



Energia House
62 New Forge Lane
Belfast
BT9 5NF

Tel: +44(0)28 9068 5941
Fax: +44(0)28 9068 5935

Elena Ardines
Utility Regulator
Queens House
14 Queen Street
Belfast
BT1 6ER

20 January 2010

Dear Elena,

FORWARD WORK PROGRAMME: APRIL 2010 – MARCH 2011

Thank you for the opportunity to comment on the Utility Regulator's work programme for 2010/11.

The positive level of engagement with stakeholders by means of this consultation and the workshop hosted by the Utility Regulator (NIAUR) and chaired by Ian Osbourne on 15th December 2009 is welcome. From this it is clear that NIAUR has set itself very challenging targets across a wide ambit of areas in both energy and water regulation for the forthcoming year. It is also clear that the work programme is about turning strategy into actions and is hence strongly influenced by the priorities set out in NIAUR's corporate strategy for 2009-14. In this response Viridian Power & Energy (VP&E) will restrict its comments to energy regulation.

Given limited resources it will be necessary for NIAUR to prioritise its tasks for the coming year and whilst it is important to be cognisant of its corporate strategy formulated in 2008 the current economic environment cannot be ignored. For example the global credit crisis has significantly increased the difficulty in raising capital and this will inevitably place a serious strain on investment decision making. As such, measures that will enhance regulatory certainty should be prioritised as this will deliver efficient investments and minimise cost to consumers.

In particular VP&E would encourage measures to ensure flexible thermal generation investment by maintaining a stable market and regulatory framework amenable to securing capital funding for new investments. There is a particular need to enhance stability of the capacity payments mechanism (CPM) and consistency of methodology employed. Recent ad hoc alterations to the CPM undermine the credibility of the mechanism (e.g. the change from a 15 to 20 year investment horizon) and its ability to ensure efficient investment in flexible generating capacity and the orderly exit of existing plant from the market. VP&E recognises that with falling demand a challenge to security of supply is unlikely in the short term, particularly with a number of new generators now in the market or under construction. However the CPM provides long term investment signals and short term deviations in the methodology used will have long term consequences for security of supply and efficient investment. VP&E suggests that the medium term review of the CPM remains a high priority for 2010 and we prefer an approach where conventional plant would be commercially incentivised to be flexible through ancillary services and by not manipulating the capacity payments mechanism.

We note that environmental sustainability is an important goal in NIAUR's corporate strategy. It is necessary to recognise recent developments in this context also and in particular the Department of Enterprise, Trade and Investment (DETI) draft strategic energy framework (SEF) which proposes a renewable energy target of 40%. VP&E fully supports this proposed commitment to delivering stretching renewable energy targets for the benefit of the environment, energy security and economic competitiveness. However this target, or any challenging renewable target, will not be achieved without an effective and appropriate renewable support mechanism, particularly in the current economic climate. The Northern Ireland Renewable Obligation (NIRO) is working very well in this regard and can be credited for instigating a marked increase in renewable projects since its introduction in 2005¹. VP&E strongly cautions against any unnecessary changes to the NIRO and questions the need for a review of support mechanisms for renewable generation, as outlined in the work programme. We say more about this later in our response.

To meet renewable targets it will also be necessary to have appropriate grid infrastructure in place. On this note VP&E welcomes NIAUR's commitment to a Grid Development Strategy as this will be essential for meeting Northern Ireland's future environmental, economic and security of supply challenges. However more transparency is needed on this to ensure that it

¹ For example after the NIRO was introduced in 2005 there was an eightfold increase in the number of renewable projects submitted to planning compared with the previous four year average.

takes into account the planned windfarm developments across NI, well ahead of the timetable when network capacity is needed. Currently NI is lagging well behind the Republic of Ireland (ROI) in this area but this is something that can be addressed providing there is sufficient commitment, communication and resources devoted to it.

We also welcome NIAUR's commitment to contribute to wider government policy by working with DETI in delivering its strategic energy framework. We suggest it would also be helpful if NIAUR was clear about its role in delivering government and EU energy targets at the outset of the work programme with a statement along the following lines: 'We will work to support delivery of government and EU renewable, energy efficiency and emission reduction targets through stable regulatory mechanisms'

We have already noted the importance of flexible thermal generation to accompany wind. Interconnector flexibility also needs to be enhanced. On the island of Ireland we have a small electrical system that is less flexible and diverse than the GB system. Accordingly it is likely to be cheaper for consumers here to draw upon the flexibility of GB to accommodate wind variability. In the short term there is a particular need for more flexible trading arrangements with BETTA (particularly the ability to execute short term trades between SEM and BETTA by allowing market participants to trade with the system operator after SEM gate closure to manage interconnector flows) as this would be an effective measure for dealing with excessive generation events and in managing constraints more generally. We therefore suggest this be given high priority in the coming year.

VP&E would like to reassure NIAUR of its continued commitment to the development of competition, particularly on an all-island basis and VP&E recognises that the introduction of the Single Electricity Market (SEM), albeit imperfect, has significantly improved electricity retail competition across the island of Ireland. VP&E has however been disappointed at the slow pace of gas retail competition in NI. We continue to work with NIAUR to remove barriers to competition, but have found the pace of change slow. There is a real need for competition friendly regulatory measures, which we suggest later in this response.

VP&E reaffirms its commitment and support for the Common Arrangements for Gas (CAG). It has the potential to deliver a package of reform measures that will resolve a number of key gas market issues that persist today and it should ultimately improve retail market design for the benefit of competition and all consumers. These improvements will not come about

overnight but are nonetheless worth pursuing. In the meantime it is crucial not to lose sight of retail gas market developments that are urgently required.

There is a need for delivery of fully informed, well thought through, transparent, consistent and coherent regulatory policies, especially where these directly interact with market competition fundamentals and investment decisions. VP&E strongly suggests that any tasks undertaken in the coming year respect these important regulatory principles and that appropriate time and resources be given to individual projects to ensure this. On this note for example we refer to the locational signals project which constitutes the largest change in the Irish wholesale market since the introduction of the SEM. We expect further consultation on this issue, led by the regulatory authorities, which will include a full impact analysis and detailed assessment of the various options available to safeguard investor confidence and consumer confidence and to ensure the correct approach is adopted.

Finally, given the level of dissatisfaction among customers and suppliers at the way regulated tariffs are determined and communicated to the market, VP&E would request that all regulated tariffs are subject to full consultation in a fully transparent and timely manner. In addition VP&E would ask that NIAUR provide 'best estimate' forward cost projections particularly for PSO & SSS levies and Use of System charges for the incoming and following tariff years.

We comment in further detail below on these and other issues which we consider especially important to either prioritise or de-prioritise in the forthcoming work programme for the benefit of Northern Ireland's competitiveness, security of supply and environmental obligations.

We trust these comments are helpful and as always, please do not hesitate to contact us with any specific questions.

Yours sincerely



Kevin Hannafin
Senior Regulation Analyst

Detailed comments

1. CPM

VP&E remains concerned that the capacity payments mechanism (CPM) is inherently volatile and subject to significant regulatory risk and thus may not be sufficient to deliver the necessary security standard. VP&E recognises that with falling demand a challenge to security of supply is unlikely in the short term, particularly with a number of new generators now under construction. However the CPM provides long term investment signals and short term deviations in the methodology used will have long term consequences for security of supply and efficient investment. VPE suggests that the medium term review of the CPM remains a high priority for 2010 and that it should address three key issues:

- Greater transparency on how the capacity requirement is determined. The workshop last year was a first step in the right direction but more detailed information is required and a further workshop on this would be helpful.
- A more stable CPM that will facilitate efficient financing of new projects at a reasonable cost of capital
- A greater emphasis on ancillary services to reward flexibility to encourage the appropriate plant capabilities, i.e. flexible plant.

2. Renewable support schemes

The draft work programme states an intention to work with DETI to review support mechanisms for renewable generation. This is consistent with a recent DETI consultation which states on page 22 that: "In view of this anticipated difference [the introduction of a feed in tariff for small scale renewables in GB from April 2010] between the NIRO and GBRO and the earlier views expressed about the appropriateness of the NIRO in the context of the SEM (para 3.4), DETI is of the view that, rather than seeking to mirror the DECC proposals on a FIT, some further analysis should be undertaken to determine the most appropriate renewables support mechanism for Northern Ireland. The Department is currently working with NIAUR to undertake an in-depth analysis of the issues involved with a view to determining a longer term approach for renewables support in general in NI including small-

scale generation”². This implies that NIAUR and DETI are exploring the possibility of moving away from the GBRO and possibly towards a feed-in-tariff arrangement consistent with the Republic of Ireland.

A fundamental characteristic of the NIRO is its alignment with the Great Britain Renewable Obligation (GBRO). This is particularly important for financing because bankers across GB and Northern Ireland understand how it works and are comfortable with it. Any changes to the NIRO, particularly in divergence from the GBRO, will significantly concern finance providers by creating confusion, uncertainty and complexity which will inevitably raise the cost of capital and adversely affect renewable deployment in NI. For these and other reasons (such as administrative efficiencies) VP&E strongly cautions against unnecessary divergence from the GBRO.

We have previously responded to DETI on this point (please see our response enclosed) and the arguments we have made there apply equally in this context. The outcome of the GB consultation should also be borne in mind, with a revenue stabilisation mechanism overwhelmingly seen as overly complicated and impractical to implement. The government has acknowledged this and will consult further on the proposals for a price stabilisation mechanism by means of commissioning further research to assess the costs and benefits of introducing such a mechanism, reporting by the end of 2010.

If the intention is to move away from the GBRO scheme we suggest that NIAUR resources would be better deployed on more productive areas for reasons outlined above and in our response to the DETI consultation.

3. Gas competition

VP&E is disappointed to note that lack of progress in retail gas competition remains a fundamental impediment to delivering consumer choice in Northern Ireland. We have consistently raised this with NIAUR and DETI and this concern featured strongly in our response to last year’s forward work programme. We acknowledge that NIAUR is committed to ongoing work in collaboration with GMOG and relevant internal teams to ensure market opening structures in gas (switching, change of supplier) operate effectively and to ensure

² See “Proposed Changes to the Northern Ireland Renewables Obligation”, published by DETI in October 2009.

necessary data transparency to ensure new suppliers access the data they need to compete effectively. However this does not go far enough and is certainly insufficient to ensure that new suppliers can compete effectively in Northern Ireland's gas market.

There is a need to ensure that regulatory action focuses on immediate market reform opportunities such as reform of the imbalance regime, code improvements, and the introduction of regulated business tariff structures akin to fuel variation tariff (FVT) and regulated tariff formula (RTF) in the Republic of Ireland (ROI) that will enable suppliers to instigate an incremental market entry strategy. At the very least we suggest that tariffs be set according to a published hedging strategy other suppliers can compete against without necessarily revealing the propriety gas purchasing information of the incumbent supplier. We would like to stress that we do not need to wait for Common Arrangements for Gas (CAG) to get this started.

Supplier switching processes is another area badly in need of reform. This is currently being addressed in the retail electricity market through the NIE Enduring Solution project but remains a manual process in the Greater Belfast gas market with only 250 gas customers a month able to switch supplier. Meter reading is also a major barrier to entry in the Northern Ireland gas market because the obligation is on the supplier to take meter reads. Direction is needed from NIAUR on how to resolve this fundamental market barrier.

Urgent action must be taken to ensure Northern Ireland's electricity and gas customers do not lose out on the wide ranging benefits of competition. If gas competition is to have a serious chance of developing, it requires the same level of positive activity as seems to be the case for electricity - it must not play second fiddle. This means ensuring that NIAUR embeds this philosophy into all policy reviews, strategy groups, and any workstreams that evolve.

4. Market monitoring in the SEM

At the workshop on 15th December Ian Osbourne stated that in electricity the priority is to ensure the SEM is working well because if it is not then nothing else will work effectively. On this point we emphasise the continued importance of market monitoring in the SEM and that the market monitoring team should focus purely on this specific mandate.

5. Demand side response

The forward work programme states an intention to explore the best proactive approaches to achieving high level demand responses and produce recommendations. VP&E welcome this review and would suggest that demand side management initiatives should not just focus on reducing energy consumption but should also promote dynamic demand which compliments high penetrations of wind on the system. Along these lines we suggest the following:

- Stimulate automatic demand side response and on-site distributed generation technologies.
- Promote dynamic energy efficiency using smart meters and new technologies.

We strongly advise that aggregated generator units are potentially an important part of demand side response. We are disappointed at the length of time it has taken to make progress in making this a feasible approach and note that more needs to be done urgently. We would be happy to meet with NIAUR to discuss these issues in more detail and to share our experiences.

6. Fuel mix disclosure

VP&E welcomes NIAUR's intention to develop the enduring solution for fuel mix disclosure. We suggest this should be dealt with as a matter of urgency and implemented by 2011 at the latest because the interim arrangement is entirely unsatisfactory and does not seem to meet the objectives of Article 3(6) of the Internal Markets Directive. The interim arrangement only recognises bi-lateral purchases (effectively renewables and peat). This means that customers cannot differentiate suppliers on the basis of their full remit of fuel sources. Neither does it recognise that fuel sources other than renewables and peat contribute to a secure and sustainable electricity system.

This contrasts with the enduring solution which will enable suppliers to differentiate their offerings via Renewable Energy Guarantees of Origin (REGOs) for renewable energy sources and Generator Declarations for non renewable energy sources.

Depending on its implementation VP&E would favour the enduring solution as this would seem broadly consistent with the objectives of Article 3(6) of Directive 2003/54 and would

allow customers to differentiate between electricity suppliers based on their coal, gas, oil, peat and renewable generation mix.