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Dear Paul,

PROPOSALS ON A ROADMAP FOR DEREGULATION

Thank you for the opportunity to respond to the above consultation.

The deregulation of retail electricity prices would constitute the biggest change to the Irish retail energy market in over a decade and this would be a very difficult process to reverse. Whilst Viridian Power & Energy (VP&E) advocates competitive market principles and appreciates the benefits that effective competition can bring, the Commission's (CER) approach to relaxing retail price regulation needs to be very carefully managed to ensure the development of sustainable competition on a level playing field. The publication of a proposed roadmap for deregulation is a welcome first step. VP&E acknowledges the work that has gone into this and looks forward to contributing to the process of deregulation to ensure that effective competition prevails in the long run.

Unlike the United Kingdom (UK) the Irish energy market is characterised by the fact its largest energy utilities are semi-state owned companies which are trusted household names and often recognised as national champions by government with no prospect for inter PES competition - an important distinction not recognised in the consultation paper is that the UK did not have a unitary supply business prior to liberalisation. Although there were local monopolies these were as 12 PESs in England and Wales, and 2 in Scotland so there was room for inter PES competition from the outset. It is highly questionable that ESB companies have the same commercial drivers and restrictions shaping their motivation and behaviour as their privately owned competitors. For example state ownership brings credit rating benefits, access to capital benefits, and greater tolerance towards and latitude for non-commercial (non profit maximising) behaviour. Under these circumstances VP&E is particularly

concerned about the risk of non-commercial behaviour and predation following removal of end-user prices. Unfortunately this legitimate concern is not recognised in the roadmap. VP&E strongly suggests that it should be as this type of abuse is far more likely than excessive pricing following deregulation of end-user prices and would be more difficult to remedy via competition law¹.

We do however note that proposals set out in the paper “represent the initial views of the Commission on the necessary steps to deregulate the Irish retail electricity market” (p. 5, emphasis added). This is a sensible approach given the significance of the proposals made and the potential risks of deregulating too soon without appropriate safeguards and market structures in place. It is surprising therefore that the CER might consider deregulating some market sectors as soon as October 2010. Given its irreversible nature and the work that has to be done before deregulation can take place VP&E considers this an unrealistic and overly rushed timetable.

In moving to a deregulated retail market it is important that the CER lays out a clear vision for a competitive electricity market. This vision should be characterised not simply in terms of market shares and the number of participants but also in terms of the methods and processes that should exist. For example it would be important to consider in more detail the need for more liquidity in the CfD market, the implementation and impact of global aggregation, metering developments, and switching arrangements. Important qualitative aspects of a competitive market, including branding separation and ex post remedies, are also given insufficient scrutiny and weighting in the roadmap. We suggest these issues need to be explored further, understood and formally incorporated into the roadmap, if not fully resolved, before deregulation can take place. At the very least however branding separation and ex post remedies should be necessary pre-requisites for deregulation, although there may be some inter-relationship between these factors and the thresholds chosen.

In addition to criteria proposed by CER (which we later comment on) we therefore strongly recommend the following pre-requisites:

¹ We understand that the Competition Authority follows a ‘structured rule of reason’ approach to investigating allegations of predatory pricing and that this focuses on recoupment and economic rationality. For an allegation of predatory pricing to succeed it is likely that there would have to be a reasonable expectation that short term losses could be recovered through charging higher prices in the medium to longer term. VP&E has little confidence this could be established if ESB engaged in predatory behaviour following deregulation given its questionable commercial motivations and restrictions.

- a. **Re-branding of ESB supply businesses** – the branding issue is particularly relevant in Ireland where ESB is a state owned established household name both in respect of generation, networks and supply. It is unambiguously clear from the 3rd Directive that branding separation is required to prevent customer confusion. It is also necessary to create a level playing field for all suppliers operating in the market. This is because the potential exists for companies to misuse branding in ways that could distort competition. It is widely recognised that this is a particular concern where a commonly owned group of businesses uses the brand of an upstream business to the advantage of a downstream business². This would seem particularly relevant to Ireland where much of the market will have little appreciation of the difference between ESB power generation, ESB networks, ESB customer supply, or ESB Independent Energy. We strongly believe this is a situation that will need to be addressed before the market can be held to be on a level playing field and thus fully competitive.
- b. **Credible and effective safeguards in place to ensure that competition is not undermined following deregulation** – In terms of remedies, the roll back of price regulation is not a feasible or credible option. Once removed it is very difficult to re-introduce end-user price regulation as this would be an admission of failure for all concerned and would be very damaging to the industry's reputation as a whole. It would mean the roll-back of measures needed to remove the price control in the first place (including legislative changes) which would be expensive, cumbersome and inefficient. It would also be confusing to customers and would seriously undermine their confidence in competitive markets and the ability of independent suppliers to compete effectively. At the same time it is unclear what it would achieve, in the short-term at least, as the damage would already have been done in terms of dominance being re-established. The re-introduction of end-user price regulation is not therefore a credible threat, nor is it necessarily desirable or effective. Hence it is crucially important to have in place ex ante safeguards to ensure that competition will not be undermined post deregulation. A price cap on all suppliers as suggested in the draft roadmap is unnecessary (predation is more likely) and would be inconsistent with the intention of deregulating the market. Competition law remedies with financial

² See for example Ofgem's open letter on review of branding in the electricity distribution and supply markets; 27 January 2005.

penalties may have some role to play – for example a warning that there would be a referral unless the PES redressed the situation might be a practical approach. But it is not enough. We suggest that if ESB exceeds 35% market share in business markets or in the domestic market their customer acquisition operations are suspended until their market share drops 5% below the stated thresholds and financial penalties applied also. CER could make it a licence condition but this might require a little more thought. A traffic light system where the PES was shown an amber light if it were approaching a dominant position (which could be defined in the licence) might be one idea. However the thresholds are enforced it is crucially important to be explicitly clear about this in advance of deregulation with sufficiently detailed tests. From our experience of selling wholesale electricity in the market this is a weakness of the EPO obligation on ESB CS which frustrates effective enforcement of the obligation.

c. **A clear understanding of the effects of integrating the two ESB generation businesses on the wholesale market and implementation of measures necessary to protect the competitive integrity of the wholesale market –**

- CfD liquidity constitutes a major challenge. Whilst the principal generators make CfD cover available through annual directed allocations and non-directed auctions these offerings cannot be used to fine tune a customer portfolio that is constantly shifting, especially where the dynamic is for significant change in market shares. We do not agree with the conclusion in the consultation paper that there is an availability of CfD cover to manage wholesale price risks satisfactorily.
- A formal review of the market power mitigation strategy in the SEM would seem necessary, including the DC process and the market monitoring unit (MMU) resources and mandate.

d. **Global aggregation** - At present ESB CS as PES shoulders the risks and costs of the mismatch between the profiles and actual demands of the customers of independent suppliers, and their associated loss factors. The PES can accommodate these risks partly because of the size and diversity of its own customer base in the parts of the market where it is dominant, and partly because it can rely on the k-factor in its price regulation to compensate for any net cost it incurs. Global aggregation (GA) is designed to replace this obligation with a methodology that equitably shares

these profile error costs amongst all suppliers. It is difficult to imagine that PES will give up its k-factor protection until the GA methodology gains regulatory approval. The implementation of GA should also be a pre-requisite in determining that a competitive framework has been established.

The issues identified above are not trivial and require open dialogue with all stakeholders involved through public consultation in order to achieve satisfactory and expedient solutions. Their resolution is essential for the well being of competitive markets at the wholesale and retail level and for the deregulation of end-user electricity prices. **The timetable for deregulation set out in the consultation paper is unrealistic for what has to be achieved to ensure a level playing field and efficient outcomes.**

In addition to these comments we set out below our key points in relation to the criteria proposed in the roadmap, and we respond to the substantive questions raised in the consultation paper in annex 1.

VP&E comments on criteria proposed in the roadmap

1. VP&E believe lower and more stringent market share thresholds should apply to the Irish retail electricity market before price deregulation is contemplated.

The consultation paper cites market thresholds referenced in European Commission Guidelines³, and then argues for a higher market share threshold in the domestic sector on the grounds that a proportion of this customer base is unlikely to ever change supplier. Having reviewed the same Guidelines it is clear that a market share of 40% will always raise concerns and 50% will invariably be dominant save in exceptional cases (see paragraph 75 of the Guidelines). This is not apparent in the consultation paper. In addition, the Guidelines list the following criteria as relevant in establishing dominance:

- Overall size of the undertaking;
- Product/service diversification;
- Easy or privileged access to capital markets/financial resources;
- Control of infrastructure not easily duplicated;

³ Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, 11 July 2002.

- Technological advantages;
- A highly developed distribution and sales network;
- Product differentiation;
- Vertical integration.

These are not referenced in the consultation paper either and we would suggest many, especially privileged access to capital and financial resources, are applicable to ESB CS and ESBIE given the state ownership of these companies and thus argue for a lower market share than the normal limit of 40% to be used as the dominance criterion.

We would also refer the CER to the Irish Competition Authority case in considering a complaint against Greenstar Recycling Holdings Ltd where it was noted that market share was not the only consideration⁴. In addition to the above another factor that would be relevant in establishing dominance is cited as:

- Relative market shares and the level of concentration in the industry

This highlights the need to appreciate the significance of the very high Herfindahl-Hirshman Index (HHI) scores, ranging from a high of 7,234 to a low of 2,190, peculiar to the Irish retail electricity market (anything above 1,800 is universally considered highly concentrated). The consultation paper does acknowledge the use of the Herfindahl-Hirshman Index (HHI) as a measure of market concentration, and the empirical figure of 1,800 is referenced as the minimum acceptable level. However its relevance is quickly rejected on the grounds that the scale of the market is insufficient to support six or so evenly sized supply businesses that would be needed to achieve this value of the index. Whilst we accept that scale will be a consideration it should remain a regulatory objective in the context of deregulation to respect the principles of competition and dominance analysis. We therefore suggest, in light of HHI scores in excess of 7,000, that high market concentration should be an additional consideration in deciding on appropriate market thresholds. It would seem reasonable to suggest that at least three strong players should have market share equivalents, e.g. 30/30/30 and one should not be state owned, with the residue for other players. This implies a 30% threshold but 35% might be acceptable providing other issues are addressed.

⁴ See decision of the Competition Authority (Case COM/108/02), 30th August 2005.

It has been suggested that a higher PES share may be appropriate in the domestic sector where a proportion of customers could prove immovable. If such a characteristic is evident then there is no reason why it should be the privilege of ESB CS to retain the right to supply these customers. Indeed if the supplier of last resort obligation is to be shared amongst all suppliers then the supply of so called “sticky” customers could be similarly shared.

For the above reasons we would propose a maximum market share for any supplier of 35% in the business sectors **and** 35% in the residential sector.

2. **VP&E does not agree that the electricity market can be segmented into four sectors and each treated separately.** The segmentation proposed is artificial in that it simply tracks the extant tariff structures which in turn reflect the legacy of historic and relatively crude metering. It is VP&E’s view that the electricity market is a continuum of customers of varying size and intensity of demand. We believe that of these some 3,000 are equipped with interval metering but the vast bulk of 2.2 million customers have single or two rate meters that cannot distinguish the time of energy use. Attribution of the energy consumed by these customers is on the basis of profiles, and provides prospects for cross subsidy if regulatory scrutiny of the dominant player is abandoned. Furthermore, a dominant position in one sector of the market can be used to be more aggressive in other sectors. And because the overall market is so small it is necessary for suppliers to be active in multiple market sectors to achieve the critical mass necessary to be sustainable. Tests of dominance based on market shares should thus apply across all sectors rather than being restricted to artificially ring-fenced segments (also see point 7 below).
3. **We further suggest amending the CER criteria to reflect that BGE should not be considered an independent supplier as BGE and ESB are owned by the same shareholder and therefore under no test could they be considered independent.**
4. **We do not believe that a single market share test is sufficient to indicate that a market has achieved effective competition.** We would wish to see multiple supplier switching within the metrics to demonstrate that the removal of price regulation is appropriate. Multiple switching is a measure of customers who switch supplier on a number of occasions, including returning to their former supplier, and will indicate the degree of market maturity.

5. **In respect of the market status review VP&E strongly recommends a more conservative approach by using historical assessment only rather than the alternative prospective assessment suggested in of the consultation paper.** Whatever metrics are addressed our view is that the review should be based upon historical information. Projections based on forecasts are likely to be extremely uncertain at a time when major shifts in market shares are occurring, and subjective hence leaving them open to challenge. It is very important to be prudent because once the market is deregulated it is very difficult to go back. Once CER has transferred responsibility for protecting customers from price regulation to abuse of a dominant position judged by the Competition Authority, there is no obvious way back. To have a settled down position would give comfort that any market share change was not a short term perturbation.
6. **VP&E believes that the CER concerns regarding the risks of leaving a market segment price regulated longer than necessary need to be viewed in the context of other developments.** In particular:
- Other aspects are being addressed to ensure regulated tariffs are pro-competition in the transition to a deregulated market. More specifically, proposals concerning the development of k-factors and margins, and retail tariff structures which are to be consulted upon shortly. Many of the ideas in the reports from Skyplex and Pöyry published immediately before Christmas would provide an interim half way house to full price deregulation;
 - In the meantime competition in the domestic market is progressing rapidly; and
 - Structural measures that will facilitate competition could be addressed such as creating more liquidity in the CfD market, re-branding of supply businesses, the implementation of GA, and the maturing of the wholesale electricity market.
7. **Given the lack of a clear distinction between the costs of serving smaller SME loads and domestic loads we do not believe it appropriate to deregulate prices in the business sector in advance of those to residential customers.** The suggestions above are a clearer statement of the proposal in Option 3 for the removal of price controls on page 68 of the consultation paper. However, our view is that this requirement should be applied to all sectors of the market. The investment by a

supply business in the billing and customer query arrangements will apply across all non-interval metered customers, and require a critical size for their economic deployment. Applying price deregulation to SME customers in advance of the domestic sector will tend to frustrate these investments and thus detract from opening up competition generally.

Concluding remarks

The CER consultation is a tour de force but it is a little unfortunate it did not take a more holistic look at what is needed. For example global aggregation, metering codes of practice, CfD trading, profiling, all have their place in moving to a fully competitive supply market. It would be helpful if the “Roadmap” could have embraced all these aspects.

Price deregulation on a sector by sector basis is likely to be inefficient and less effective. The management of wholesale risks does not naturally break down into the market sectors proposed in the consultation paper, nor do other supply costs. The danger of cross subsidy between SME and residential customers has already been highlighted if prices for one group are deregulated but not for the other. Furthermore a number of structural aspects to the market infrastructure require implementation in order to create a level playing field for all participants. It is our firm view that for price deregulation to be effective in facilitating competition it should be applied universally across all sectors of the market at one time and those other aspects of the market arrangements should be resolved as a pre-requisite.

In summary therefore VP&E strongly recommends that removal of end user price regulation should only be contemplated subject to:

- Fulfilment of necessary pre-requisites noted in this response;
- Achievement of the market share thresholds suggested in this response, demonstrated using historical information rather than subjective and potentially inaccurate forecasts, and;
- Proof that a significant level of multiple switching has been achieved,

We strongly believe that the timetable set out in the consultation paper is not achievable given the issues that have to be resolved before we can be confident that deregulation will lead to efficient outcomes and truly competitive markets.

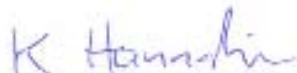
As noted at the outset of our response the publication of a proposed roadmap for deregulation is a welcome first step and will no doubt benefit from constructive stakeholder input, as suggested above, but much more has to be done and VP&E looks forward to contributing to that process.

In the meantime VP&E believes that CER concerns regarding the risks of leaving a market segment price regulated longer than it should be need to be viewed in the context of other developments. In particular:

- Other aspects are being addressed to ensure regulated tariffs are pro-competition in the transition to a deregulated market. Specifically proposals concerning the development of k-factors and margins, and retail tariff structures which are to be consulted upon shortly. Many of the ideas in the reports from Skyplex and Pöyry published immediately before Christmas would provide an interim half way house to full price deregulation;
- Competition in the domestic market is progressing rapidly; and
- Structural measures that will facilitate competition could be addressed in the interim such as creating more liquidity in the CfD market, re-branding of supply businesses, the implementation of GA, and the maturing of the wholesale electricity market.

Please do not hesitate to contact us if you would like to discuss further or to arrange a meeting if that would be helpful.

Yours sincerely

A handwritten signature in blue ink that reads "K Hannafin".

Kevin Hannafin
Senior Regulation Analyst

Annex 1 – VP&E response to formal questions posed in CER 09/189

Proposal 1

Respondents are invited to comment on the proposal in Section 4.5 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.

Question 1

Are you in favour of the proposals outlined in Section 3.4, to review the market and define a roadmap for deregulation of the retail electricity market? Do you think this is the right time? Outline reasons for agreement or disagreement.

VP&E Response

In moving to a deregulated retail market it is important that the CER lays out a clear vision for a competitive electricity market. This vision should be characterised not simply in terms of market shares and the number of participants but also in terms of the methods and processes that should exist. For example it would be important to consider in more detail the need for more liquidity in the CfD market, the implementation and impact of global aggregation, metering developments, and switching arrangements. Important qualitative aspects of a competitive market, including branding separation and ex post remedies, are also given insufficient scrutiny and weighting in the roadmap. These issues need to be explored further, understood and formally incorporated into the roadmap, if not fully resolved, before deregulation can take place. At the very least however branding separation and ex post remedies should be necessary pre-requisites for deregulation, although there may be some inter-relationship between these factors and the thresholds chosen.

The draft roadmap is a good first step and will no doubt benefit from constructive stakeholder input as suggested above to provide a good basis for moving towards fully competitive and efficient markets. However, the timelines set out in the roadmap are unrealistic for all that has to be achieved before we can be confident that deregulation will lead to efficient outcomes and truly competitive markets. The roadmap would also benefit from painting a broader picture embracing the prospects for smart grids, load management and the growth of distributed generation.

Question 2

In relation to Proposal 1, Section 4.5, 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.

VP&E Response

Price deregulation on a sector by sector basis is likely to be inefficient and less effective. The management of wholesale risks does not naturally break down into the market sectors proposed in the consultation paper, nor do other supply costs. The danger of cross subsidy between SME and residential customers will be significant if prices for one group are deregulated but not for the other. Furthermore, a dominant position in one sector of the market can be used to be more aggressive in other sectors. And because the overall market is so small it is necessary for suppliers to be active in multiple market sectors to achieve the critical mass necessary to be sustainable. In addition a number of structural aspects to the market infrastructure require implementation in order to create a level playing field for all participants. It is our firm view that for price deregulation to be effective in facilitating competition it should be applied universally across all sectors of the market at one time and those other aspects of the market arrangements should be resolved as a pre-requisite.

In the meantime real improvements can be made to ensure regulated tariffs are pro-competition in the transition to a deregulated market. In particular proposals concerning the development of k-factors and margins, and retail tariff structures which are to be consulted upon shortly. Many of the ideas in the reports from Skyplex and Pöyry published immediately before Christmas would provide an interim half way house to full price deregulation. Structural measures that will facilitate competition could also be addressed such as creating more liquidity in the CfD market, re-branding of supply businesses, the implementation of GA, and the maturing of the wholesale electricity market.

Question 3

In relation to Proposal 1, Section 4.5, 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.

VP&E Response

Public lighting should not be considered a relevant market for deregulation at this stage because there is little competition in this sector and it does not pass the criteria set out in the roadmap or as suggested elsewhere in this response.

Question 4

In relation to Proposal 1, Section 4.5, 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.

VP&E Response

From a profiling perspective domestic customers are allocated either a 24-hour or Day/Night profile. This is also the case for the smaller end of the SME market. It is our view that the same market dynamics are likely to pertain for both groups of customers. Given the scope for cross subsidy between these groups we believe that no distinction should be drawn between domestic and smaller SME customers. Indeed many smaller SME customers may be combined commercial and residential premises.

Proposal 2

The Commission is proposing in Section 5.2 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

Question 5

Respondents are invited to comment on the proposal to assess the level of retail competition using the factors outlined in Proposal 2, Section 5.2. Are you in favour of the proposal? Outline reasons for agreement or disagreement.

VP&E Response

Although market share metrics will be useful in helping to establish how prevalent competition is in any market sector they should certainly not be used as the sole measure to assess whether a market is competitive. An assessment of switching rates is also necessary. In assessing the degree to which competition had become established in the GB market Ofgem looked not only at gross and net switching rates but also at multiple switching rates⁵. The initial switching of suppliers may not indicate a settled position and multiple switching rates (a measure of customers who switch several times, including returning to their former supplier, or switching to another non-incumbent or new entrant) would seem a better guide to establishing that the market is sufficiently competitive to allow customers to change supplier freely. We would suggest that this is an additional measure that CER should rely on in making its judgement. A simple snap shot of market shares that could prove volatile will not of itself indicate a stable position.

The development of qualitative aspects is also important in establishing competition. The branding issue is particularly relevant in the RoI where ESB is an established state owned household name in respect of generation, networks and supply. It is also a 3rd Directive requirement necessary for a level playing field. Other market features that level the playing field are also important. Some of these are mentioned in the consultation document but progress on issues such as global aggregation and switching arrangements will also determine the competitiveness of a market sector.

As explained in our cover letter a further area of concern largely neglected in the consultation paper is the issue of market concentration. We comment further on this aspect in response to Question 6.

We believe that an ex-post review of these aspects is an essential test. CER has proposed a six monthly review and this, together with a consultation on its results, should be an integral part of establishing that competition has been achieved.

Question 6

For each of relevant markets discussed in Section 5.3, 5.4 and 5.5, 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.

⁵ Ofgem: Domestic gas and electricity supply competition, Recent developments, June 2003

VP&E Response

For reasons explained elsewhere in this response VP&E strongly recommends that removal of end user price regulation should only be contemplated subject to:

- Fulfilment of the pre-requisites noted in our cover letter and review of the qualitative factors noted above;
- Achievement of the market share thresholds demonstrated based upon historical information rather than subjective and potentially inaccurate forecasts (see answer to question 8), and;
- Proof that a significant level of multiple switching has been achieved,

We do not believe that these conditions can be achieved in 2010.

We are concerned that whilst the smaller end of the SME market shows a proliferation of suppliers this is not the case in the residential sector. The ability to cross subsidise energy and supply costs between these two sectors should require that a similar mix of suppliers should be evident in the domestic market as in the smaller SME sector. The qualitative review should also indicate progress in the market structural changes that are needed before removing price regulation in this sector is contemplated.

The consultation paper describes the importance of the Herfindahl-Hirshman Index (HHI) as a measure of market concentration. Whilst the use of the (HHI) is referenced as a measure of market concentration its relevance is dismissed on the grounds that the scale of the market is insufficient to support the six or so evenly sized suppliers that would be needed to achieve the limiting recommended value for the index of 1800. Whilst scale will be a practical consideration it should remain a regulatory objective to support the principles of dominance analysis. Against a backdrop of an HHI score currently in excess of 7,000 high market concentration should remain a primary concern in deciding when the market is ready for price deregulation. It would seem reasonable to suggest that for conditions to be deemed competitive there should be at least three strong players having similar market shares, e.g. 30/30/30, and that one should not be state owned, with the residue shared by other players. This would indicate an overall HHI below 3,000 and implies a minimum threshold of 30% for any player, although 35% might be acceptable providing other issues are addressed.

Question 7

Respondents are invited to comment on the assessment of the barriers to entry, exit and expansion within the retail electricity market outlined in Section 6. 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.

VP&E Response

Section 6 of the consultation paper addresses some but not all key concerns relevant to establishing a competitive retail market. For example we have discussed at length elsewhere in this response the importance of global aggregation. Furthermore, we do not share the regulatory confidence that the issues that have been recognised have been fully addressed or that their outcome is settled (e.g. customer switching and CfD liquidity). In addition, the significance of some of the issues that are addressed does not seem to be fully appreciated (e.g. branding and relative market shares).

Switching rates for domestic customers have accelerated rapidly but this is against a backdrop of PES retail prices that may not fully reflect the fall in wholesale prices seen by new entrant suppliers to the domestic market. More time is required to establish that competitive inroads into the PES dominance of this sector can be sustained.

Non-discriminatory network access may be there for suppliers but problems are evident for distributed generation on which independent suppliers may depend to hedge the exposure to Pool prices.

Branding is an important feature in all competitive markets. The presence of recognisable brands in a market, along with informative advertising, can alert customers to the choices available to them. This will help customers to make informed decisions in choosing their energy supplier. Branding and advertising are therefore an important part of the competitive process encouraging competition between suppliers.

However, as Ofgem has pointed out⁶, there exists the potential for companies to misuse branding in ways that could distort competition. This could be where a commonly owned group of businesses uses the brand of an upstream business to the advantage of a

⁶ Open letter on Ofgem's review of branding in the electricity distribution and supply markets; 27 January 2005

downstream business. This would seem particularly relevant in the RoI where much of the market will have little appreciation of the difference between ESB power generation, ESB networks and ESB customer supply. We believe that this is a situation that will need to be addressed before the market can be held to be on a level playing field and thus fully competitive.

CfD liquidity constitutes a major challenge. Whilst the principal generators make CfD cover available through annual directed allocations and non-directed auctions these offerings cannot be used to fine tune a customer portfolio that is constantly shifting, especially where the dynamic is for significant change in market shares. We do not agree with the conclusion in the consultation paper that there is an availability of CfD cover to manage wholesale price risks satisfactorily.

As set out in our cover letter all of the above issues are of critical importance, especially given state ownership of the incumbent.

Proposal 3

The Commission is proposing in Section 7.2 that regulatory price controls should be removed when competition is reached in a particular market where all the following criteria have been met

- (i) at least three suppliers active in the relevant market, and
- (ii) where there is a minimum of 2 independent suppliers, that at least two of the independent suppliers in a particular market has at least 10% share of load (GWh) in the relevant market, and
- (iii) ESB PES and ESBIE combined serves or will within a defined period 40-50% GWh in the LEU market, 40-50% GWh in Medium-Sized business market, 40-50% GWh in the small business market and 55-60% GWh in the domestic market

Question 8

In relation to Proposal 3, Section 7.2, 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.

VP&E Response

As discussed above we do not believe that a single market share test is sufficient to indicate that a market has achieved effective competition. We would wish to see multiple supplier switching within the metrics to demonstrate that the removal of price regulation is appropriate. These metrics should not rely on forecasts given the volatile nature of the market dynamics, but be based on historic data. There should also be a qualitative review to establish that market structural aspects such as the establishment of CfD liquidity are satisfactory to support competitive processes.

In any event we believe that the thresholds suggested are an inappropriate extrapolation of the guidance provided in the European Commission guidelines⁷. A more balanced and natural conclusion from this paper, as noted in our cover letter, is that the maximum market share that could be tolerated in any market sector would be 40%. In the Irish context, characterised by high HHI scores, state ownership of the incumbent with an enviable brand across generation, networks and supply, and small market size that could only reasonably sustain a supplier that operates across multiple market sectors, we would suggest a market share in excess of 35% should cause regulatory concern. It has been suggested that a higher proportion may be appropriate in the domestic sector where a proportion of customer could prove immovable. If such a characteristic is evident then there is no reason why it should be the privilege of ESB CS to retain the right to supply these customers. Indeed if the supplier of last resort obligation is to be shared amongst all suppliers then the supply of so called “sticky” customers could be similarly shared.

In addition we would challenge the independence of BGE as an independent supplier in ascertaining whether the thresholds have been achieved because BGE and ESB are owned by the same shareholder and therefore under no test could they be considered independent.

Proposal 4

The Commission is proposing in Section 7.4 to review conditions in each market on a bi-annual basis starting in March and October 2010 including an assessment of each supplier's market share. The review will take account of the following:-

- (i) The expected market share of ESB (PES and ESBIE together). This will be based on actual market information from MRSO and CER forecasts.

⁷ Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services,; 11 July 2002

- (ii) The expected market share of every other supplier. This will be based on actual market information from MRSO and CER forecasts

Question 9

Respondents are invited to comment on the options for the review of market conditions in March and October outlined in Section 7.3. Are you in favour of Proposal 4? 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.

VP&E Response

A bi-annual review would be a useful device for assessing if sufficient competition had been achieved but it should be conducted in the a more heuristic context than a simple assessment of market shares and it should be conducted in an open manner using a transparent and generally accepted methodology. Whatever metrics are addressed our view is that the review should be based upon historical information. Projections based on forecasts are likely to be extremely uncertain at a time when major shifts in market shares are occurring, and subjective hence leaving them open to challenge.

Once price regulation is abandoned, and the jurisdiction for assessing dominance migrates to the Competition Authorities then it may prove difficult for the RA to re-establish any price control in the event that the PES (in conjunction with ESBIE) breached the CER criteria. We would therefore suggest that CER consider embedding the maximum market share permitted as a Licence Condition such that exceeding it would constitute a Licence breach rather than requiring referral to the Competition Authority.

Proposal 5

The Commission is proposing in Section 8.3 that further to all the criteria for a competitive market being met in all markets and subject to the DCENR making all necessary legislative changes, the Commission will also take steps to change the form of regulation to reflect the following principles:

Price Controls

- Removal of all price controls on ESB PES
- The removal of any ESB PES Economic Purchase Obligation from ESB PES.

Other

- Review of the obligation of Non – Discrimination
- Review of the designation of ESB PES as the Supplier of Last Resort and the Universal Service Obligation.

Question 10

Respondents are invited to comment on the options outlined in Section 8.2 for 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 PES 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.

VP&E Response

Since the test of market share is to aggregate both ESB CS and ESBIE we can see little point in either option 1 or 2. For reasons explained elsewhere in this response price deregulation on a sector by sector basis is likely to be inefficient and less effective. Thus our view would be that the price controls should remain in place until the market threshold test is passed for all sectors (including in the domestic sector) and the other criteria we have considered above apply. If the market is deregulated on a sector by sector basis more detailed information would be required to understand how options 1 or 2 would be implemented. From the limited information available VP&E would choose accounting separation even though it is flawed and will not work because of the real potential for cross subsidisation.

Question 11

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?

VP&E Response

Under a de-regulated market we would expect all suppliers to be treated on the same basis. However, this should not detract from ESB CS and ESBIE acting in a prudent way especially since they will still enjoy the benefits of state ownership. Their shareholder should therefore

still insist that supplies are properly and sufficiently hedged as currently required by the EPO. Furthermore there should be no commercial advantage gained from the credit rating benefit state ownership brings.

Effective competition should in theory drive suppliers to reflect costs to their customers but retaining the non-discrimination provision may be necessary to give confidence that this will remain the objective. The non-discrimination obligation also needs to be considered in the context of ESB CS customers potentially transferring to ESB IE.

More generally, VP&E would expect to see detailed consultations in respect of Proposal 5 before any decision would be taken.

Proposal 6

The Commission is proposing in Section 8.4 that further to the removal of price controls, the Commission will continue to monitor market activity and any significant change in market conditions, imposing appropriate remedies on ESB PES and/or ESBIE as required.

Question 12

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.

VP&E Response

We have already noted our concerns that price deregulation may be a one way ticket and suggested a device whereby the RA could retain some control over future abuse of a dominant position by enshrining the maximum market share permissible in the supply licence.

Proposal 7

The Commission is proposing in Section 10.3 that once regulatory price controls have been removed, ESB PES and any other supplier may be required (through licence) to offer tariffs to vulnerable and or other groups of domestic customers, as defined by the Commission, on principles acceptable to the Commission.

Question 13

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?

VP&E Response

Our position is that a fully competitive market should treat all suppliers on the same basis. We accept that with the supply of electricity go certain social responsibilities. This is likely to require regulatory assistance to achieve, for example, the equitable management of the role of supplier of last resort. Similarly with the treatment of vulnerable customers although we would hope that support for specific groups of customers would not obviously distort competition. Those parts of the business that remained price regulated (most obviously the network companies) would seem to be the most obvious route for providing financial assistance where this was deemed appropriate.

Question 14

Respondents are invited to comment on the interim work programme outlined in Section 11.4 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.

VP&E Response

As we noted at the outset to this response the roadmap could have been cast more broadly to contemplate the impact some of the very substantial challenges the industry now faces. The impact of technological change in generation, the roll out of smart metering, and the evolution of smart grids will all bear heavily on supply businesses. We believe it important that CER consults fully on the regulatory changes that will be necessary as a result of these developments. We therefore suggest that CER does not adopt a prescriptive approach in

deciding when competitive maturity has been achieved but seek the views of market participants before the implementation of any change.