

Joint development agency submission to the CER on a roadmap for deregulation of the retail electricity market (CER/09/189).

February 2010



The development agencies, Forfás, IDA Ireland and Enterprise Ireland, represent the interests of the internationally trading business sector in Ireland. The reported exports of all agency-assisted firms accounted for 79 percent of total Irish exports in 2008. Total employment in agency-assisted companies operating in the manufacturing or internationally traded services sectors amounted to 285,474 in 2009.

Introduction

We refer to the proposals on a roadmap for deregulation of the retail electricity market (CER/09/189). The development agencies welcome the opportunity to provide an input to this important review.

It is important that the CER communicates its proposals and decisions in simple and clear terms to energy customers to ensure transparency and confidence in the regulatory process. In this regard, we welcome the publication of a large amount of market information in a concise and clear fashion.

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.

We are in favour of the proposal to develop a roadmap for the deregulation of the retail electricity market. Now is the right time to develop the roadmap - potential exists in some markets segments to deregulate prices in the near future. In other segments, the roadmap can set out clear criteria that can guide future decisions and provide certainty to market participants.

The correct timing of removing price regulation is very difficult to ascertain ex ante. Removing regulation of ESB pricing too soon could undermine the benefits of competition arising from the entry of BGE / Airtricity and waiting too long could leave ESB at a continuing disadvantage - which would not be in the interests of electricity consumers.

Despite the recent moderation in international fuel prices, high electricity prices in Ireland remain a serious cost competitiveness disadvantage for firms operating in Ireland. It is important to drive further efficiencies in all segments of the market - generation, networks and supply. Competition in the retail market has an important role to play in removing inefficiencies in the supply market. Increased competition in the retail electricity market should benefit consumers through lower prices and greater product differentiation. However, it is important to manage expectations about the likely impact of full competition. We recognise that in a fully competitive market, changes in fossil fuel prices will still be the dominant factor in determining the level of Irish electricity prices.

The success of deregulation of the retail electricity market in delivering lower prices is dependent on a fully competitive wholesale electricity market, including network tariffs. Therefore, it is vital that the Department for Communications, Energy and Natural Resources and the Commission for Energy Regulation demonstrate that structural measures are also progressing as a matter of urgency to ensure a long term improvement in wholesale electricity cost competitiveness.

These structural measures include:

- Ownership unbundling of the transmission network;
- Minimising network charges passed through to ESB Networks; and
- Ensuring that renewable resources are brought on stream in a fashion consistent with large scale deployment on a competitive basis over the long term.

The unbundling of the transmission network is central to improving efficiencies in the electricity market and must be advanced, as set out in the 2007 Energy White Paper. The proposed transfer of the asset from ESB Networks to Eirgrid needs to be accelerated in order to ensure that new entrants to the market have certainty and network access on transparently equivalent terms. It is also important to ensure that the ESB is not able to cross-subsidise its supply businesses with an artificially low cost of capital due to its ownership of an asset which it no longer controls.

It also important to address the legacy of high electricity transmission and distribution charges in Ireland compared to other EU countries. The CER should provide the maximum level of transparency to ensure that electricity customers benefit from further efficiencies in the labour, operational, maintenance and capital costs of ESB Networks and Eirgrid.

The appropriateness of all price support mechanisms for renewable energy sources needs to be reviewed. As highlighted by the International Energy Agency and National Competitiveness Council, support mechanisms for renewables should be designed to be transitional with decreasing support levels over time as technologies mature. Regular reviews of the mechanisms in place and of the progress achieved are crucial to ensure that renewable energy penetration and deployment occurs smoothly and effectively.

There is scope to enhance the effectiveness of Ireland's support mechanisms to facilitate the development of a competitive renewables market and improve Ireland's cost competitiveness by periodically reviewing the level of support and allowing for progressive reduction of supports as technologies mature (onshore wind is regarded as a mature technology). The support mechanisms in place in other European countries, such as France and Germany, include annual efficiency reductions in addition to the potential for regular reviews to reflect technological and market developments - these are good examples.

At a more general level, standard guaranteed price supports (such as that operating in Ireland), isolated and protected from the risks and competition in the rest of the energy sector, are not economically sustainable as a support scheme in the medium to long-term when renewable energy reaches very large-scale deployment.

Ultimately, these structural factors, which policy and regulation can influence, coupled with the price of imported fossil fuels will have a greater impact on consumers' electricity bills than whether there is full deregulation of the retail market. It is important provide electricity customers with transparency and certainty that measures are being taken to enhance cost competitiveness to the maximum extent possible given our fuel mix and geography.

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.

We are in favour of the proposals. The three business categories provide for a reasonable degree of differentiation between business customers.

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.

Potential exists to include public lighting in the relevant business market. It is notable that exceptions are not proposed for other distributed public services - e.g. schools, hospitals. Deregulating price controls may encourage the State to procure electricity more strategically and at attractive rates if procured centrally.

Q.5 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

The experience of other deregulated electricity markets suggests that demand-side trends in customer switching, product differentiation on factors other than price (e.g. bill payment options, tracker options etc.) and consumer awareness are important determinants of how the market develops following deregulation. International experience of deregulation indicates that there is likely to be a significant degree of consumer inertia in many electricity markets. It is possible that a market displaying vigorous competition can also exhibit a high market share for the incumbent.

In Ireland's case, the ESB enjoys particularly strong brand recognition and is associated with a secure supply of electricity. ESB Networks manages the electricity distribution system for all electricity providers and serves all customers on a neutral basis. There is a case for requiring ESB Networks to use a different brand. A natural monopoly does not need a brand and a supply company should not derive competitive advantages from association with the network management entity. This could help clarify ESB's brand among other market participants and help address consumer inertia.

Realising the benefits of full price competition hinges to a large extent on raising awareness of different pricing options likely to emerge among the long tail of consumers who are relatively price inelastic. If the CER is no longer regulating electricity prices, it needs a stronger role in communicating with final customers and raising awareness of the pros and cons of pricing structures which may emerge in future in a deregulated market. There may be potential to learn from experience in the telecommunications market where ComReg undertakes a range of initiatives to raise awareness of the different products and suppliers available and the suitability of different options for users' profiles. The extent to which the emergence of smart metering can increase electricity consumers' price sensitivity will also be a key driver of consumer behaviour and competition in a deregulated retail market.

The Commission correctly assesses the impact of ESB PES and ESBIE together given the close relationship between these companies. In this respect, the analysis could also assess the merit of assessing ESB and BGE together and independently. The fact that they are run as independent commercial state owned firms may mean that the proposed criteria are acceptable. While there is healthy competition between the State-owned companies at present, it is important to keep this issue under review. As they share the same owner, potential for joint market dominance may exist in the future. However, it would be useful to tease this out further in order to assess if it has any regulatory implications should the market be deregulated.

Q.6 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.

We agree broadly with the criteria set out by the CER for deregulating the electricity market segments. Based on current market trends, conditions are broadly in place to deregulate prices in the business segments in the near future.

In the residential market, significant progress has been made in recent times where the entry of BGE and Airtricity has resulted in high levels of customer switching in a very short period of time. However, the competitive situation in the residential segment is less clear than in the business segments due to the recent emergence of competition. While it is not the responsibility of the development agencies to assess the correct timing of deregulation for residential customers, we see the merits of setting out a clear roadmap for deregulation with regular review towards the thresholds and market conditions necessary.

It would be useful to assess market activity in light of the response to question 5.

Q.7 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.

We broadly agree with the assessment that the Irish retail market is developing appropriately in terms of the structures and processes required to support a fully competitive market. The assessment of sunk costs, switching costs, non discriminatory network access, branding and access to wholesale products could benefit from greater detail.

The premise for the deregulation of retail prices is that competition exists at the wholesale level. While some of these issues are touched upon in this section, the paper states that *“the Commission considers that the wholesale supply of electricity, the transmission grid, the distribution grid and the retail supply of electricity to be separate product markets. While the regulatory arrangements in place for the wholesale markets and networks access provide the context for a competitive retail market, this review deals with the regulatory controls as applied to the retail market for electricity only”*.

We believe it would be useful to assess the competitiveness of the wholesale electricity market in more detail, and the factors that support or impede the development of wholesale competition (e.g. regulatory arrangements of the networks). It is not appropriate to assess the retail market in isolation from the wholesale market and more information could usefully be provided in this regard.

Q.8 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.

The proposed thresholds for deregulation of price controls in the relevant segments in the Irish retail market are 40-50% for both SME segments and 55-60% for domestics. We support the proposals on the market share thresholds for the removal of controls in the relevant retail markets for electricity.

We note that current market share is an informative indicator of the potential for sustainable competition. Nonetheless, the key issue facing the regulator is whether the ESB would enjoy pricing power in a deregulated market.

The potential for ESB to enjoy significant pricing power in a deregulated market has been significantly reduced by the successful launch of the wholesale Single Electricity Market in 2007 and more recently the entry of rival suppliers with significant financial resources and generation capacity

It is important that the regulator is satisfied that the ESB no longer enjoys pricing power and we would caution against any rigid adherence to market share thresholds alone in determining this issue.

Q.9 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.

We agree that regular review pre and post potential deregulation are important. In addition to assessing the quantitative factors outlined in proposal 3, it would be important that the CER also regularly assesses barriers to switching, non-discriminatory network access, and the availability of wholesale energy, etc.

A growing energy surplus, the demand destruction due to severe recession and recent new entrants may be leading to a surge in competitiveness pressures in the market as demonstrated by high recent customer churn rates and falling market share of the incumbent. Such trends may not continue and could be reversed in future. It would be important that the thresholds do not create uncertainty if proposed market metrics oscillate around the thresholds. It would be important that the implementation mechanism takes account of this possibility as circumstances change in future.

Option 1 (waiting until thresholds have been met and maintained) might provide the best option to avoid uncertainty. However, it would also be important that market developments are not moving against a change in regulatory policy. Hence a mixture of both options may be advisable - where the threshold for a relevant market as set out in Proposal 3, is found to have been met and maintained for a period of time (option 1), and where the threshold for a relevant market is likely to be maintained following the date of the review.

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.

We strongly concur with the need for regular monitoring of prices, market share and barriers to entry and exit and customer switching. Competition law will play an important role in this regard. The State, as the owner of ESB and BGE, may also have a role to play in ensuring that the market develops competitively.

We welcome the indication that the CER will seek to cooperate with the Competition Authority in performing these monitoring duties with regard to competition in the Single Electricity Market.

It is our view that competition law is sufficiently robust to deal with any collusion between suppliers in a deregulated market or to take companies to court in the case of abuse of a dominant market position. Nonetheless, vigilance and close cooperation between the CER and the Competition Authority will be important to ensure transparency and trust in the functioning of a deregulated retail electricity market.