for different 'shades' of competition policy⁹⁹. More specifically, in examining the case of New Zealand, Gal points out how the case law has appropriately recognised the different circumstances of a relatively small and isolated economy, while still based on the principles of competition law established in larger contexts.

More specifically Nir Ofer, one of Gal's students, maintains that small economies need to take a different approach to excessive pricing from those that may be established in large economies such as the United States. In particular, he argues that the market may not correct itself, even in the long run, and so authorities may need to intervene more actively¹⁰⁰. In another regulated sector with competition in retail, telecommunications, Symeu and Pollitt find that regulatory institutions have a greater effect on regulatory outcomes in the presence of technological change (in this case the introduction of mobile telephony), again emphasising the different circumstances of small economies¹⁰¹.

These circumstances affect not only competition policy but also regulatory capacity. Apart from the fixed costs of regulatory offices, and the difficulty of internal specialisation with a smaller staff, economic regulators in small economies are likely to have fewer comparators for their analysis, for example of identifying models of costs. Such comparative competition is a valuable part of any regulator's toolkit, and where there are fewer players (either competitive or monopoly based) within a state, there will be more dependence on information from other jurisdictions. Here international experience will be valuable, but again the special circumstances of the country concerned (whether size or in other aspects, including geographical and social) will need to be taken into account in interpreting the analysis.

⁹⁹ For example p.338 of *Market Conditions under the Magnifying Glass: The Effects of Market Size on Optimal Competition Policy*: Michal Gal, *The American Journal of Comparative Law*, vol 50 No 2, Spring 2002.

¹⁰⁰ *Excessive Pricing by Dominant Firms in Small Market Economies*. Dissertation for the European Master in Law and Economics, by Nir Ofer, August 2012

¹⁰¹ *Fixed Voice Telephony in Economies of Different Sizes: When Industry Policy meets Technological Change*. Pavlos C. Symeu and Michael G. Pollitt, *Technological Forecasting and Social Change* 86 pp 273-286, 2014

4 Conclusions

This review of the effectiveness of NI energy retail markets has come at an opportune time. All customers have had a choice of supplier in the markets assessed for at least four years, and over time price regulation has been gradually removed for large customers so that it remains for household and smaller I&C customers. The review allows a focussed evaluation of very small markets in both electricity and gas with unique local characteristics, which has nevertheless begun to see significant and sustained competitive activity.

At the same time the electricity wholesale market is undergoing a major re-design and major infrastructure developments continue—including plans to reinforce the electricity transmission system between NI and RoI. Significant change is also underway in the gas market, with plans to extend the gas network to the west of the territory. NI is interconnected for both fuels with the neighbouring markets of RoI and GB, and the European single target markets are coming into focus. An evaluation now will enable regulatory policy to adapt if necessary to ensure the competitive momentum is maintained and built on.

4.1 Findings

While the markets for larger non-domestic electricity customers opened to competition in 2002, markets for households and smaller business customers were only opened in 2007 (but with no entry occurring until 2010) and the incumbent supplier is still subject to price control outside of the larger business market. Total connections are less than 850,000, which makes NI very small compared with other EU member states.

The gas market is smaller and was initially opened in the Greater Belfast area to competition for larger consumers in 2006, and domestic consumers in 2010. As with the electricity markets, households and smaller business gas customers of the incumbent suppliers are still subject to a regulated price. Total connections are less than 200,000.

The energy markets in NI are maturing with new entrants continuing to win market share from the two incumbents, Power NI in electricity and SSE Airtricity in gas in Greater Belfast. Market shares are now pegged at 72% in terms of domestic electricity customers (69% market share by consumption) and 72% in terms of domestic and small I&C gas connections (69% market share by consumption). The figures are 71% of customers (37% by consumption) in electricity and 71% (56% by consumption) in gas for the Greater Belfast area for the total markets (that is, including all business customers).¹⁰² However, the rate of loss of market share by the incumbents has declined since Q2 2013.

From the quantitative and qualitative information we have gathered and analysed, we conclude that competition in the NI energy retail markets is becoming established, and delivering benefits to customers that have switched. At the same time the conditions for tacit coordination exist, though price regulation for smaller I&C and households has ensured reasonable and stable prices for the benefit of those that have chosen not to switch.

We believe that overall NI has achieved reasonable levels of switching given its context of deregulation. Indeed rates in the period following the emergence of competition in the domestic and smaller business markets once new entry occurred were good, although these have slowed as the pool of active switchers has diminished and in the absence of the emergence of further alternative providers. There has also been steady erosion of the incumbent's market share in both electricity and gas. Indeed switching levels and loss of market share by the incumbents compare very favourably to other small markets with a similar length of experience of liberalisation within the EU.

The incumbent's market share in both sectors remains high, and with few active suppliers conditions exist that are conducive to tacit coordination. In this context we have noted the discount approach to pricing adopted by competing suppliers where they specifically price their offerings relative to the regulated prices

¹⁰² http://www.uregni.gov.uk/uploads/publications/TransparencyReport_2014_AUG.pdf

applied to the incumbents. However, this is a rational approach to price setting that we would expect to see in relatively immature markets, and we have not identified any customer detriment arising from it.

Furthermore, market size will continue to limit the number of suppliers who can viably compete given the obvious limits on customer acquisition and the high level of fixed costs associated with market entry. These constraints are greater in gas than electricity markets given very low existing levels of gas penetration.

It is likely that most price sensitive customers will already have switched. Switching rates in both electricity and gas are unlikely to change significantly and might even continue to tail off. All suppliers face similar costs and achievable customer savings from switching are unlikely to change dramatically. Technology change is unlikely to be a significant factor over the near term, and indeed could raise entry costs.¹⁰³ There is little scope for domestic customers to switch back to the incumbents given that all new entrants price at a discount to the incumbents in both gas sectors. Aggressive competition in other jurisdictions has been enabled by falling commodity prices and the ability to make dual fuel offerings, but these conditions are absent from NI.

Across the different customer segments, the competitive pressures that are present are delivering benefits to customers in the form of lower prices, with new entrants offering prices at a discount to the incumbents, significantly so in the case of electricity where typical bill savings in excess of 15% are available against the regulated tariff, which is more than in most European capitals.

Even in the markets subject to regulated pricing, knowledge of switching is high and levels – albeit declining and at lower levels than certain less high profile markets – have averaged a level of around 5,000 customers/month over the last year across both domestic markets combined, representing an annualised rate of 6%. Countries with higher levels of switching have generally been subject to liberalisation for longer, and ACER itself has recently noted that “there is usually a delay between liberalisation and the observed switching effect. This is because certain elements for switching need time to develop (e.g. consumer awareness of competition and choice and the switching process).”¹⁰⁴

Customer satisfaction levels are high, though interest in switching has declined in a jurisdiction where the cost of provision of energy has not been unduly politicised. One factor behind declining switching rates is almost certainly the withdrawal by suppliers from direct selling, including doorstep sales, compounded by the absence of any organised switching site in NI, though there is an electricity comparison site.

Based on ACER data switching rates in 2012 for markets with regulated prices are generally inferior to those achieved in NI, but with notably higher levels in only two jurisdictions, namely Portugal and Spain. Both of these have considerably longer experience of deregulation.¹⁰⁵ ACER also notes a relationship between low switching rates and “different consumer preferences or higher satisfaction with the current supplier”.¹⁰⁶

The existence of price controls seems not to have constrained competition, but it has limited prices to customers who have not switched.

In the larger non-domestic markets, we were told supplier margins were transparent and contract flexibility (payment, flexible options regarding access to commodity markets, etc.) and choice is being delivered.

It is necessary to recognise the specific circumstances of the NI market and the limitations they impose on vigorous competition. These are:

- the relative recentness of full market opening and the comparatively late point at which new entrant suppliers emerged;
- the very small size of the NI energy markets, which are bounded by neighbouring markets with very different trading systems and rules;

¹⁰³ An example here would be the roll-out of smart meters, which will in due course increase costs of supply across both electricity and gas markets.

¹⁰⁴ *The ACER Review 2013*, p71.

¹⁰⁵ The Portuguese rate (13.2%) was higher than GB (12.1%) and RoI (10.6%), and the Spanish rate comparable (11.6%). *The ACER Review 2012*, pages 35 and 40.

¹⁰⁶ *The ACER Review 2013*, p72.

- consequently, limits on the number of suppliers, and the profits they can make; and
- the limitations on access to dual fuel offers, which in turn reduces the cost savings realisable to drive the competitive process.

The limitations imposed by size are particularly important. NI is a small market, one of the smallest in Europe. The existing pool of energy suppliers across all market segments may be small, but it does not compare unfavourably relative to other small markets all of whom started down the deregulation path from a similar place at around the same time.

The ratio of customers to suppliers is already low and significantly less than in neighbouring markets. The converse of this is that the ratio of suppliers to customers is high. Consequently we believe there are real limits on the number of further active suppliers that can be sustained in both electricity and gas markets. Several suppliers and switching site operators that we spoke to both pointed to this as the reason for their non-entry. One existing supplier said to us this factor was the primary reason why they did not intend to further expand into certain market segments given the high associated fixed costs. There are also difficulties in differentiating essentially homogenous products (a generic problem) in a market where suppliers face a high level of similar costs (a specific issue in NI).

We have also emphasised the limitations imposed by very limited access to gas. Roughly one in five domestic customers has access to gas. While gas penetration in NI is set to increase, competition is likely to continue to be based for most customers for the foreseeable future on single fuel provision.

As monopoly markets are opened to competition, the rationale for regulating consumer prices of the ex-monopoly provider (incumbent) is well understood. In this context, we have referred to NI as a hybrid market. GB and RoI have followed different deregulation paths to NI. Residual price controls were removed in GB in 2001-02, while those in RoI were lifted in electricity in April 2011 and in gas in July 2014. However, household prices are still subject to regulation in 14 member states and many of these jurisdictions also continue to apply price controls in at least the smaller business markets as well (and in some cases the larger business markets). This hybridity clearly has implications when reviewing the effectiveness of markets—indeed the presence of price controls is proof that the regulatory authorities deem conditions to be unconducive as yet to allow suppliers to compete on an equal regulatory footing.

There are expectations in energy markets subject to liberalisation that price control and associated regulations are a transitional phase, acting as a proxy for competition until it becomes effective. Within the EU, regulatory policy promulgated by ACER generally assumes that price controls can be progressively removed pending the development of full competition, and that while regulatory controls are in place the competitive process will be distorted.

We would temper this view by saying that in some markets competition for all customers by multiple suppliers may not be feasible, especially where there is a lack of market scale. The scope for effective competition and market size clearly interrelate. It is to be expected that competition in such circumstances will not be as effective as might be expected in larger and more mature markets. The scope for its development and the pace at which this might be expected to occur is almost certainly reduced in smaller markets, with the consequential effect that some form of dominance could well endure, and competitive benefits may not extend to all customer types to an equivalent degree.

Against this background, we find the UR's "ideal vision" set out in its May 2014 *Strategic Approach Information Paper*¹⁰⁷ an appropriate set of objectives for small energy markets with the hybrid features present in NI, where liberalisation is progressing but with a high level of residual regulation. These features are based on a mix of measures to promote competition with explicit consumer protection through price controls and non-discrimination licence conditions. Consequently the blend of the two is, and will continue to be, somewhat different from regulatory policies exhibited in larger, more established markets with multiple competitors. We consider this to be in line with a body of academic literature that we have cited in the report.

¹⁰⁷ [UR Strategic Approach to Energy Retail Markets and Consumer Protection An Information Paper](#), May 2014.

We also believe the NI experience strongly suggests that regulation and competition can usefully co-exist. Some form of direct price regulation is often necessary to deliver and sustain competitive entry until it is well-established. Even in an effectively competitive market consumers cannot necessarily be protected in all respects at all times. As we have seen in the GB market the removal of price control does not invalidate regulatory interventions. Indeed in the case of GB the rate and degree of interventions has increased dramatically since 2008.¹⁰⁸ Thus we believe a hybrid market can provide the dual benefits of competitive offering and regulated prices to ensure excessive profits are avoided, and there is transparency with regards pricing for regulators, government and customers.

Furthermore, in a small market with clear limits on the number of viable players, we see real risks of oligopolistic pricing and associated customer detriment if price controls are removed too quickly. In such circumstances it is a moot point whether sufficient suppliers are likely to emerge that will enable regulated pricing to be removed altogether. Consequently we would expect that this co-existence of competition with price regulation of the incumbents in NI will continue for some time. Competition could be stimulated by increasing the allowed profit (increasing “headroom”) in the price controls, but we believe this will tend to create customer detriment as costs to the large number of sticky customers will increase. At the same time new entry will continue to be limited by the size of the market and relatively high costs of entry.

Through the review we and stakeholders who we interviewed identified a number of measures that could or should be considered to improve the functioning of the energy markets in NI. These warrant consideration as part of the follow-up to this report and as the scope of stage 2 is considered. We note these in section 4.4. While these measures might improve some aspects of the competitive process, for instance, improving customer access to information or improving predictability of costs, it is important to emphasise that they are unlikely to fundamentally change the competitive dynamic, and we would expect to see continuing price regulation being a feature of the market for some time to come.

4.2 Conclusions by competitive characteristic

We now summarise our conclusions on the different benchmarks adopted by the CMA and other regulators to evaluate the state of competition.

4.2.1 *Weak customer response*

We found household customer response to competition has been adequate but could be strengthened. The level of engagement measured by switching is reasonable but has fallen when looking at switching activity between suppliers. Compared with smaller markets that have been recently introduced to liberalisation, the NI performance in both electricity and gas is not unfavourable.

We conclude that the current position is primarily driven by the following factors:

- NI is a small market;
- while there is an electricity only comparison site, there are no switching sites in NI;
- there are different consumer preferences and/or high satisfaction levels with existing suppliers; and
- the presently limited potential for dual fuel offers.

Evidence gathered indicated similar trends in smaller businesses. Switching levels are below average by international standards and there currently exists no central resource for such consumers to independently compare or contrast offers and prices. Brokers are relatively new to the NI landscape but are growing their activities.

In contrast the larger I&C market was found to show signs of strong consumer response. Consumers at this end of the market are generally very well informed and often have a detailed understanding of the cost elements of their contracts.

¹⁰⁸ In other markets with high switching rates such as Netherlands the regulatory authorities still scrutinise tariffs and have the power to ask suppliers to vary them.

4.2.2 *Weak competition*

NI energy markets are still characterised by high levels of market concentration in all sectors other than the larger business markets in electricity, but become less so towards the higher consuming end of the market. The number of suppliers in all sectors is small. However, comparison with neighbouring markets, and markets across Europe, indicates that there is nothing peculiar to the NI markets at this stage of liberalisation given its size.

We also found that a relatively high proportion of domestic customers in NI are satisfied with prices. There are savings to be made from switching, especially in electricity. A combination of regulated and market based tariffs has resulted in a wider market where customer satisfaction levels are very high compared with neighbouring markets.

Overall we conclude that NI energy market is seeing increasing competition, and the strength of market competition increases with the size of the consumer.

4.2.3 *Vertical Integration*

While three suppliers in NI are part of corporate groups that include generation companies, we have concluded that there is no evidence that any of these relationships are harming competition. Given the nature of the SEM, which is mandatory pool, all imports must be routed through it and all exports must be purchased from it, which limits the ability of integrated parties to foreclose the market.

However, through the introduction of the I-SEM and subsequent changes in corporate structure, we may see vertical integrated companies leveraging market power, and this is an area for the regulator to continue its monitoring.

4.2.4 *Barriers to entry*

The main barrier to entry in all market segments is market size, especially given the levels of competition that already exist. That said the competitive infrastructure is poorly developed (for instance, while there is a comparison site for electricity, there are no commercial switching sites).

Many suppliers indicated that the entry processes were not a concern, but several indicated further alignment between gas and electricity could be desirable and might encourage greater entry. On balance, while we would always support measures that improve market access and efficiency, we are not convinced alignment for the sake of it will lead to new entry that would not otherwise occur.

4.2.5 *Tacit coordination*

There is evidence of tacit coordination in the smaller NI markets, primarily through the mimicking of the incumbents pricing behaviour. This however is a rational response by the new entrants. Given that the aim appears to be price at a discount to the incumbents, this behaviour benefits customers.

We conclude that in the household and smaller I&C markets it is entirely rational for new entrants to follow the price of dominant suppliers.

There was insufficient empirical evidence to draw any conclusion on tacit coordination in the larger business markets. We did not receive any complaints in this regard, but on the contrary generally found a good level of satisfaction with supplier margins and responsiveness.

4.3 Issues for possible further investigation

We have identified a number of issues that the UR should consider further, in conjunction with market participants, to improve market processes and support competition. In our view these are worthy of exploration regardless of the future direction of the market framework, which will see roll out into the Ten Towns next year of itself increasing competition.

Although this report was not commissioned to propose remedies, we believe the following could help shape the scope of the second phase of the UR's review of retail markets. The findings fall under three headings, customer engagement, cost transparency and other issues.

4.3.1 Customer engagement

The household and smaller I&C market requires continued education on the process for taking advantage of the competitive retail market. There is certainly a role for the UR and CCNI to play in this area, but so does the rest of the industry. This is particularly important in the context of elements of the local media reporting on the negative aspects of GB energy markets (but not NI).

Development of an online comparison service in both fuels that also allows for customers to switch providers could improve consumer engagement, especially in the domestic markets. Although such services are not necessarily easily accessible by all consumers (i.e. requires internet access and a degree of consumer proficiency), they have been shown to drive increased engagement in markets where they are present, especially in a market that is generally experiencing a move away from face-to-face marketing. Such facilities can also be used by advisers to those who do not have direct access to the internet.

In a market the size of NI it is open to question whether such services will appear commercially (the current comparison site limits itself to electricity tariffs and does not allow for switching). While it does not allow a switch to be completed, it does enable customers to be directed to their preferred supplier based on the comparison to effect a switch. We believe it is worth exploring whether the industry and/or public authority (such as CCNI or the UR) could provide the service if it appears that the private sector will not. This could deliver the benefit of a trusted and impartial broker providing the service on a not-for-profit basis. The impacts on the ability for private operators to offer services would need to be carefully considered.

It appears to be the case that many price sensitive customers have switched, but real savings continue to be available. The UR should consider how awareness of the benefits of competition can be better communicated to the public.

An accreditation and suitable regulatory framework for brokers operating in the I&C market should also be considered against existing legal and regulatory protection, before issues arise and trust is damaged. This could be seen as a pre-emptive move by the UR, but our assessment suggests there is sufficient reason to investigate the case for additional consumer protection now.

4.3.2 Cost transparency

The process for communicating third party charges to suppliers could be improved.

The timeliness of notice periods for changes to network charges could be longer to allow suppliers to more effectively assimilate costs into tariffs (and give the required notice to consumers) and for customers with pass-through contracts greater time to budget for changes. Longer notice periods should also reduce risk premia being passed onto consumers (as higher than necessary prices) and outweigh any dis-benefit to the regulated company in terms of revenue collection.

There is also a case to be made that the rationale for the derivation of regulated charges to be more clearly communicated. For network charges this is particularly important for larger customers who struggle to rationalise within their own businesses why a significant fraction of their energy bill has changed but where their own consumption pattern has not.

In the same vein, the communication of how future price regulation changes will be derived should assist new entrant suppliers in hedging their own costs and pricing tariffs.

Related to this, the UR should consider whether there is merit in establishing a forum to help suppliers better understand third party charges, including policy costs as well as network charges.

4.3.3 *Other issues*

An important consideration throughout the review was for us to have regard to circumstances specific to NI. These centred on the size of the market and whether the competitive framework was effective in the context of the UR's current duties.

In all but one case (Budget Energy), new entrants to the NI retail market had degrees of presence in neighbouring energy markets (Airtricity, Electric Ireland, Energia, and Vayu) or were already present in NI as a retailer of alternative fuels (LCC). This suggests that additional entry is more likely to come from existing energy companies (as seen in other markets) where economy of scale benefits can be realised. This view was reinforced by the opinions expressed by many stakeholders, including customers and their representatives during our interviews. However, it is not possible (without major political and legislative change) to fully align the NI retail market with either neighbouring markets. Moreover the UR's duties are to have regard to the interests of NI consumers.

We have set out already our view that the UR seems to have delivered reasonable levels of competition in a relatively short period of time. We have nevertheless identified some possible measures, in addition to those around customer engagement above, that might help support switching in NI, some of which reflect suggestions put to us during the course of the review.

These areas for further consideration are:

- an assessment of the gas switching process, and a review of the objections process for both fuels would verify the scale of concerns reported and determine if action is appropriate;
- the UR should more generally consider whether entry processes within its remit are appropriate and facilitate market entry;
- the UR should consider how it might better fulfil the role of “critical friend” for prospective new entrants, including establishing a “road-map” for them in both electricity and gas, but also the resource implications of taking on such a role;
- as a minimum it should nominate an individual to deal with market entry questions and concerns; and
- where regulatory changes are proposed they should also be assessed against the impact they could have on both existing competition and new entry.

Appendix A: Glossary

Acronym	Meaning
ACER	Agency for the Cooperation of Energy Regulators
CMA	Competition and Markets Authority
CCNI	Consumer Council Northern Ireland
CPS	Consumer Protection Strategy
CEER	Council of European Energy Regulators
DETI	Department of Enterprise, Trade and Investment
EU	European Union
FWP	Forward Work Programme
GB	Great Britain
I&C	Industrial and Commercial
I-SEM	The planned reformed SEM (see below)
KPI	Key Performance Indicator
NI	Northern Ireland
NIAUR	The Authority or Board of the Utility Regulator
NIRO	Northern Ireland Renewables Obligation
NISEP	Northern Ireland Sustainable Energy Programme
OFT	Office of Fair Trading
PAYG	Pay As You Go
PSO	Public Service Obligation
QTR	The Utility Regulator's Quarterly Transparency Reports
RoI	Republic of Ireland
REMM	Retail Energy Market Monitoring
SEM	Single Electricity Market
SME	Small and medium enterprise
SoLR	Supplier of Last Resort
IME3	The European Union's third internal energy package for electricity and gas
UR	The Northern Ireland Utility Regulation (the Utility Regulator). This is the executive arm of the NIAUR
Ofgem	The Office of Gas and Electricity Markets in Great Britain

Appendix B: Key metrics of the NI energy retail market

Electricity retail markets were initially opened for large non-domestic consumers in 2002, with the smaller non-domestic market being opened over the following couple of years. In 2007, the domestic market was opened to competition but it was a further three years before the first new entrant entered into the NI market.

Power NI is the incumbent electricity supplier and is still demonstrably the largest supplier to domestic and small business customers. Domestic electricity customers and smaller non-domestic industrial and commercial (I&C) customers are protected by a regulated tariff control which is set out in Power NI's supply licence. I&C customers above this threshold, and customers of other electricity suppliers in NI, are currently not covered by the UR's supply price control regime.

Natural gas was introduced to NI in 1996 and there are now around 185,000 households and 12,000 businesses with a gas supply (including power generators), compared to 80,000 in 2004. The gas distribution network in NI is currently divided into two distinct areas:

- the Greater Belfast area was opened to supply competition in 2007, Phoenix Natural Gas is the distribution network owner; and
- the "Ten Towns" area, which encompasses the major towns outside Belfast, was opened to supply competition for I&C customers on 1 October 2012. The smaller business and domestic market will not open to competition until April 2015. Until then all customers in this market will be supplied by Firmus energy, an integrated supply and distribution network operation. There is also a major project to deliver gas in the future to consumers in the west of NI.

In Greater Belfast, SSE Airtricity (following the purchase of Phoenix Supply Ltd) is the incumbent supplier. Domestic and smaller non-domestic I&C customers of SSE Airtricity are protected by a maximum average price approved by the UR as set out in their supply licence. I&C customers using above this threshold, and customers of other gas suppliers in the Greater Belfast area, are not covered by UR's supply price control regime.

In the Ten Towns area the incumbent (Firmus energy) is the sole supplier for domestic and small business consumers. The costs of the incumbent are controlled through a distribution price control.

At the end of March 2014 the NI energy markets featured the following:

- 784,057 domestic electricity customers;
- 60,355 non-domestic electricity customers;
- Five active domestic electricity suppliers;
- Eight active non-domestic electricity suppliers;
- Power NI (the ex-incumbent electricity supplier) held 73% domestic market share and 50% non-domestic market share by meter point;
- Domestic electricity prices are around the EU-15 median, but generally slightly above GB prices;
- Non-domestic (particularly larger I&C) face higher than the EU-15 median electricity costs;
- The Greater Belfast area has 165,429 domestic and small business gas customers and 3,189 large non-domestic customers;
- There are two active domestic and four non-domestic gas suppliers in the Greater Belfast area;
- SSE Airtricity (the ex-incumbent) held 72% domestic market share and 67% non-domestic market share (by connection points) in the Greater Belfast area;
- The Ten Towns area has 20,273 domestic gas customers and 2,163 non-domestic customers;

- There is one active domestic (Firmus) and two non-domestic gas suppliers in the Ten Towns area;
- Firmus (the sole domestic supplier) holds 92% of the large non-domestic market (by connection points) in the Ten Towns area; and
- NI domestic gas prices are the lowest in the EU-15

Appendix C: Quantitative and qualitative information sources

- Utility Regulator Northern Ireland (2013) *Forward Work Programme 2014 – 15*.
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- Competition and Markets Authority (2014) *Energy Market Investigation*.
- Ofgem (2014) *State of the Market Assessment*.
- Competition Commission (2013) *Guidelines for market investigations: Their role, procedures, assessment and remedies*.
- Utility Regulator (2014) *UR Strategic Approach to Energy Retail Markets and Consumer Protection*.
- Ofgem (2011) *The Retail Market Review - Findings and Initial Proposals*.
- CER (2014) *Findings from 2014 Research on Attitudes and Experience in the Domestic and SME Electricity and Gas Markets in Ireland*.
- DECC (2014) *Quarterly Domestic Energy Switching Statistics*.
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- Northern Ireland Electricity (2014) *NIE Schedule of Public Service Obligation (PSO) Charges for the Period 1 October 2014 to 30 September 2015*.
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- Utility Regulator Northern Ireland (2014) *Northern Ireland Sustainable Energy Programme*.
- Utility Regulator Northern Ireland (2014) *Gas to the West Consultation*.
- Republic of Estonia Competition Authority (2014) *Annual Report 2013*.
- Republic of Estonia Competition Authority (2013) *2013 Guidelines for the Determination of Weighted Average Cost of Capital*.
- Cyprus Energy Regulatory Authority (2014) *2013 National Report to the European Commission*

- European Commission (2007) *Questions and Answers*
- European Union (2007) *Official Journal of the European Union* , Available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:161:0006:0006:EN:PDF>
- *Fixed voice telephony in economies of different sizes: When industry policy meets technological change*. Pavlos C. Symeou and Michael G. Pollitt, *Technological Forecasting and Social Change* 86 pp 273-286, 2014
- *Excessive Pricing by Dominant Firms in Small Market Economies*. Dissertation for the European Master in Law and Economics, by Nir Ofer, August 2012
- ACER, CEER, *Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets in 2012, 2013, and 2014*

Appendix D: August 2014 omnibus questions

1. Are you responsible for paying electricity and gas bills for your household?
2. Is gas the main source of heating in your home?
- 3a. Do you have a choice of electricity supplier?
- 3b. Do you have a choice of gas supplier?
4. Who is your electricity supplier?
5. Who is your gas supplier?
- 6a. How do you pay for your electricity?
- 6b. How do you pay for your gas?
- 7a. When did you yourself last look at your electricity bill or statement of expenditure (either by post/email or online)?
- 7b. When did you yourself last look at your gas bill or statement of expenditure (either by post/email or online)?
- 8a. How easy or difficult is it to understand your electricity bill or statement?
- 8b. How easy or difficult is it to understand your gas bill or statement?
- 9a. How accurate do you think your electricity bills or statements are?
- 9b. How accurate do you think your gas bills or statements are?
- 10a. If you thought there was a problem with your electricity bill or statement, what would you do?
- 10b. If you thought there was a problem with your gas bill or statement, what would you do?
- 11a. How would you prefer to receive bills and statements from your electricity supplier?
- 11b. How would you prefer to receive bills and statements from your gas supplier?
- 12a. Thinking about your electricity meter, do you agree with these statements?
 - I know where my meter is
 - The location of my meter is convenient for me to access
 - I find the information on my meter to be useful
 - I find the information on my meter easy to understand
 - I would like to be able to obtain more information from my meter
- 12b. Thinking about your gas meter, do you agree with these statements?
 - I know where my meter is
 - The location of my meter is convenient for me to access
 - I find the information on my meter to be useful
 - I find the information on my meter easy to understand
 - I would like to be able to obtain more information from my meter
- 13a. How satisfied are you with these aspects of the services provided by your current electricity provider?
 - Price
 - Flexibility of payment options
 - Customer service

- Overall

I3b. How satisfied are you with these aspects of the services provided by your current gas provider?

- Price
- Flexibility of payment options
- Customer service
- Overall

I4a. Have you ever switched your electricity supplier?

I4b. Have you ever switched your gas supplier?

I5a. What prompted you to switch your electricity supplier?

I5b. What prompted you to switch your gas supplier?

I6a. Would you consider switching electricity supplier?

I6b. Would you consider switching gas supplier?

I7a. What is the main reason why you would consider switching your electricity supplier in the future?

I7b. What is the main reason why you would consider switching your gas supplier in the future?

I8a. How easy or difficult is it to compare the tariffs on offer from the different electricity suppliers?

I8b. How easy or difficult is it to compare the tariffs on offer from the different gas suppliers?

I9a. Have you ever approached your existing electricity supplier to switch to another tariff they offer?

I9b. Have you ever approached your existing gas supplier to switch to another tariff they offer?

20a. To what extent do you trust or distrust your electricity supplier to be open and transparent in their dealings with consumers?

20b. To what extent do you trust or distrust your gas supplier to be open and transparent in their dealings with consumers?

Appendix E: List of interviewees

- Belfast Education & Library Board
- Bord Gáis
- Budget Energy
- Consumer Council NI
- Electric Ireland
- Energia
- Federation of Small Businesses
- Firmus Energy
- Flogas
- Jamie Delargy/Enirgy.info
- LCC
- Major Energy Users Council
- Manufacturing NI
- NI Water
- Power NI
- Seagate
- SSE Airtricity
- Vayu
- Which?

Appendix F: List of interview questions

1. Given where the current market liberalisation programme is do you believe that NI markets are as competitive as they could be? [Give reasons]
2. The UR has set out a proposed consumer segmentation of the market—do you agree with their categorisation?
3. Do you have evidence (and if not a view) on which parts of the retail market are the most contested and why?
4. Do you believe the following actions would improve or worsen competition in the energy retail markets:
 - public awareness raising campaign
 - extending the gas network
 - entry of brokers/comparison sites
 - more sophisticated metering
 - publication of more advice/information (for consumers)
 - publication of more data/information (for participants)
 - reforming the wholesale (SEM to I-SEM) arrangements
 - aligning UR's gas and electricity duties
 - otherwise changing UR's duties
5. How do you see the retail market evolving over the medium-term?
6. What do you think of the wider European programme to liberalise and harmonise markets?
7. Does accessing wholesale markets have any detrimental impacts for suppliers? [product access, shape, credit]
8. Which, if any, processes could be improved in the retail markets? [And if yes, how would this be implemented?]
 - switching process
 - meter registration
 - market entry
 - price control settlements
 - monitoring/reporting to authorities
 - other?
9. What are your views on how non-discretionary costs are passed through (ultimately) to consumers?
 - network charges—for delivering energy to customer's meters/properties
 - policy costs—programmes to support the development of renewables or improve energy efficiency
10. Which areas of the retail market (or upstream) do you believe work well?
11. Are there factors that may prevent suppliers expanding at the rate they would like?
12. Do you believe retail markets currently sufficiently protect the interest of consumers? Does this also apply to vulnerable customers.

Appendix G: Third Energy Package

The NIUR is subject to clear statutory duties with regard to its regulation of the NO energy markets. These duties are applied within the wider context of the European energy directives.

The European Commission's Third Energy Package¹⁰⁹ was adopted in September 2007. The legislation sought to build on the two previous suites of directives to establish internal gas and electricity markets in the EU, primarily by:

- unbundling of networks;
- facilitating cross-border trading;
- strengthening the role of national regulators; and
- introducing an Energy Customers' Charter.

The package was adopted two months after all markets, in principle, were opened to consumers (1 July 2007) and strengthened the legal framework for opening retail markets.

The rationale for retail competition, as stated in accompanying European Commission press releases¹¹⁰, is that "competing suppliers ... will try to make sure that their clients have the lowest prices and the best possible service, for example dealing with customers' complaints in a professional manner, making sure that switching to them as the new supplier is as easy as possible, etc." and "consumers can also choose to fix their price for a few years or not, depending on their own estimates of market developments". Experience in other jurisdictions with much higher levels of competition than NI illustrates that these two objectives will not always be achieved or that both can be achieved coincidentally.

The Commission also highlighted that market opening could not guarantee lower prices, but stated that "studies indicate that in liberalised energy markets the difference between production- and end-consumer prices is smaller than in non-liberalised markets. This demonstrates that consumers pay less for energy in liberalised markets than what they would pay in markets where there is no competition".

The Third Energy Package demands a 'reasonably priced' energy supply should be guaranteed: "Member States shall ensure that all household customers, (...), enjoy universal service, that is the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices. To ensure the provision of universal service, Member States may appoint a supplier of last resort".

A key element of the European liberalisation programme, in the context of this review, is that it empowered national governments to ensure that all citizens can access affordable energy. It also allowed for the imposition of energy prices to protect vulnerable customers or to ensure public service obligations, provided they respect certain conditions. National regulators interpret universal service characteristics and the need for a supplier of last resort (SoLR) from the perspective of how they are applicable in their jurisdiction.

For example, these range from the minimum SoLR arrangements whereby the SoLR simply acts as a backstop and ensures that consumers will continue to receive electricity if a supplier fails (the GB model); through to a SoLR that provides the full backstop services including a "last resort" price regulated tariff (as in Estonia).

The legislation does make clear that regulated prices "should be the exception and not the rule in a competitive environment" as their presence for all customers would prevent the benefits of competition being realised.

Infringement proceedings have been brought against Member States that have, in the opinion of the European Commission, not introduced legal or regulatory frameworks for prices to be set primarily by supply and demand dynamics.

¹⁰⁹ http://ec.europa.eu/energy/index_en.htm

¹¹⁰ http://europa.eu/rapid/press-release_MEMO-07-362_en.htm?locale=en

The Court of Justice¹¹¹ clarified in a case in 2008 that the criteria under which regulated prices could be compatible with internal energy market legislation. These were where the measure is in: the general economic interest; compliant with the principle of proportionality; clearly defined, transparent, non-discriminatory and verifiable; and guarantees equality of access for EU energy companies to national consumers.

¹¹¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:161:0006:0006:EN:PDF>

Appendix H: Data on small markets

In this Appendix we set out a range of supporting information on smaller markets and possible comparators.

It comprises:

- further detail on the 2012 ACER review;
- summary notes on three markets similarly sized to NO with the European Union; and
- summary tables of key information from the ACER reviews from 2011, 2012 and 2013.

HI. ACER 2012 review

The ACER/CERR *Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets 2012*¹¹², published November 2013, provides a particular focus on retail markets and consumer issues and unlike the 2014 survey, which has been published since specifically includes NI in the sample of reported countries.

In 2012 regulated prices were in place for households in 18 electricity (of 27) and 15 gas (of 25) retail markets. In the four years from 2008 to 2012 the percentage of European household electricity consumers supplied via a regulated price reduced from 58% to 49%.

As a consequence customer prices clustered around the regulated price. The report stated that, where regulation reduced margins (or featured negative margins), it could reduce market entry incentives and ultimately dilute competition. Concerning this aspect the report noted that “to continue promoting market entry, retail price regulation should be removed when the main barriers to entering retail markets have been addressed.”

Where regulated prices are present ACER/CEER recommended that the sourcing cost parameter(s) in the tariff should be updated frequently to follow costs movements that non-regulated suppliers faced. In terms of setting out plans to remove price controls only one-third (Denmark, Latvia, Lithuania, Poland, Portugal and Romania) of the 18 electricity markets with regulated prices reported to have developed plans to remove them.

At the very core of the European energy packages is the belief that effective retail competition is the mechanism by which consumers should receive high quality choices regarding the nature of their contract (length, payment terms, service levels etc.) and have confidence that prices closely reflect costs.

While price-regulation is often viewed as a surrogate for competition, it provides the essential role of filling the consumer protection gap in circumstances where effectively competitive markets have not been achieved (for whatever reason). It is therefore incumbent on energy regulators to demonstrate, and make the case on best available information, for retaining or removing price regulation. As it is to be expected that a market created from a previously monopolistic arrangement features price regulation, it does not necessarily follow that price regulation should be removed simply because the market is of a certain age, or the incumbent’s market share has dropped to a pre-agreed level.

It may be that a SoLR with an administered price is required where the regulator cannot be confident market forces alone will always result in adequate protection (including price) for the most vulnerable in society. In the NI context the issue of the size (and contestability and appetite for entry) of the market is an additional dimension for consideration (see 3.6.3). It may also be that there are fundamental barriers that may never support fully liberalised competition e.g. small market size.

¹¹²

http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202013.pdf

The ACER/CERR *Annual Report* also concluded that, in general, consumer choice is facilitated through online comparison services and the adoption of standardised fact sheets for tariff offers (including comparable unit rate and standing charges for standard consumption profiles). Interestingly the report found that “switching and competition were more pronounced in Ireland, but are either stabilising or decreasing in strength in mature markets such as GB.”¹¹³

The report found that in gas markets where higher savings could be realised by switching the rate of switching was also higher, but no such trend was found in electricity markets.

On the issue of barriers to entry, the report concluded that across the EU-27 barriers persisted (with a number of exceptions), with the reasons being primarily:

- difficulties and reluctance of consumers to switch;
- retail price regulation; and
- regulatory framework for network pricing.

It also highlighted that non-quantifiable aspects of consumer behaviour might act as a barrier to retail entry including consumer loyalty, inertia and risk aversion.

H2. Notes on small markets

Estonia

Estonia fully opened up its retail electricity markets to all customers on 1 January 2013. According to the Estonian Competition Authority’s (ECA’s) *Annual Report 2013*,¹¹⁴ by the end of 2013 there were 15 licensed electricity suppliers. Prior to this distribution and supply were unbundled.

Customers “that had not concluded an agreement with an electricity supplier” have access to a “universal service” contract provided by the local network operator. These prices are monitored ex-post and based on the monthly weighted average Nord Pool Spot plus justifiable profit margins¹¹⁵. As of the end of 2012 only one supplier had a market share greater than 5%.

The transition to competition is thus based on a very different path to more traditional market opening where new entrants are encouraged to compete with an incumbent.

Given the transitional status of the electricity retail market, the ECA has not set out its plans for the future of retail competition and regulation.

Malta

The Maltese islands have derogations from the EU third energy package requirements by virtue of being islands without interconnection, and are so deemed to be physically “isolated” and unable to benefit from harmonised and liberalised markets.

The Malta Resources Authority (MRA) acts as the energy regulator. The MRA has derogations concerning unbundling networks, third party access to networks and retail market opening. In essence the electricity sector is a state monopoly with the MRA determining and approving tariffs sold by Enemalta Corporation (fixed annual service charges and kWh unit rate). Lower consuming households can benefit from an “eco reduction” tariff and single person households can apply for a 25% reduction on the unit rate.

A 225MW interconnector with Sicily is planned (expected to be operational by the end of 2015) and will allow access to the wider European market at which point the derogations are likely to be reviewed.

Cyprus

¹¹³ We would note that the GB market has seen a significant change in the last 18 months, with new entrant suppliers in the household market almost doubling in number and as a group increasing their market share from under 1% to 7.5%

Cyprus also has derogations from the EU third energy package requirements by virtue of being islands without interconnection, and are so deemed to be physically “isolated” and unable to benefit from harmonised and liberalised markets.

Cyprus opened its electricity retail markets to larger consumers in 2004 with the smaller business market opened in 2009. The Electricity Authority Cyprus (EAC) was the incumbent generator and supplier. The Cyprus Energy Regulatory Authority (CERA) 2013 *National Report to the European Commission*¹¹⁶ states that no new entrants have emerged, making EAC the only supplier. The electricity market was fully opened to competition on 1 January 2014. The CERA has taken steps to reduce cross-subsidy between tariffs by distinguishing different customer segments (household through to larger industrial) and applying different unit rate % annual increases.

There is no publically available information on the CERA’s plans for the future of retail competition. It should be noted that a large explosion in 2011 in the vicinity of the country’s largest power plant resulted in an energy market emergency and rolling blackouts.

H3. Key information from ACER 2011, 2012 and 2013 reviews

Table H1: Small European electricity markets¹¹⁷

Country	Regulated household prices			Regulated SME prices			Regulated industrial prices			Household consumers			No of suppliers			Household switching rates %		
	2013	2012	2011	2013	2012	2011	2013	2012	2011	2013	2012	2011	2013	2012	2011	2013	2012	2011
N. Ireland		✓		Information not available		Information not available	Information not available	✓	Information not available	Information not available	2mn	Information not available	4	4	Information not available		2.0%	2.0%
Estonia		✓	✓		✓			✓			18mn		19	16		12.8%	0.0%	0.0%
Cyprus	✓	✓	✓		✓			✓			300k		1	1			0.0%	0.0%
Malta	✓	✓	✓		✓			✓			200k		1	1			n/a	0.0%
Latvia	✓	✓									1mn		1	1			0.0%	0.0%
Lithuania	✓	✓	✓		✓						1mn		1	1			0.0%	0.0%
Poland		✓	✓		✓						18mn		21	7		0.7%	0.6%	n/a
Portugal		✓	✓		✓						5mn		5	4		26.6%	13.2%	1.1%
Romania	✓	✓	✓		✓			✓			10mn		1	1			0.0%	0.0%
Slovenia											-		7	8		3.8%	5.9%	4.0%
Greece		✓	✓		✓			✓			5mn		4	1			4.0%	1.8%
Luxembourg											-		5	6			0.1%	0.2%
Denmark		✓	✓		✓						4mn		23	19		6.1%	3.7%	1.8%
Slovakia		✓	✓					✓			2mn		7	16		3.8%	5.0%	1.4%
Hungary	✓	✓	✓					✓			4mn		4	2			1.6%	n/a
Czech Republic											-		32	24		5.8%	7.6%	7.4%
Bulgaria	✓	✓	✓					✓			4mn		1	1			0.0%	0.0%

¹¹⁷ : [ACER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets 2011](#), [ACER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets 2012](#), [ACER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets 2013](#)

Table H2: Small European gas markets¹¹⁸

N. Ireland	Information not available	37%	Information not available		✓	✓	Information not available		Information not available	Information not available				Information not available		3mn	Information not available	0	-	Information not available		-	7.5%					
Estonia		8%			✓							37%	33%			2mn			6			12.3%	-	3.6%				
Latvia		53%			✓	✓		✓				50%	-			500k		I	I			0.0%	0.0%					
Lithuania		44%			✓	✓							-			500k		I	I			0.1%	-	0.0%				
Poland		-			✓	✓		✓					-			8mn		I	I			0.1%	0.0%	0.0%				
Portugal		33%			✓	✓		✓					38%		17%			1mn	4		3		6.1%	n/a				
Romania		42%		✓	✓	✓		✓							-			2.5mn	I		I		n/a	n/a				
Slovenia		15%			-										-			-	14		6		5.6%	-	1.7%			
Greece		7%		✓	✓	✓		✓							-			-	I		I			0.0%	0.0%			
Luxembourg		40%			-										-			-	I		-		0.1%	-	0.1%			
Denmark		-			✓	✓									8%	-			10		11		9.8%	3.2%	n/a			
Slovakia		74%			✓	✓		✓								-			1.5mn		13	12		6.1%	9.3%	1.5%		
Hungary		87%			✓	✓										-			3mn		4	-		n/a	n/a			
Czech Republic		64%			-											3%		3%			-		18	18		10%	-	12.5%
Bulgaria		3%			✓	✓									✓			-			2mn		I	I			0.0%	0.0%

118 : [ACER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets 2011](#), [ACER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets 2012](#), [ACER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets 2013](#)