

**Bord Gáis Energy Response
to
Proposals on a Roadmap for
Deregulation**

1st February 2010

Executive Summary

Bord Gáis Energy (BG Energy) welcomes the opportunity to submit this response to the Commission for Energy Regulation's (CER) Consultation Paper which sets out proposals on a roadmap for deregulation of the retail electricity market ("Roadmap Consultation"). BG Energy fully supports the policy view underlying the Roadmap Consultation that a fully competitive retail market can bring real benefits to consumers in terms of the choice and quality of the offers available from suppliers, improved value-add services and potentially lower prices. Indeed, BG Energy has called on the CER on many instances to provide a similar roadmap for the Irish gas market for the same reasons.

BG Energy considers that transition to deregulated, fully competitive and open markets should be the fundamental goal of regulation. Towards that end, BG Energy fully endorses the policy that, once a satisfactory level of competition is fostered in newly or recently liberalised markets, all regulation should be removed in favour of free-market solutions. In terms of timing of the CER's proposal to adopt a roadmap, BG Energy considers it important – consistent with the aim of promoting market transparency, openness and competitiveness – that the CER adopt a roadmap for full deregulation of Irish energy markets (both electricity and gas) at the earliest possible moment. Importantly, in order to ensure commensurate and non-discriminatory levels of market transparency across the energy sector, any such roadmap should cover both electricity and gas.

Notwithstanding the considerable effort the CER has put into evaluating market developments in the Roadmap Consultation, the review set out in CER/09/189 "deals with the regulatory controls as applied to the retail market for electricity only." **BG Energy believes, however, that the scope of and for competition in the retail market cannot be looked at in isolation of what is happening in the wholesale market.** The business of retail supply is essentially one of managing the risk of the mismatch between the availability and cost of wholesale power, on the one hand, and retail demand and prices, on the other. It is not possible for suppliers to enter, and expand in the retail market unless they are able to procure power on terms which meet their customers' demand profile and willingness to pay. In the absence of analysis of wholesale market developments, the Roadmap Consultation fails to capture a key segment of the market that pertains to the determination of the final retail price – this segment accounting for the majority of value of the electricity market.

Around 70 per cent of the final price of electricity is comprised of wholesale power costs. The retail component, by comparison, is miniscule,

comprising just 5 to 8 per cent of the final price at most. A competitive assessment that focuses solely on the retail component therefore cannot fully explain final retail prices. Of particular relevance is the functioning of the wholesale spot and contracts markets, on which independent suppliers are reliant to meet their customers' requirements. ESB Power Generation's (ESB PG) dominance in setting prices in the Single Electricity Market (SEM) and in the contracts market, as well as the lack of liquidity of the contracts market itself, are factors which act as a barrier to the development of retail competition. The omission of these factors from the analysis in the Roadmap Consultation leads to the wrong conclusions about the competitiveness of the retail electricity market, an analysis which deals with the minor rather than the major part of the competitive market.

The Roadmap also does not consider the role that regulation has played in promoting retail competition. Removal of the current regulatory regime is likely to put a break on competitive developments and, depending on what type (if any) of regulation takes its place, there is a significant risk that competitive developments may be reversed. This risk is heightened if ESB PG, ESB Customer Supply (ESB CS), ESB International (ESBI) and ESB Independent Energy (ESBIE) are allowed to reintegrate, as foreshadowed in the Roadmap Consultation. ESBI and ESBIE were established to provide a source of competition to ESB PG and ESB CS respectively. If reintegration is permitted in the future, ESB's market position will be strengthened, providing less scope for price competition and raising the risk of foreclosure of the wholesale contracts market to independent suppliers. An example in this case would be where ESB PG, once it has reintegrated with the other retail divisions, offers less favourable terms (in the CfD market) to its competitors and/or new entrants in the supply sector, with the purpose of driving out existing competing suppliers and/or discouraging new entry into either sector, thereby increasing profitability.

BG Energy recognises that ESB's possible future reintegration is not the subject of this consultation. However, this matter is nonetheless a significant potential development which will affect the future structure and competitiveness of the ROI electricity market. In flagging such a sensitive issue, the CER also appears to ignore the type of issues highlighted in the report for the Irish Government by Deloitte & Touches LLP in December 2005, which was so concerned as to the dominance concerns that it recommended that the best way to promote competition in the Irish electricity market would be to split ESB through the auction of two portfolios of ESB's generating plant, including a material level of price-setting plant and three supply packages (two from ESB CS plus ESBIE). It is important for the CER to recognise the competitive impact of the possible reintegration of ESB.

The following are the key points and concerns outlined in BG Energy's submission which are addressed in detail in the body of this document.

- 1. The Roadmap gives insufficient attention to the linkages between retail competition and wholesale markets.** BG Energy believes that such a Roadmap will be ineffective and potentially catastrophic to competition unless it recognises the linkages between wholesale and retail competition. The Roadmap Consultation provides little analysis of competition in the wholesale market, either in the SEM itself or in the contracts market. This results in a static and incomplete assessment of competition and leads to the wrong conclusions about the competitiveness of the retail market.

BG Energy is adamant that price regulation on relevant Irish retail electricity markets should not be removed until the structural problems in wholesale markets have been effectively remedied and the market structure is able to sustain competition. Furthermore, any assessment of ESB's dominance in the retail market needs to be viewed in conjunction with its dominance in the wholesale market (particularly dominance in price-setting and wholesale contracts).

- 2. The analysis of retail competition gives too much weight to recent competitive developments without exploring their underlying causes.** The very high levels of customer switching have largely occurred during the past year. ESB CS's market share was relatively stable for the previous four years and ESBIE's market share has increased since the introduction of competition. Thus the CER's analysis is focusing on just one year of in which ESB CS's market share has been reduced.
- 3. Greater consideration needs to be given to the CER's ex-post monitoring role.** The Roadmap Consultation is vague on how the CER will continue to monitor the conduct of ESB CS following the removal of price controls. Whilst the CER recognises that legislative changes are likely to be required, there is no discussion of what the CER's monitoring powers might be and how they may be carried out. It would have been helpful to have information on how ex-post monitoring is carried out in other markets to determine if similar approaches might be appropriate in Ireland.
- 4. It is too soon to remove price controls on ESB CS.** BG Energy is fully supportive of the CER's initiative to develop a Roadmap to a fully competitive Irish energy market. Notwithstanding this, it is too soon to remove price controls on ESB CS. Retail competition in the electricity market is nascent, with independent suppliers gaining ground in just the past year. It is too early to say whether recent developments may be sustained. Premature removal of price controls is likely to put a brake on competition and could even reverse recent developments.

The remainder of this submission sets out BG Energy's response to the questions in the Roadmap Consultation.

1. Market Definition

Q1. Respondents are invited to comment on the proposal to review the market and define a roadmap for deregulation of the retail electricity market. Are you in favour of the proposal? Do you think this is the right time? Outline reasons for agreement or disagreement.

BG Energy agrees with and fully supports the CER policy position, as set out in the Proposal on a Roadmap for Deregulation CER/09/189 (the “Roadmap Consultation”), that “ ... *effective competition is superior to regulation*” and that, “ ... *where markets are effectively competitive, the replacement of end user retail tariff regulation in electricity and gas markets is a desirable outcome*”.

At the same time, BG Energy is acutely conscious that liberalisation, if it is to lead to fully competitive markets, must be accompanied by proportionate and necessary regulation to ensure effective market opening and monitoring.

Timing and Scope of the Proposed Roadmap

In terms of timing of the CER’s proposal to adopt a roadmap, BG Energy considers it important – consistent with the aim of promoting market transparency, openness and competitiveness – that the CER adopt a roadmap for full deregulation of Irish energy markets over the coming 18 months.

Importantly, in order to ensure commensurate and non-discriminatory levels of market transparency across the energy sector, **any such roadmap should cover both electricity and gas**. While the time-frames proposed within any such comprehensive roadmap for full deregulation of Irish energy markets could obviously vary (depending on the level of competition in each relevant market segment), it seems inconsistent and unjustified to prioritise one sector (*i.e.*, electricity) over another (*i.e.*, gas). At a minimum, some regulatory explanation and impact assessment should be given in proceeding to prioritise the electricity sector via the early adoption of a specific deregulation roadmap only for Irish electricity markets.

To be consistent with both EU law (including, in particular, Article 106 TFEU), as well as the position set out in the Sector Inquiry and the ERGEG Position Paper, **any move to full deregulation must be carried out in a careful and phased manner that reflects the level of emergent competition in national markets**.

The Roadmap should also address the structural issues that currently affect the determination of prices in wholesale markets. As discussed above (and will be

expanded on in later sections), competition and innovation in the retail market is significantly dependent on the level of competition and liquidity in the electricity wholesale market. Therefore the Roadmap must cover all the factors that affect competition in retail markets.

Finally, we strongly support the concept of a roadmap from the perspective of providing regulatory certainty. Some of the regulatory changes posed in the paper may have a profound impact, especially on the market entrants in electricity. It is critical to support the longer term position of the new entrants in the market that a roadmap with clear and objectively defined milestones is set so that entrants can have the confidence to invest and build sustainable positions in the market.

Q2. Respondents are invited to comment on the proposal to define 4 relevant markets for the supply of retail electricity. Are you in favour of the proposal? Outline reasons for agreement or disagreement.

Any assessment of the competitiveness of a market begins with market definition. In European competition law the courts have consistently ruled that the European Commission (EC) must define a market before a conclusion on the market position of the firm or firms under investigation can be reached. In this context the EC has stated that:

“Market definition makes it possible to calculate market shares that would convey meaningful information regarding market power.”¹

In defining markets, therefore, regulators must take into consideration the factors that constrain the market power of firms. Such a definition is likely to have a geographic, product and consumption dimension, to take into account the ability of consumers to switch from one supplier and/or product to another in response to a small but significant price increase. In the context of retail energy markets in Ireland, the ability of consumers to switch between energy suppliers without incurring costs and/or supply disruption would be an important constraint on the market power of incumbents.

CER Preliminary View 1: “The review is focussed exclusively on the retail market for electricity”

The EC, as part of its investigation of mergers between energy companies, has determined that gas and electricity are separate product markets. This was on the

¹ The European Commission Notice on the definition of the relevant market for the purposes of Community competition law, 1997 (OJ C372).

basis that consumers generally cannot switch readily between gas and electricity without a significant outlay of expenditure to modify equipment or purchase new equipment. **BG Energy therefore agrees with the CER's distinction between the electricity and gas markets for the purpose of reviewing and assessing the development of competition in the relevant markets for electricity.** However, this is not to say that they are distinct markets within the overall Irish energy market and BG Energy still contends, for consistency and transparency purposes, a roadmap for deregulation should be conducted for both the gas and electricity markets – i.e. for the entire 'regulated Irish energy market'.

CER Preliminary View 2: "The geographic market for electricity is currently defined at national borders"

The EC also considers that, given the relatively limited level of cross-border integration across Member States, that relevant geographic markets should continue to be defined along, at most, national lines (see, for instance, DG Competition Report on Energy Sector Inquiry (SEC(2006)1724, 10 January 2007). In BG Energy's view, there is currently insufficient harmonisation of the electricity retail markets in ROI and NI that would allow suppliers in both jurisdictions to compete directly for customers in both jurisdictions. **BG Energy believes, therefore, that the markets are currently geographically separate until there is evidence that customers in the two regions are able, and willing, to switch to a supplier in the alternative region.**

The current work-streams to further retail harmonisation between the two markets will allow for greater competition between the two markets. When this project is completed, such that it allows for direct competition between suppliers for customers in ROI and NI, it may then be appropriate to consider the relevant market on an all-island basis.

CER Proposal 1: "The Commission is proposing that competition in the retail market for electricity should be reviewed on the basis of four relevant markets; Large Energy Users (DG 7, 8, 9, 10 & TCON), Medium-Sized Business (Low Voltage Maximum Demand – DG6) , Small Business (Low Voltage Non-Maximum Demand – DG5) and Domestic Customers (DG 1,2, 3 & 4)"

On the demand side, the relevant product markets put forward in the Roadmap Consultation – including the segregation of business customers by size and conditions of supply (resulting in the definition of separate markets for (i) LEU customers, (ii) medium-sized business customers, and (iii) small business customers) and a separate market for domestic customers – seem broadly (although certainly not precisely) in line with the general practices of the EC.

The EC has typically defined electricity supply antitrust markets along the following lines: (i) supply to large industrial customers connected to the high and medium voltage grid; (ii) supply to smaller industrial, commercial and domestic customers connected to the low-voltage grid². In the E.ON/MOL merger (Case No COMP/M.3696 E.ON/MOL) the retail supply of electricity to medium and large commercial and industrial customers, to small commercial and industrial customers and to residential customers were each held to be different markets.

Given the European precedent and the different characteristics of the customers and suppliers in the different customer sub-segments, **BG Energy concurs with the CER's proposal to define four relevant markets for the purpose of this review.** However, this proposal is at odds with previous market analysis that has been carried out by the CER in relation to the gas market where large-medium business customers (RTF) and small business customers (FVT) were considered to be part of the same relevant market on the basis that competition in one was contingent on competition in the other. For consistency purposes the CER should clarify its position and apply it across its energy market analyses.

Q3. Respondents are invited to comment on whether public lighting should be considered as a relevant market. How should it be treated in a deregulated environment? Outline reasons for agreement or disagreement.

European law provides that all customers, regardless of their consumption patterns and levels should be eligible to choose an alternative supplier. For this reason, public lighting customers should be included as part of a relevant market, potentially the SME market for the purposes of reviewing competition.

With respect to the deregulation of the market segment, meter provisions and data services provided by ESB Networks are not sufficient for smaller, independent suppliers to provide such a flexible service to public-lighting customers. The CER should focus on improving these services by the distribution system operator if competition is to truly develop in this market segment.

Q4. Respondents are invited to comment on the proposal to consider all domestic customers part of the same retail market. Are you in favour of the proposal? Outline reasons for agreement or disagreement.

BG Energy agrees that all domestic customers should be considered as part of a single relevant market. However, **administrative and regulatory arrangements**

² See, for example, Case COMP/3440 ENI/EDP/GDP and Case COMP/M.4110 E.ON/Endesa

currently inhibit independent suppliers in entering and gaining market share in the prepayment and free-electricity-allowance customer segments respectively (Representing approximately 20% of the retail base). These barriers need to be addressed if competition is to be allowed to develop and all domestic customers treated equally with respect to market analyses.

With respect to large and small domestic customers, there is little difference in terms of processes and service provisions for suppliers serving these customers and therefore there is no real basis for de-compartmentalising them further. Dividing these customers into separate relevant markets could actually hamper the development of competition at the lower consumption levels as suppliers tend to focus on higher consumption customers.

2. Market Analysis

Q5. Respondents are invited to comment on the proposal to assess the level of retail competition using the factors outlined. Are you in favour of the proposal? Outline reasons for agreement or disagreement.

Proposal 2, on page 40 of the Roadmap, states the CER is proposing that in assessing the level of competition in the retail market, the following factors should be considered:

- The number of suppliers active in a particular market.
- Individual market shares of the incumbent (and its affiliates) and independent suppliers.
- Barriers to entry, expansion and exit including: sunk costs, switching systems and processes, branding, non discriminatory network access and access to wholesale product.

BG Energy agrees with the general approach, set out above, but believes that there are some more important factors that the CER has overlooked, or not given sufficient attention to, in the competitive analysis. In particular:

1. There is no analysis of wholesale market issues. Issues affecting suppliers' access to wholesale product, such as transparency, availability and liquidity, are not expounded upon. There is also no mention of the competitiveness, or otherwise, of the SEM. **BG Energy believes that wholesale market competitiveness is central to a competitive retail market and should have been a central feature of the CER's analysis.** The ability of market participants to provide efficient and stable prices to customers depends greatly on the quality of the wholesale market arrangements. New entrants depend on the wholesale market to allow them to provide the best service to customers.
2. There is no analysis of the dynamics of competition – how competitors are reacting to ESB CS, what their product and pricing strategies are, and how ESB CS might in turn respond to the continual erosion of its market share. Given that competitors' strategies have largely focused on beating ESB CS price, **there is surprisingly little analysis of whether that strategy is likely to be sustained in the long-run**, particularly if there is a significant reduction in ESB CS prices. Again, the quality of the wholesale markets will be key in underpinning the provision of high quality alternative price offerings by ESB's competitors.
3. There is no **comparative analysis of competition in other energy markets** which would help provide a perspective on the competitiveness, or otherwise, of the retail electricity market in Ireland. There is no discussion of the features that make the Irish electricity market similar to, or different from, comparative European markets and, given the characteristics of the Irish electricity market, the suitability and timing of measures to promote full market liberalisation.
4. There is **too much emphasis on recent market developments.** The CER's analysis makes much of the erosion of ESB CS's market share which has largely occurred in the past year. Prior to 2009, ESB CS's market share was relatively stable. Moreover ESBIE has been increasing its market share during the past five years. Looking at the evolution of competition through time, 2009 looks like a typical year, rather than a year which is indicative of a trend.
5. At 40-60 per cent market share, the CER's threshold for dominance appears overly lenient. **Market shares should be viewed alongside other quantitative and qualitative factors when assessing dominance.** If specific measures dealing with the liquidity issues are addressed, it may be more reasonable to consider the thresholds suggested by the CER.

Q6. For each of relevant markets discussed, respondents are asked to consider if there is sufficient activity to consider the removal the regulatory controls in that market. Outline reasons for agreement or disagreement.

The CER's analysis of market shares puts much emphasis on one recent market development, namely on the entry of BG Energy and Airtricity to the residential supply market (described in paragraph one of the Executive Summary as a "significant step". Indeed, given the Roadmap Consultation's apparent conclusion that switching in the business segments has been low (or "dormant" in the language of the Roadmap Consultation), the entry of BG Energy and Airtricity seems to be the single most important factor in the recent past motivating the proposed Roadmap Consultation.

Against that background, it is useful to recall just how nascent competition in the domestic segment is: as per the Roadmap Consultation, the domestic market was opened to competition since 2005, BG Energy and Airtricity entered only in February 2009, and combined those entities account for no more than around a 16% share of the segment.

With this in mind, although the figures provided by the CER in its analysis suggest that there has been a significant increase in the number of customers choosing to switch suppliers in 2009, it does not provide insight into the level of competition between other suppliers apart from the incumbent. **When conducting a similar analysis of customer movement in the gas market, the CER concluded that a sustained pattern of churn³ over a number of years would be needed before it would remove regulatory restrictions. This has not been demonstrated to date in the electricity market and BG Energy looks forward to the results of the Regulatory Authorities' market research in providing greater insight into the switching and churn rates within the market.**

The CER's competitive analysis does not assess the characteristics of market players, their competitive strategies and how ESB CS might respond to retail offers. Hence, there is little assessment of the nature of competition – the range of prices and products on offer. Evaluating competitors' strategies and offers would help provide

³ Although sometimes used interchangeably, customer churn and customer switching are not the same thing. Switching relates to the process and the ability of the customer to move from one supplier to the next whereas churn relates to multiple switching by customers between suppliers including back to the incumbent – this relates more closely to the characteristics of the customer and the likelihood of a customer switching more than once. Churn is therefore a more relevant approach in understanding how competition has developed as switching or movement away from the incumbent really only demonstrates how the incumbents market share has been impacted.

insight into the sustainability of competition in the market. It may also provide information on whether the recent developments are sustainable or may be easily reversed. For example market share statistics in the LEU sector can change quickly as these customers are highly price sensitive and hence most likely to switch. The loss of one or two LEUs can significantly alter a supplier's competitive position. Market share statistics are quite meaningless without an understanding of the dynamics of supplier and customer behaviour.

When examining the market share of the incumbent it is also important to consider their market share in wholesale generation. Market power in the SEM, particularly as ESB PG is the only generator currently offering CfD contracts in RoI, is equally important in this review. A dominant generator that also owns a dominant downstream retail company can use its market power in the upstream market to squeeze its downstream rivals. It can also potentially foreclose other suppliers' access to the wholesale contracts market. These factors require careful consideration, particular if the ESB subsidiaries are allowed to reintegrate at a future date.

In short, given earlier conclusions in the Roadmap Consultation that switching in the business segment was low and dormant at least in 2007/8, the dearth in an analysis of churn in each of the business markets and the fact that the "vast majority" of switching has been in the domestic market; **it would appear both somewhat premature and perhaps unjustified to put propose that “the Irish retail market is developing all of the appropriate areas in terms of its structures and processes to support a fully competitive market”.** Furthermore, until greater clarity is given on the subsequent regulatory regime, **BG Energy cannot support the removal of regulatory controls in any of the relevant markets at this time.**

Q7. Respondents are invited to comment on the assessment of the barriers to entry, exit and expansion within the retail electricity market. Do you agree or disagree with the preliminary conclusions? Are there other issues which have not been discussed which would prevent or undermine the development of a competitive market? Outline any suggestions to improve the situation for existing suppliers and new entrants.

The switching process and systems are generally recognised to support competition in the retail electricity market. However, other barriers persist which hamper further and sustainable developments in competition and therefore the market.

1. Wholesale Competition and Liquidity

There is relatively little discussion of competition in the wholesale market, either in the SEM itself (i.e., competition to be dispatched) or in the contracts market; and of what effect the various options for deregulation (the removal of price controls on ESB CS, the horizontal and vertical reintegration of ESB etc.) would have on the wholesale markets. BG Energy believes that this results in a somewhat incomplete assessment of retail market developments.

In a liberalised energy market, liquid wholesale markets are desirable because they:

- facilitate new entry in generation and supply by allowing new entrants to buy and sell electricity to match their output and customer base with confidence and by allowing new entrants to manage long-term risk;
- reduce the ability of market participants to engage in market manipulation;
- are likely to provide a wider range of products and counterparties for participants to hedge their risk exposure, thereby reducing the cost of electricity to the final customer;
- increase confidence in traded prices;
- allow all entrants to participate on the same terms as vertically integrated, diversified incumbent firms; and
- can allow market participants to fine-tune their positions at minimum cost ahead of real time, thereby improving the efficiency of dispatch and wholesale and retail prices.

As a result, liquidity in wholesale markets creates competitive pressure in both the retail and wholesale markets, in particular by facilitating new entry (or the threat of new entry). Without a liquid wholesale market and the ability to hedge, new suppliers may find it difficult to enter the market and independent generators/producers may not be confident of a market for their output. In addition, potential investors may be reluctant to invest.

Market participants, including BG Energy, have expressed to the CER their concerns about the lack of transparency over the allocation of CfDs, their limited flexibility and duration and the overall lack of liquidity of the wholesale market.⁴ The Roadmap Consultation acknowledges that “there are ongoing improvements which need to take place” in relation to these matters, but states that “there are established industry fora

⁴ See SEM 09-016 “Contracts for differences in the SEM: the 2009 Contracting Process”

and work programmes to address these issues”. **However, BG Energy is not at all convinced that these matters, and in particular access to wholesale product are at a stage where they evidence or could support a competitive market.** Section 6.2.5 is particularly important in this regard. While the CER acknowledges that suppliers have raised concerns about the CfDs available it concludes that:

*“It is necessary that those [mechanisms to ensure access to wholesale products] be **maintained** if effective competition is to flourish in the retail market [emphasis added]”*

BG Energy believes that the existing mechanisms for access to wholesale products (and their mere maintenance) are in no way adequate to support competition in the retail market. There needs to be greater transparency and certainty regarding the availability and pricing of these contracts before access to wholesale product is available to all suppliers on a fair, reasonable and non-discriminatory basis.

In the current regulatory regime, even with ESB CS regulated prices, the available CfD products are insufficient and they pale compared with wholesale gas market arrangements. It would then appear axiomatic that the removal of price regulation would need to be accompanied by significant enhancements in the wholesale market to maintain some balance between ESB and new entrants. To do otherwise will simply create even greater commodity risk in the market, risk which will be detrimental to the customers’ interests in the longer term. We believe that nothing less than mandatory requirements on ESB to support the wholesale markets, in excess of those provided today, are required to support competition and to support the interests of the electricity customers. Such mandatory requirements must persist long after price controls have been relaxed and until the liquidity of the wholesale market has reached an adequate standard. We would draw attention to Ofgem concerns as to the level of wholesale liquidity in the GB electricity market, notwithstanding that it is fundamentally more advanced than that pertaining in the current all-island market.

2. Reintegration of ESB Power Generation and Supply Subsidiaries

The proposed reintegration of the ESB generation and supply subsidiaries will reduce liquidity in the wholesale market further. Given that the Irish market is small, has limited interconnection and no forward contracts market, allowing for further integration of the incumbent, combined with the other factors cited above, is likely to result in a deterioration in competition. A fully-hedged ESB could further reduce the volume and frequency of trading in the contracts markets, thereby potentially raising price volatility and uncertainty, making it difficult for independent suppliers to

compete with ESB. Appendix A highlights the dominance of ESB PG in setting the wholesale prices in the SEM, further integration would extend their advantage further to the detriment of competition in both the wholesale and retail markets.

3. *“Stickiness of Customers”*

Regarding the “stickiness” of customers which is suggested by the CER may hamper the level of switching to the disadvantage of the incumbent, a recent report by Ofgem has recognised that these customers are an advantage for the incumbent, allowing them to charge higher prices and earn higher margins from a group they know is unlikely to switch. For this reason, stickiness is an issue that should be addressed by the CER as part of a customer education campaign (discussed further below) rather than being used as a reason to ‘readjust’ the thresholds for the removal of regulatory controls.

4. *Prepayment and Free-Electricity-Allowance Customers*

As referred to earlier, regulatory and administrative barriers currently exist which inhibit the ability of independent suppliers to supply pre-payment and free-electricity-allowance customers. This excludes independent suppliers from approximately 20% of the domestic retail market. Again, these issues should be addressed by the CER in conjunction with the relevant government departments and system operator.

Q8. Respondents are invited to comment on the proposal for the thresholds for the removal of regulatory controls in the relevant retail markets for electricity. Are you in favour of the proposal? Outline reasons for agreement or disagreement.

Price control tends to be judged appropriate only for market structures in which incumbent firms might be referred to as super-dominant or close to super-dominant.⁵ **The EU’s threshold for dominance is a market share of 40 per cent. However, this is indicative as in practice some companies with higher market shares are not regulated, due to the competitive pressure exerted by other market participants.**

In its guidelines on the application of Article 82 of the Treaty, the EC defines dominance and how it may be assessed as follows:

“When the relevant market has been defined, it can be analysed whether on that market the allegedly dominant undertaking has the power to behave to an appreciable extent independently of its competitors, its customers and

⁵ The notion of “super-dominance” was first discussed in: *Compagnie Maritime Belge SA (C-396/96 P)* and *Dafrá-Lines A/S (C-396/96 P) v Commission of the European Communities* [2000] ECR I-01365. para [112]-[119].

ultimately of the consumers, that is, whether it holds substantial market power. In conducting this analysis it is relevant to consider in particular the market position of the allegedly dominant undertaking, the market position of competitors, barriers to expansion and entry, and the market position of buyers. The existence of a dominant position may derive from several factors which, taken separately, are not necessarily determinative.”⁶

The EC uses market shares as indicative thresholds in assessing dominance – and considers the difference between 40 and 60 percent to be meaningful for the assessment of dominance.

However, as stated earlier, market share is just one (inconclusive) factor in dominance assessment which should evaluate a range of factors. In this respect the Competition Directorate of the EC has said:

“The strength of any indication based on market share depends on the facts of each individual case. Market share is only a proxy for market power, which is the decisive factor. It is therefore necessary to extend the dominance analysis beyond market shares, especially when taking into account the difficulty of defining relevant markets in Article 82 cases.”⁷

In examining the market share of the incumbent, the CER must also consider its dominance in the wholesale market and its potential to appreciably influence retail and wholesale prices in the absence of competition.

Appendix A demonstrates ESB PG’s dominance in the SEM and furthermore illustrates the problems with simply relying on market share thresholds. It shows that ESB PG’s share of dispatched generation is significantly higher than its share of installed capacity. This is because ESB PG’s portfolio is comprised of fully depreciated generators which, because of their low running costs, are pushed up the generation dispatch merit order. This means that ESB PG’s generators are running much of the time, pushing competing generators down the merit dispatch schedule. ESB PG therefore has super-dominance in the dispatch merit order and is the price-setter in the market. As long as ESB maintains its dominance in the SEM and contracts markets, it poses a risk for competition in generation and retail supply.

⁶ DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, European Commission, December 2005.

⁷ DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, December 2005, page 12.

Q9. Respondents are invited to comment on the options for the review of market conditions in March and October. Are you in favour of the proposal? Should the reviews be historical or prospective? What actions do you think the Commission should take if competition tests fail in subsequent market reviews? Outline reasons for agreement or disagreement.

BG Energy believes it would be reasonable and prudent to consider future expected or potential changes in the market when analysing market developments. As stated above, competitive developments need to be viewed over time, to provide a dynamic and forward looking analysis of competition. Regular market reviews should help provide an assessment of whether competitive developments are sustainable. **Until such time as there is evidence of effective and sustainable competition at the wholesale and retail levels of the market, BG Energy believes it would be imprudent to remove regulatory controls.**

If future reviews find competition to be ineffective the CER should consult with industry, wholesale, networks and retail participants, to better understand where the bottlenecks are and to address these issues in a collaborative manner rather than amending and adjusting market rules and processes in a piecemeal manner.

3. Transition to Ex-Post Regulatory Regime

Q10. Respondents are invited to comment on how the price controls should be removed in the context of only a portion of the relevant business markets reaching the threshold for the removal of the price control. Should the de-regulated customers be transferred to ESBIE? Should ESB CS be allowed to serve regulated and unregulated customers or should the price control remain in place until all markets have reached their thresholds. Is there another course of action that you would be in favour of? Outline reasons for agreement or disagreement.

With respect to the suggestion to migrate deregulated customers over to ESBIE, this indicates that the CER has essentially already made its decision on the reintegration of the two ESB subsidiaries. **BG Energy cannot support any such reintegration or migration of customers until such time as all of the retail and wholesale, market and regulatory barriers are addressed and removed.** In the meantime, ESB CS should be permitted to serve both regulated and unregulated customers, *providing* that a sufficient level of accounting separation is provided for and monitored effectively by the CER.

In the interest of protecting the end consumer and competition, an additional provision regarding re-regulation and penalties should be included in the licence of ESB CS. This provision would only apply in the event that competition levels are reversed and ESB CS and ESBIE revert to hold a dominant position within the market.

BG Energy agrees that following the removal of price controls the CER will need to continue to monitor the market. The CER has not stated how it intends to do this but BG Energy is aware of other jurisdictions which have recently made the transition from ex-ante regulation to ex-post monitoring. These include the Netherlands and Victoria in Australia, where incumbent retailers are obliged to publish their offers which may be scrutinised by the regulator. In both Netherlands and Victoria, the regulator has maintained a close watch on retail market developments for 2-3 years following the removal of ex-ante price controls. **BG Energy believes that, following the removal of ESB CS's price controls, a similar level of regulatory oversight is likely to be required in the Irish context, particularly in the light of ESB's dominance in both the wholesale and retail markets.**

During the initial stages of deregulation, the CER should keep a close monitoring role on the activity of all participants in the market to ensure that their decision is not having an adverse impact on customers or suppliers in the market. Similar to the role of Ofgem in the deregulated GB market, the CER should complete annual reviews of the market, highlighting areas of concern and where customers are being adversely impacted. Competition law in itself is only effective to the degree that the market is operated and parties are willing to take actions – it is widely recognised that regulation and competition law only work in conjunction with and not independently of each other (Massimo Motta – *Competition Policy: Theory and Practice*, 2004).

Price cap regulation was also proposed as a regulatory alternative to ex-ante price regulation. This is generally applied to network utilities and would not be appropriate in a competitive retail market. If the CER is confident that competition is sufficient to support deregulation it should allow the market to set the prices. Rigorous monitoring, adequate liquidity, the ability to switch suppliers and most importantly competition itself should ensure that the right prices are being charged to customers and that they in turn are being offered choice by suppliers.

Q11. Respondents are invited to comment on Proposal 5, Section 8.3, to change the principles of regulation, should the criteria for deregulation be met. Are you in favour of the proposal? Are the principles outlined correct? Should any additional principles apply?

In BG Energy's view the Roadmap Consultation is vague about the transition from the current regulatory framework to an ex-post competition policy regime. Whilst the CER appears to anticipate an ongoing monitoring role, it is not clear what that might entail. The CER recognises that legal modifications will be required to amend the CER's powers and duties, enabling it to monitor ESB's position. These amendments will need to take into account the possible reintegration of ESB which will in practice increase the regulatory burden through the loss of transparency which would result if ESB is permitted to reintegrate. It will be more difficult for the CER to monitor an integrated ESB to ensure that:

- there is no cross-subsidy between generation and supply;
- the wholesale contract terms offered to third parties are not discriminatory;
- costs are allocated appropriately with the aim of preventing a predatory price squeeze;
- there is no wholesale foreclosure.

Hence the CER will need to give considerable thought to the details of a transitional monitoring regime. It will also, however, need to consider the effectiveness or otherwise of Irish competition law in checking the behaviour of the dominant incumbents, as discussed below.

The Roadmap Consultation makes several references to the regulatory framework in the EU telecoms sector. However, the telecom framework does not support the notion of an immediate move to ex post competition law regulation. Rather, it suggests a continuing transition approach whereby ex ante regulation remains possible even today. **Furthermore, under the telecoms framework, market operators can be subject to ex-ante restraints when found to have significant market power on narrowly cast, pre-defined markets (i.e. without the need to define markets by reference to competition law principles). Such an approach would reduce significantly the CER's dominance threshold.**

The approach to impose regulatory obligations in the telecoms sector would not be typical of that followed in Irish energy legislation. The CER should therefore consider the practicality, as well as desirability, of implementing such an approach for regulating energy markets.

Q12. Respondents are invited to comment on Proposal 6 Section 8.4, to maintain regular monitoring to ensure that ESB PES & ESBIE continues to operate at or below the defined competitive thresholds. Are you in favour of the proposal? Should any additional monitoring apply? Will competition law be sufficient to deal with any

problems? Should a price cap be implemented? Outline reasons for agreement or disagreement.

The Roadmap Consultation asks whether, in a fully deregulated electricity market, competition law “will be sufficient to deal with any problems.” The “strict separation” model of competition law enforcement in Ireland – whereby, unlike in the vast majority of other EU countries, the Competition Authority is responsible for investigating complaints and compiling evidence, but cannot adopt infringement decisions or impose sanctions (a function reserved to the courts) – means that, to impose any meaningful fines for anti-competitive conduct, the Competition Authority must prove its case to a criminal standard of proof.

Recognising that meeting such a standard in abuse-of-dominance cases is nigh-on impossible, the Competition Authority has previously publicly announced that it will not take criminal enforcement action in abuse of dominance cases. **This effectively means that dominant companies face no risk of fines for abusive conduct.**

Further, under EC modernisation rules adopted in Regulation 1/2003 – a central purpose of which was to devolve local enforcement of European competition law onto national competition law enforcement agencies – it is highly unlikely that the EC could be persuaded to use its powers (under which the EC can impose fines) to intervene in a case of purely national interest.

Accordingly, in a fully deregulated electricity market that relied solely on competition law to check market abuses, it is fair to say that the incumbent entity would face no risk of meaningful fines for engaging in anti-competitive conduct that foreclosed entry, expansion, or indeed competition itself.

Other factors and precedence which also suggest competition law will not be effective in isolation to monitor an unregulated market are;

1. No Abuse of Dominance Case has, to date, been proven by The Competition Authority

While the Competition Authority has on a number of occasions sought to prosecute abuse of dominance cases to a civil law standard – seeking Court mandated injunctive relief to require a halt to the alleged abusive behaviour – it has been unable in any case to persuade the Irish courts to take action against the conduct in question.

2. Proving Dominance is Difficult in Newly Liberalised Markets

While economic theory suggests that high market shares alone are not probative of market power, it is clear that the Irish Courts typically view a declining market share as dispositive of market power.

In perhaps the most pertinent case to date, *Meridian v Eircell* – in which the High Court was required to examine whether the incumbent mobile operator (with a 60% market share and just one rival mobile operator) was dominant – the Court held that “... a market share of 60% in the context of a steady increase in share over a period of years is much more likely to indicate dominance than the same share in the context of a decline over a period.”

Accordingly, the Court found that, notwithstanding that the incumbent retained a 60% share and faced competition from just one other mobile operator (in a market with patently high entry barriers) – the incumbent was not dominant.

3. Price-Based Exclusionary Abuses Are Extremely Difficult to Prove

The classic types of anti-competitive unilateral conduct in which incumbent utility firms may engage – including, in particular, price-based exclusionary abuses – necessitate detailed and highly complex analysis of costs and are extremely difficult to prove. Thus, to substantiate an allegation of predatory pricing, it must be demonstrated both that the pricing was below a relevant measure of the incumbent’s costs (such as, for instance, average variable costs or marginal costs, both extremely difficult costs to calculate in an industry like electricity) and that an “as efficient” rival could not match those prices.

Q13. Respondents are invited to comment on Proposal 7, Section 10.3 that ESB PES, ESBIE and any other supplier will be required (through licence) to offer tariffs vulnerable and other groups of domestic customers, as defined by the Commission, on principles acceptable to the Commission. Are you in favour of the proposal? Outline reasons for agreement or disagreement. Are there any other specific consumer measures required with the removal of price controls?

In relation to the need to provide for vulnerable customers, ERGEG states that “*whatever support system is chosen, it must not hinder competition but should allow those customer groups to actively take part in the liberalised market in order to take advantage of cheaper offers and to be able to shop around for the best deal*”. The current free-electricity-allowance scheme cannot be said to facilitate competition amongst a portion of the vulnerable customers in the market.

Regulators in other markets have provided requirements on suppliers to provide energy efficiency initiatives to help customers manage their consumption and their cost of energy. Others have implemented payment schemes and corporate social responsibility schemes to provide for households in financial crisis. Some regulators (GB, Greece, Spain, Italy, Austria, Finland and New Zealand) in conjunction with the relevant government ministries provide a level of state aid to vulnerable customers in the form of direct subsidies in their retail or network charges.

Suppliers in other countries meet the requirement to protect vulnerable customers by targeted assistance programs such as;

- ensuring that customers who are not in a position to pay a bill due to exceptional circumstances are assisted;
- arranging debt recovery in a timeframe that avoids adverse credit conditions;
- ensuring that customers are aware of their ability to be identified as a vulnerable customer; and
- providing that an identified vulnerable customer is not disconnected

Precedence from other international markets suggests that targeted financial aid or more favourable tariffs for vulnerable customers tend to be supported by the relevant government authority and regulatory authority where it is appropriate. By and large, suppliers are required to be empathetic towards vulnerable customers and to provide facilities which allow for more flexible payment and credit schemes. BG Energy is very supportive of a policy which obliges suppliers to support vulnerable customers and this is evident in our recent dealings with various charities to alleviate the heating costs of gas customers during the recent unprecedented cold snap and in our discussions with the CER on improving competition for pre-payment and free-electricity allowance customers. However, to enforce suppliers to provide a specific vulnerable customer tariff may not be appropriate or indeed sufficient in a fully competitive market. Such financial aid is possibly better provided for through a state-aid allowance similar to the free-electricity-allowance.

4. Work Programme

Q14. Respondents are invited to comment on the interim work programme which will develop the current regulatory framework until the roadmap has been implemented (in part or in whole) Are you in favour of this approach? Outline reasons for agreement or disagreement.

Before an interim work programme can be agreed a better understanding of what and where the CER is working towards and in what timescales is needed. The current approach where the RAs consulted on K-Factors and Tariff Structures independently

and ahead of this consultation is not helpful for retailers in the market trying to develop their market share, particularly in the difficult domestic market. This roadmap is very welcome but the CER should work towards a holistic approach to the development of the electricity market – both retail and wholesale given the reliance of the retail market on a liquid and well-functioning wholesale market – if these signals are to be meaningful for market participants.

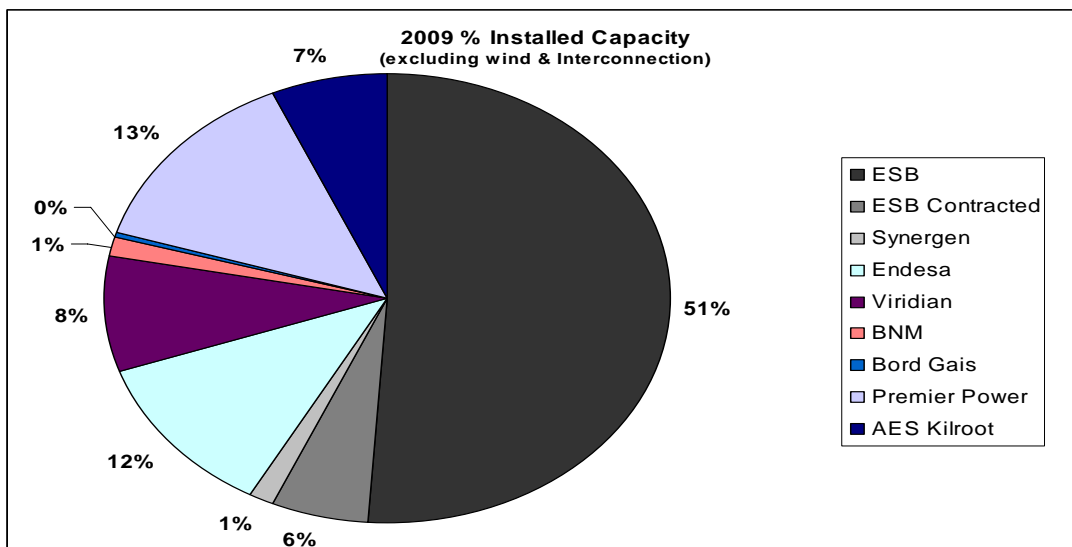
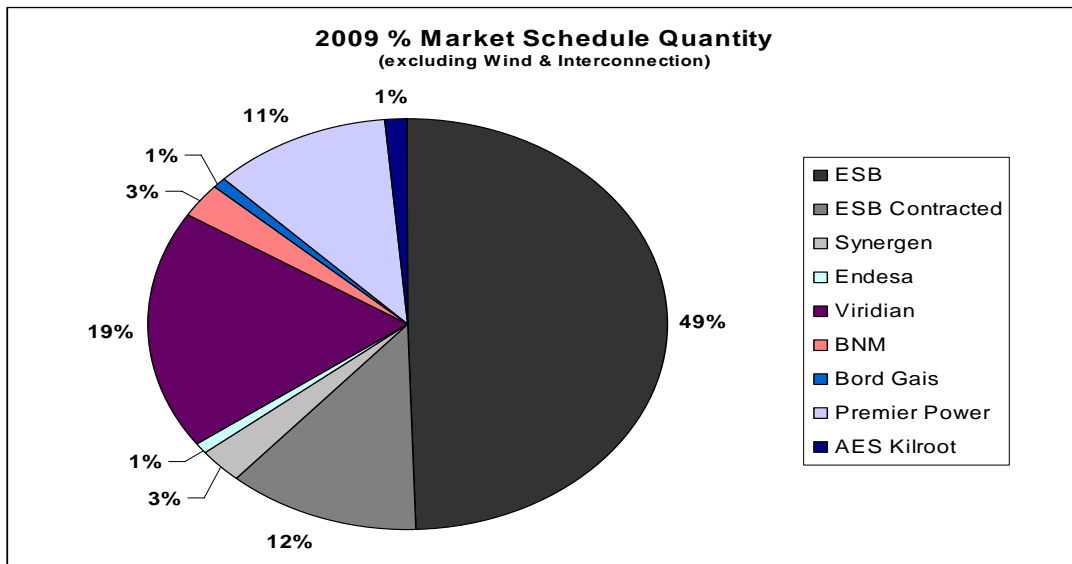
The timescales provided as part of the CERs consultation is also of concern. **Considering the level of analysis that is needed and the significance of this consultation and its conclusions, the CERs suggestion to be in a position to publish a final decision on a deregulation roadmap by the 1st March 2010 infers that a decision has been made or that sufficient time will not be given to consider and understand the proposals of respondents.** This decision is also dependent on a further decision relating to the reintegration of ESB CS, ESB PG, ESBI and ESBIE. Given the detail that is still needed, it seems overly zealous, if not inappropriate, to attempt to make a decision in such a short timeframe while also completing the first market review of competition by the end of March.

APPENDIX A: SEM MARKET SHARE ANALYSIS

BG Energy Assumptions

- The analysis excludes wind generation and interconnection to the UK.
- “ESB” includes 70% of Synergen’s generation with the balance classified as Synergen. “ESB Contracted” includes full Seal rock generation and majority Tynagh generation.

2009 Historical Generation & Installed Capacity

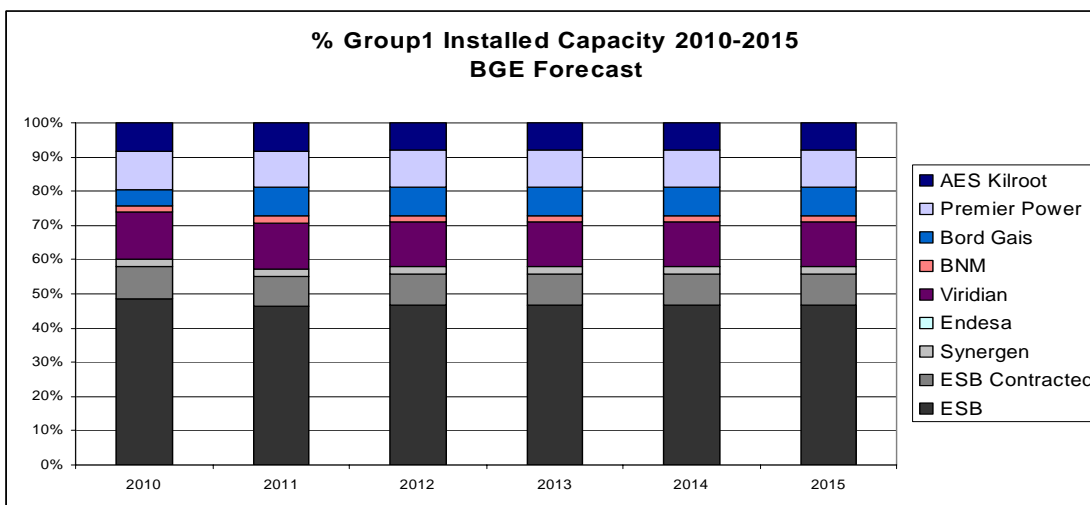
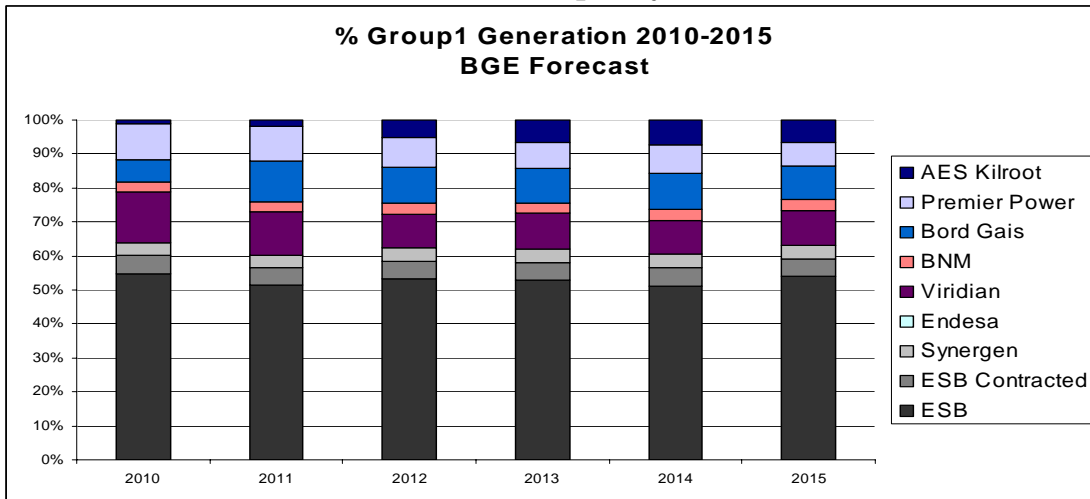


BG Energy has carried out analysis based on three existing groups. These groups are broadly consistent with Baseload, Mid-Merit/Peaking and Hydro/PS and are constructed as follows.

- Group1
 - CCGT
 - Coal Fired
 - Peat
 - Large CHP
- Group2
 - All other conventional plant
- Group 3
 - PS/Hydro

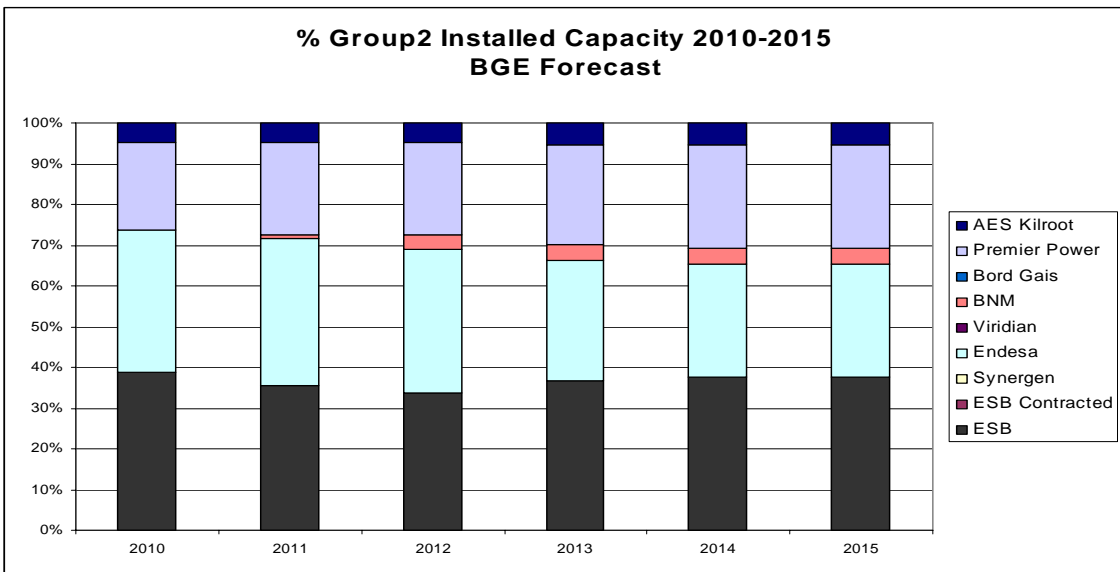
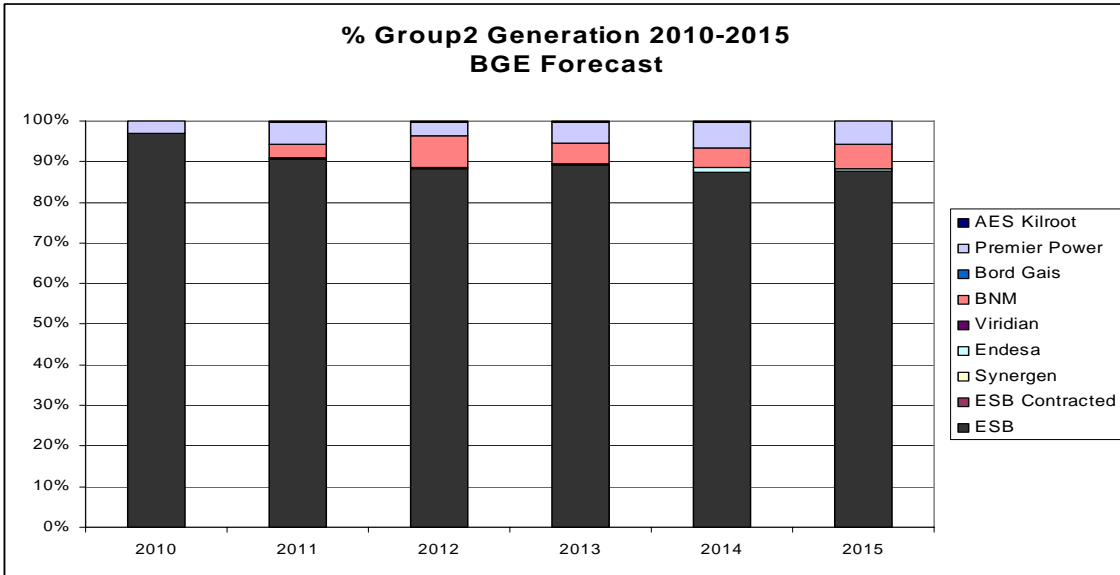
Group 1

Forecasted Generation Vs Installed Capacity 2010-2015



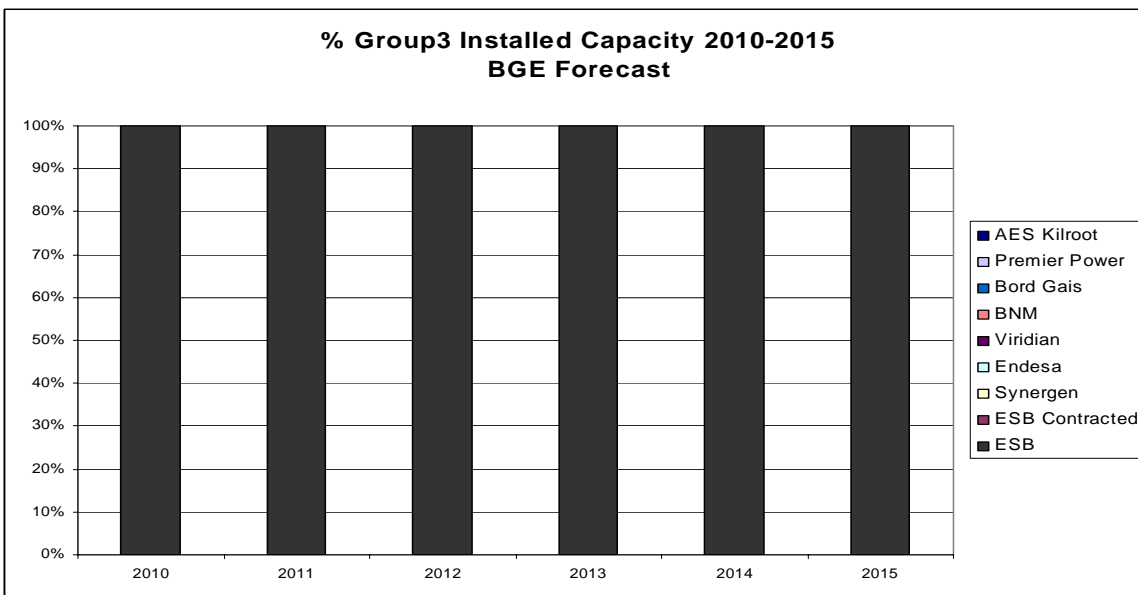
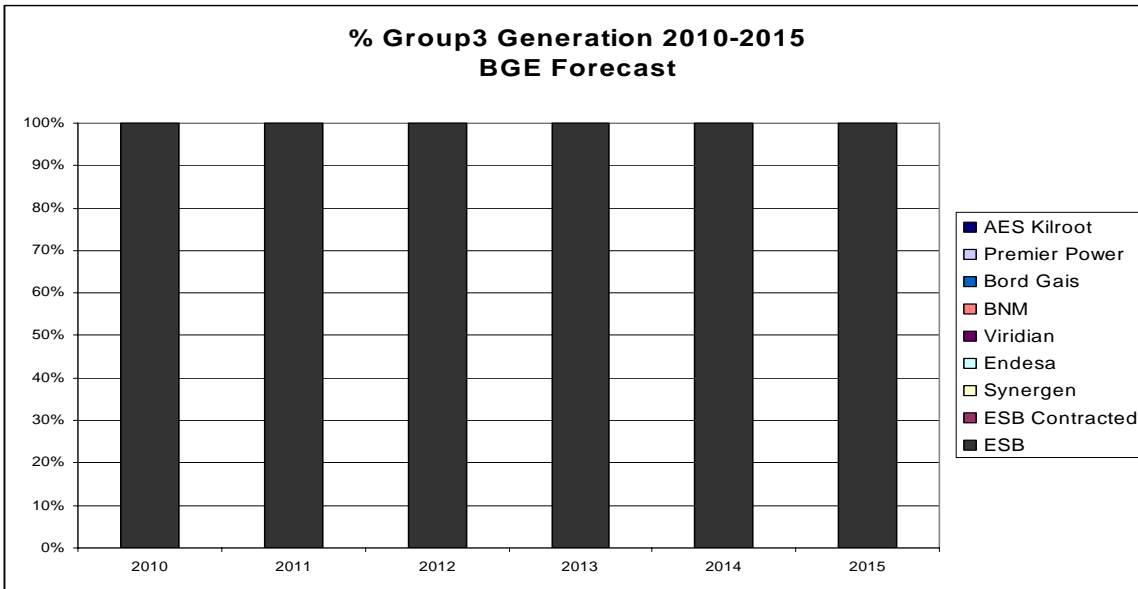
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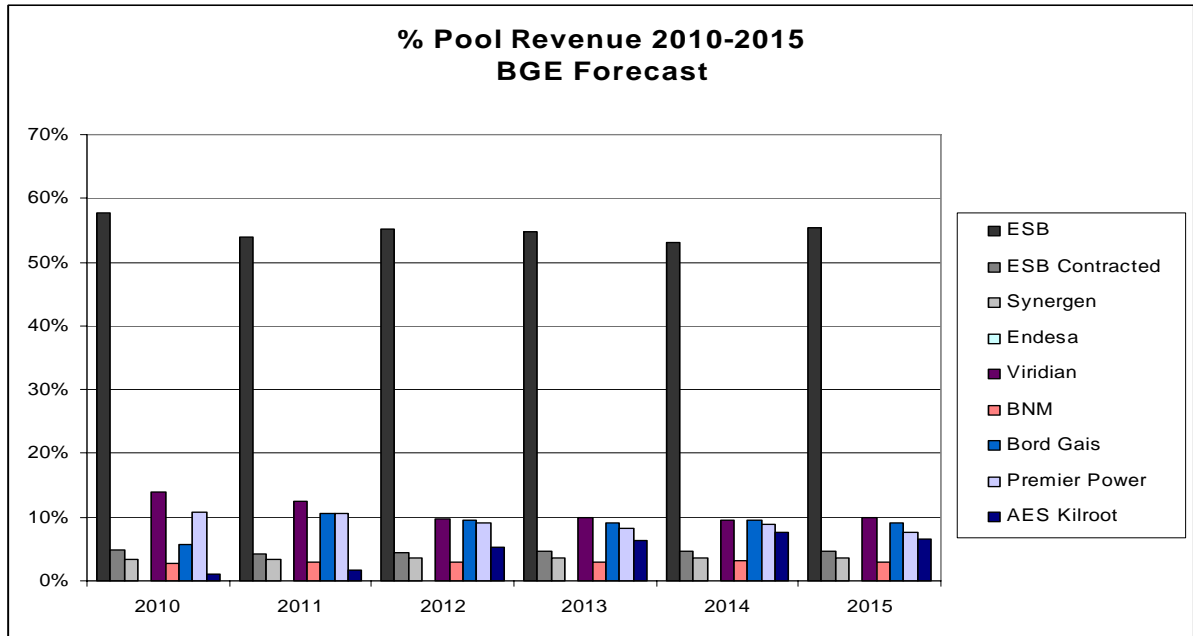


Group 3

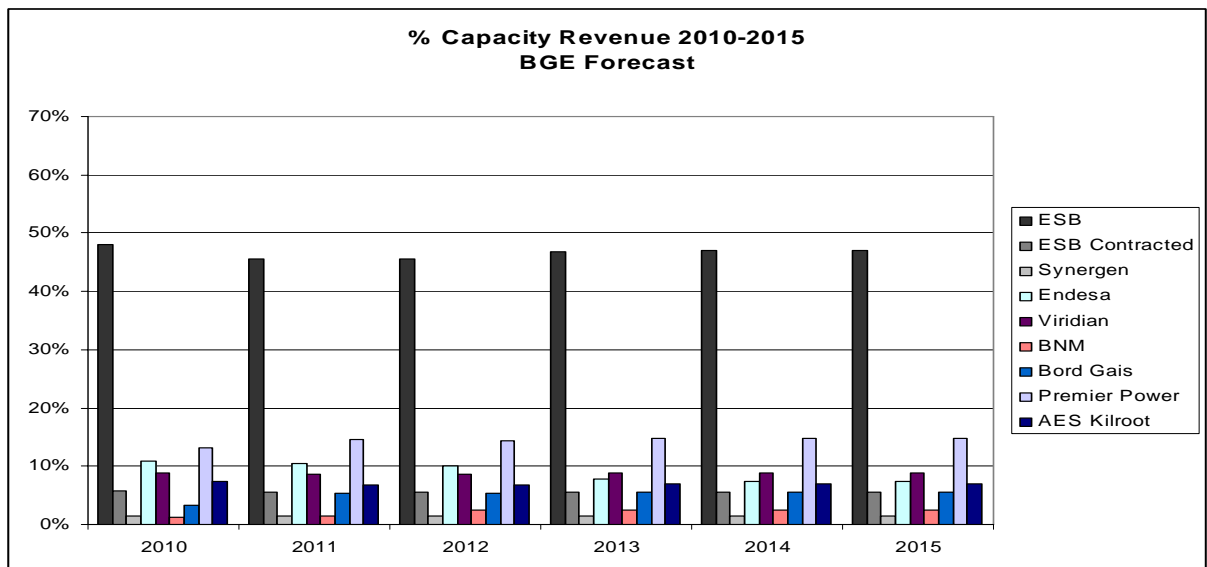
Forecasted Generation Vs Installed Capacity 2010-2015



Pool Revenue



Capacity Revenue



Pool & Capacity Revenue

