# Proposals on a Roadmap for Deregulation in the Non-Daily Metered Retail Gas market

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*The CER for Energy Regulation,*
*The Exchange,*
*Belgard Square North,*
*Tallaght,*
*Dublin 24.*

www.cer.ie

## CER – Information Page

**Abstract:**

The Commission for Energy Regulation (CER) is consulting on the circumstances under which the revenue and price controls should be removed from Bord Gáis Energy in the retail Non-Daily Metered sector. The CER is also inviting submissions on what other actions should be taken apart from the removal of the revenue and price control in order to ensure a fully competitive deregulated gas retail market.

**Target Audience:**

This paper is for the attention of members of the public, the energy industry, and all other interested parties.

Responses to this consultation should be returned by email, post or fax and marked for the attention of Stuart Coleman (scoleman@cer.ie) at the CER**.**

**The CER intends to publish all submissions received.** Respondents who do not wish part of their submission to be published should mark this area clearly and separately or enclose it in an Appendix, stating the rationale for not publishing this part of their comments.

# Glossary

Within this document the following terms are used:

**ERGEG -** European Regulators' Group for Electricity and Gas

**FEA** – Free energy allowance

**FVT –** Fuel Variation Tariff

**GPRO** – Gas Point Registration Operator

**I&C** – Industrial and Commercial

**NDM** – Non Daily Metered

**RTF** – Regulated Tariff Formula

**SOLR** – Supplier of Last Resort

**Please note that the above is merely a glossary of terms used within this document and where appropriate, interested parties should refer to the Code of Operations for specific definitions.

# Executive Summary

The Irish gas retail market has historically been dominated by Bord Gáis Energy (BG Energy) which was the incumbent supplier of gas to all consumers. The prices in supply have been regulated by the CER since 2003, with full market opening in 2007. In the last 2 years, there has been new entry into all sectors of the regulated gas market. The deregulation of the Regulated Tariff Formula (RTF) sector and the entry earlier this summer by Airtricity into the residential supply market were significant steps. It is against this background that the CER considers it appropriate to consult on a roadmap for removing regulation from the Non Daily Metered (NDM) retail gas market.

The theory of regulation suggests that gas supply markets can be marked by fully effective competition, and evidence from de-regulated supply markets tends to support this view. This is further supported by policy coming from the EU, including the European Commission, Member States and the Regulators, which suggests that effective competition is likely to be superior to regulation and thus where markets are effectively competitive the replacement of end user retail tariff regulation in electricity and gas markets is a desirable outcome. The CER considers 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.

The CER considers it important to note, however, that removal of price regulation does not automatically guarantee low prices. Irish gas prices are predominantly determined by prices in the UK market. In a fully competitive market, changes in gas prices in the UK will still be the dominant factor in determining the level of Irish gas prices.

This paper outlines a “road-map” setting out the likely path for NDM retail deregulation and the various possible trigger points that might indicate that full or partial deregulation is merited. It considers the possible complete withdrawal of direct price controls in the small business and residential sectors. In detailing the roadmap, the CER suggests there should be a structured process of assessment, and the mechanisms and processes provided by competition law for the assessment of dominance appear to provide a reasonable framework for decision-making. This process involves defining relevant markets, analysing them structurally and assessing the case for retaining or removing ex-ante tariff regulation.

This paper addresses retail competition in the NDM gas market only. All sectors above the NDM have been deregulated and opened to full competition, with the most recent being the Regulated Tariff Formula sector (see CER/10/088). The analysis undertaken to date suggests that the geographic scope of the market to supply gas at the retail level is national (currently excludes the NI market). Within the overall NDM market segments identified are Fuel Variation Tariff sector, NDM Industrial and Commercial sector and the NDM Residential sector.

An analysis of the development of competition in these markets suggests that under reasonable thresholds for the establishment of an effectively competitive market, the FVT and I&C markets may be close to effective competition. While the residential market has only very recently seen the entrance of a new competitor, the prospect of further new significant market penetration by new entrants in the near future could be significant. The CER is consulting on a range of thresholds for the removal of the price control in terms of the market share by volume. These are 45-55% in the FVT and I&C markets and 55-60% in the residential market. However, these do not necessarily reflect any adjustment the CER may choose to make should it decide that the retail brand of BG Energy has an effect on competition, so they could be reduced if the retail brand is seen as a factor. In any case it should be stressed that these are only indicative numbers and that further analysis and evidence will be considered before any final decision is made.

Other factors will be assessed to determine at what level deregulation occurs. This paper also suggests a range of options for assessment criteria, how price controls should be removed and suggests additional measures around consumer protection.

Finally this paper considers interim measures that could be considered until such time as the NDM markets are deemed to be competitive. While there will be benefits to consumers arising from fully competitive markets, there are some risks that, after de-regulation, competition may not flourish to the extent anticipated and market power risks could re-emerge, either from one supplier or a group of suppliers. The CER is seeking views as to whether, and, if necessary how, any *ex post* monitoring of the market should be used.

The CER would stress that any views expressed in the paper are preliminary in nature and that it is committed to a full consultation on the issues. The CER looks forward to receiving the views of all stakeholders and interested parties.

## Table of Contents

# 1.0 Introduction

## *1.1 Purpose of this paper*

The purpose of this paper is to seek the views of the public and the CER's stakeholders with regard to a 'Roadmap' for deregulation of end-user prices. In order to make an informed and impartial decision on this topic, the CER wishes to obtain comments from members of the public, the energy industry, customers and all interested parties. The CER commits to considering all views and affording each respondent the opportunity to clarify any issue raised in this paper.

The CER proposes that the roadmap will set out the milestones for when regulatory practices will change in line with developing competition in relevant sectors of the market. The roadmap will also address any additional regulatory measures that would apply the transitional arrangements and provisions for ongoing regulatory monitoring.

## *1.2 Background Information*

In its paper "End-user Energy Price Regulation"[1] ERGEG stated that all markets should move towards removing price controls and that regulators should publish a 'roadmap' outlining how they intended to do so. ERGEG stated that end-user price regulation in electricity and gas markets can frustrate the functioning of the market and even jeopardise both security of supply and the efforts to fight climate change. Therefore end-user price regulation should be abolished, or where appropriate, brought into line with market conditions.

This roadmap should contain specified and attainable steps to establish the necessary conditions for a well functioning market with no need for end-user price regulation. Where appropriate a transition period towards well functioning competition (for the co-existence of regulated and market prices) may be necessary to protect customers from potential abuses of dominant positions.

[1] ERGEG: "End-user energy price regulation An ERGEG Position Paper": E07-CPR-10-03

## *1.3 Structure of this paper*

- **Section 2.0** looks at the regulatory framework in the Irish gas market.
- **Section 3.0** assesses retail competition
- **Section 4.0** defines the relevant retail gas markets
- **Section 5.0** provides an analysis of the relevant markets
- **Section 6.0** examines criteria for a competitive market
- **Section 7.0** discusses triggers for deregulation
- **Section 8.0** proposes changes to the regulatory framework for removal of price controls
- **Section 9.0** discusses consumer protection
- **Section 10.0** sets out the conclusions and outlines the next steps in the roadmap process.

## *1.4 Responding to this paper*

Interested parties are invited to comment on the issues raised in this paper this consultation paper by close of business on ***Friday 28th January 2010***.

As responses will be published in full on CER's website, respondents should include any confidential information in a separate Annex. Submissions on this paper should be forwarded, preferably in electronic format, to:

Stuart Coleman
Commission for Energy Regulation,
The Exchange, Belgard Square North,
Tallaght,
Dublin 24.
**E-mail:** scoleman@cer.ie

# 2.0 Regulatory Framework in Ireland 2010

## *2.1 Introduction*

Under the Gas (Interim Regulation) Act, 2002, the CER is responsible for the regulation of the Irish gas network and supply or retail market. More specifically the direct deregulation of gas retail sectors is entirely a matter for the CER unlike in electricity where such decisions are under the remit of the Minister. The CER regulates the charges, tariffs and access conditions imposed by Bord Gáis Eireann (BGE) and conducts five year reviews of revenue earned by the gas network operators. There are also twice yearly reviews of the revenue allowed for the NDM customer segment by Bord Gáis Energy, the retail trading arm of BGE.

Access conditions, connection charges and use of system tariffs imposed by the transmission and distribution operators are also regulated; this concerns Bord Gáis Networks as the owner of the gas transmission and distribution systems and Gaslink as the Transmission System Operator (TSO).

## *2.2 Regulatory Controls in the Wholesale Market*

There are no regulatory controls placed on the wholesale market. Shippers/Suppliers are free to source their gas from Inch or the highly liquid NBP in the UK.

## *2.3 Regulatory Controls of Networks*

BGE owns the gas networks in Ireland which are operated by Gaslink, a separate subsidiary of BGE. The relationship between Gaslink as the system operator and BGE as asset owner is managed through the operating agreement approved by the CER. These arrangements are in accordance with Irish legislation SI 760 of 2005, which was introduced to give legal effect to Directive 2003/55/EC.

## *2.4 Regulatory Controls on the Retail Market*

All shippers/suppliers of gas operating in the retail market in Ireland are licensed by the CER under Section 16(1)(a) of the Gas (Interim) Regulation Act, 2002. All shippers/suppliers are obliged to abide by the terms of their licence. BGE, like all other licences suppliers, are obliged to abide by the terms of their contracts. As the regulated incumbent there are certain additional conditions they must abide by, i.e. ring fencing of supply business and restriction of information, prohibition of cross subsidies, duty to offer supply etc. BG Energy is also designated the Supplier of Last Resort (SOLR). It is worth noting that BG Energy have an unregulated electricity business as well as a gas business and also that part of the BG Energy gas business is unregulated (above FVT).

# 3.0 Development of Retail Competition

## *3.1 Introduction*

One of the key objectives of regulation is to promote and secure effective market competition in the interests of customers. In the early stages of market liberalisation, the primary regulatory concerns are preventing the incumbent from extracting economic rents from consumers and ensuring that non-price discrimination does not prevent competitive entry. Where a market is not effectively competitive a supplier in a dominant[2] position is able to act independently of competitors and consumers. Once the market becomes effectively competitive no supplier would be able to extract economic rents to the detriment of end customers.

Price controls are imposed on incumbents to serve as a proxy for competition in a market, encouraging new entrants and protecting consumers. As the regulatory environment matures and competition emerges from underneath the regulatory umbrella the concern can move away from control of excessive pricing towards possible exclusionary pricing by means of margin squeezes and below-cost selling. An important focus of regulatory concern in the retail market is then the incentive on the incumbent to engage in anti-competitive tactics that are intended to weaken or damage new entrants. However, as the market develops and becomes more competitive, the presence of regulated prices can ultimately become a constraint to the development of full competition where price controls prevent the ex-incumbent from freely competing and therefore introduce inefficient distortions and should be removed.

In its Sectoral Inquiry[3] in 2007, the European Commission Directorate General for Competition set out its concerns with regulated prices, pointing out that if regulated tariffs are kept low, new entrants are excluded from the market and market players will not invest in new capacity which is detrimental to security of

[2]A dominant position (according to the European Court of Justice) relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers. (United Brands case)

[3] EC Sectoral Enquiry on Competition in Gas and Electricity Markets: SEC(2006)1724

supply. The Commission pointed out that it would be important to assess the impact of regulated tariffs in the liberalised market on the development of competition.

Further to this enquiry, the European Regulators Group for Electricity and Gas (ERGEG) has conducted two reviews of the status of end-user price regulation and stated that fully open markets with well-functioning competition cannot in the long term coexist with regulated end-user energy prices.

In its position paper on end-user price regulation[4] ERGEG advocated that;-

- Member States who continue (after 1 July 2007) to offer regulated end-user prices should urgently progress towards a competitive market. The "transition period" with regulated prices should be a predetermined fixed period and should be as short as possible.

- It is essential that those countries, who during a transition period continue to have regulated end-user tariffs, draw up an individual road map towards a competitive market without end-user price regulation.

ERGEG later noted[5] that a well-functioning market needs well-informed and active customers, and strong independent regulators who monitor retail and wholesale markets. Consumers can force a supplier to deliver a quality service at the best price by the credible threat of moving their business to another supplier.

The CER agrees with ERGEG that the move to competitive markets is a good thing for consumers and will seek to effect the transition from regulated prices as soon as is appropriate to do so. It should also be noted that this is in the context of the CER's statutory mandate to promote competition[6].

## *3.2 Transition to Competition*

In his report on the impact of maintaining price regulation[7] Professor George Yarrow states that the process of transition from regulation to market liberalisation can be summarised in three phases;

[4] End-user energy price regulation An ERGEG Position Paper: E07-CPR-10-03

[5] ERGEG 2008 Status Review of the Liberalisation and Implementation of the Energy Regulatory Framework C08-URB-15-04 2008

[6] Electricity Regulation Act, 1999, Part II, Section 9 (4) (a)

[7] "Report on the impact of maintaining price regulation" Professor George Yarrow, Regulatory Policy Institute, Oxford, UK. January 2008

**1. Pre-Competitive Markets**

In the pre-competitive markets, market entry is just occurring. Incumbents enjoy significant inherited advantages in terms of established brand and customer base.

**2. Established Competition (emerging competitive markets)**

Entrants who have survived or begin to gain (or have gained) established reputations, in particular by winning the trust of large numbers of consumers in the market. Incumbents' market power is significantly reduced, although incumbents would still be judged to be dominant, and possibly strongly dominant.

**3. Effective Competition (competition developed fully)**

Competition is deemed to be effective when rivalry amongst suppliers is intense exerting strong constraining effects on the behaviour of all firms within the market.

Transition through these phases of competition will involve some intermediate steps, with the role of the regulator gradually changing from ex-ante price regulator to ex-post market monitor. Examples of this were demonstrated in the Electricity Roadmap for Deregulation (CER/09/189).

Since liberalisation of the gas market the CER has endeavoured to provide consumers with choice by ensuring that market participants have non-discriminatory access to the transmission and distribution networks, and that the appropriate price controls were in place to constrain the market power of the incumbent supplier. This process has been successful in developing an environment for sustainable competition as is apparent through:

- a reduction in BG Energy market shares;
- increase in levels of customer switching; and
- the number of new entrants that have entered the Irish retail gas markets.

Figure 3.2 illustrates the relative size of the Irish gas market and its sectors (by reference to customer size).

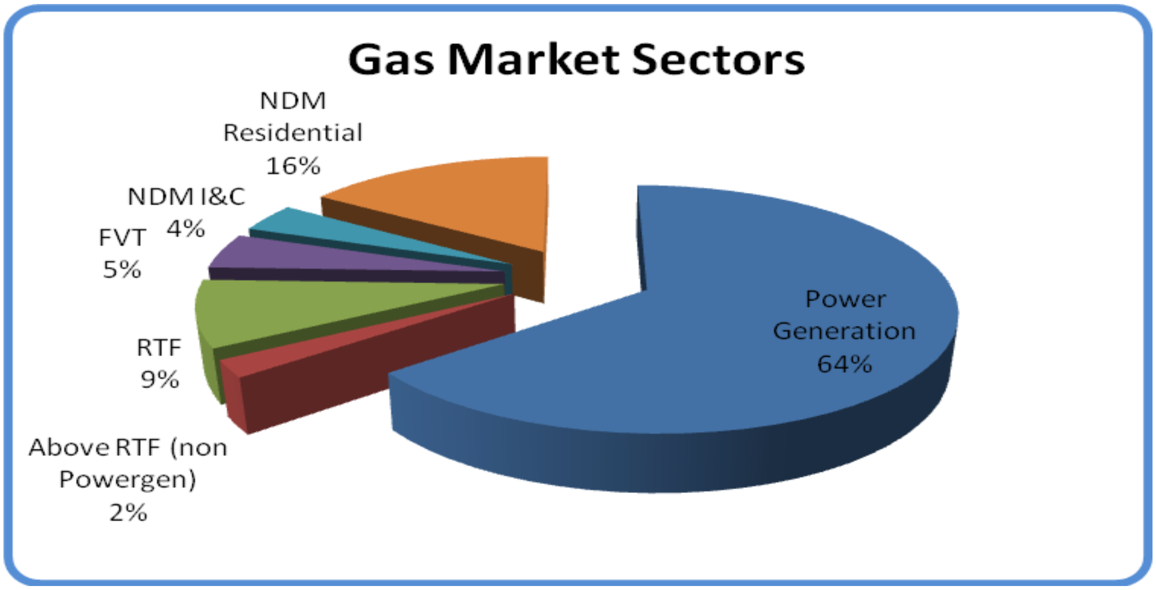



Figure 3.2 Breakout of Gas Market sectors by volume[8] for 2009

Since the gas market was liberalised, BG Energy's market share (for the gas **retail** sector RTF, FVT, NDM I&C and NDM Res as a whole) has steadily eroded, more so over the last year and a half. Table 3.2 below shows the market share by percentage of load per supplier since 2007 and demonstrates a progressive reduction in the incumbent's overall market share. It should be noted that given BG Energy's dominance in the NDM residential sector, this accounts for the majority of their market share[9]. The recent entrance of Airtricity into the NDM residential should see a further sharp decline in BG Energy's retail market share.

| YEAR | 2007 | 2008 | 2009 | Q3 2010 |
|---|---|---|---|---|
| **Airtricity** | - | 0.01% | 0.3% | 1.2% |
| **BG Energy** | 83.8% | 82.01% | 74.79% | 68.1% |
| **Energia** | 8.7% | 10.48% | 14.88% | 16.4% |
| **ESBIE** | - | - | 0.03% | 0.3% |
| **Flogas** | 0.6% | 0.66% | 1.42% | 2.8% |
| **Gazprom** | - | 0.03% | 2.26% | 3.6% |
| **Phoenix** | - | - | 0.01% | 0.1% |
| **Vayu** | 6.9% | 6.64% | 6.31% | 7.6% |

Table 3.2 Total **Regulated Retail** Market Share (GWh) 2007 – Q3 2010 (includes RTF)

[8] Total volume consumption in 2009 was 50,959GWh

[9] All market shares are calculated by volume. Q3 2010 represents cumulative volume for first three quarters of 2010.

Given that all segments of the market are open to competition since 2007 and that there is a significant increase in the level of market activity, particularly so in the last year, the CER considers that it is timely to review how the regulatory framework should evolve in a more competitive environment.

## *3.3 Assessment of Competition*

In order to assess the level of competition in the Irish retail market, it is necessary to first identify the relevant markets, determine the level of competition within those markets by looking at a range of qualitative and quantitative measures. The CER is proposing that for each relevant market it will review the following;

- number of suppliers active in a particular market,
- individual market shares; and
- barriers to entry, expansion and exit.

### 3.3.1 Calculation of Market Share Thresholds

One of the key indicators that regulators consider when reviewing the level of competition in a market is the market shares of the incumbent compared to those of the competing suppliers in the market. In the telecoms sector, regulatory practice regarding decisions on the designation of Significant Market Power will normally find that where the undertaking under review has a market share above 40% it has a dominant position. However the European Commission guidelines[10] for the determination of Significant Market Power also state that "*a dominant position is found by reference to a number of criteria and its assessment is based, as stated above, on a forward-looking market analysis based on existing market conditions*". The guidelines also refer to the case where an undertaking is gradually losing market share, that this may mean that the market is getting more competitive. This implies that the assessment of dominance should not be limited to an ex-post review.

In the United Brands[11] case, the European Court of Justice found that the dominant position relates to a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.

[10] Guidelines on market analysis and the assessment of significant market power under the European Commission Community regulatory framework for electronic communications networks and services: 2002/C 165/03

[11] Judgment of the Court of 14 February 1978. - United Brands Company and United Brands Continental BV v CER of the European Communities. - Chiquita Bananas. - Case 27/76

**Q** Respondents are invited to comment on CER’s proposed overall approach to market analysis and proposal to define a roadmap for deregulation of the retail gas market. Are you in favour of the proposal? Do you think this is the right time? Outline reasons for agreement or disagreement.

# 4.0 Relevant Market Definition

## *4.1 Introduction*

In this section we will be looking at the product market, geographic market and customer categories. The CER considers that the wholesale supply of gas, the transportation of gas and the retail supply of gas to be separate product markets. This review deals with the regulatory controls as applied to the retail market for gas only. To be clear by "retail" we mean buying, moving and selling of gas for consumption by the customer.

In order to determine the level of competition within the Irish retail market, and to identify if a change in the regulatory framework is appropriate, it is necessary to first define the relevant product markets. Market definition procedures are designed to identify in a systematic way the competitive constraints that exist; they do so in a way which also facilitates subsequent market analysis procedures. According to the European competition case law[12] a relevant product market comprises all products or services that are sufficiently interchangeable or substitutable with its products, not only in terms of the objective characteristic of those products, their prices or their intended use, but also in terms of the conditions of competition and/or the structure of supply and demand for the product in question. In essence, this leads to a definition of the market's boundaries. A key question for the review, therefore, is the extent of the boundaries in light of issues of substitution possibilities.

Market definition must also take into account the specific conditions at play in the market. The process involves considering constraints resulting from demand and supply issues (and indeed their interaction) to consider overall substitutability. If demand and supply issues suggest a lack of current or potential substitutability between different types of product, the overall market will be more tightly defined. If substitutability or its potential exists, a broader definition may be appropriate. The competitive position of each relevant market can then be considered.

[12] Commission Notice on the definition of relevant market for the purposes of Community competition law: Official Journal C 372 , 09/12/1997 P. 0005 - 0013

### *4.2 Is there a Single Market for Electricity and Gas?*

The CER notes that from the supply side, there are a number of retailers that operate in both the gas and electricity markets. Given the energy market crossover, the CER recognises that a number of suppliers have 'dual fuel' offerings with gas and electricity product bundles.

From the customer viewpoint the two primary products: gas and electricity may be viewed as linked purchases. While it is clear that gas and electricity can be supplied by the same supplier it is not necessarily the case that gas can be substituted for electricity. In fact, in most instances for a given customer gas cannot be easily substituted for electricity to meet the same basic need e.g. lighting.

The important question is whether or not this lack of substitutability is relevant from the customer's viewpoint. If the customer's view is that both products are considered in tandem, if decisions about potential change of supplier involves changing both products simultaneously then there may be a case for considering that there may be a single market for electricity and gas.

From the supplier viewpoint it may be more than just desirable to have dual fuel customers, it may be vital to the economics of the supply business. It could be the case that a relative loss of competitiveness in one fuel may lose both accounts to a competing supplier. In the case of gas it may be a relevant concern that the gas incumbent is regulated in one market (gas) and faces competing suppliers that are unregulated in both gas and electricity

If the case for a dual fuel market were to be accepted then the relevant residential markets would be circa 620,000 dual fuel customers (with1.240 million accounts) in one market and circa 1.4 million electricity only customers. A difficulty with this concept would lie with the requirement to correlate MRSO and GPRO addresses to ensure that CER could accurately identify which customers are dual fuel customers and who their gas and electricity suppliers are. Absent unique postal identifiers this would very difficult if not impossible, indeed even with such identifiers it may still prove problematic or costly to implement.

While it is worth noting that in CER/10/058 the CER stated it would review Gas and Electricity as separate Markets[13] the CER is calling for respondents views on this matter.

**Q** Respondents are invited to comment on the concept of a "dual fuel" market. Should this market be the one used to decide on deregulation in the domestic gas market? Outline reasons for agreement or disagreement.

### *4.3 Is Northern Ireland and Ireland in the same Relevant Geographic Market for the Supply of Gas?*

A relevant geographical market comprises the area in which the market participants concerned are involved in the supply and demand of products and/or services, in relation to which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different to those areas.[14]

This review is concerned with the potential changes to the regulatory framework that currently applies to the retail market for gas in Ireland.

In theory there are no barriers to prevent a supplier from operating fully in both jurisdictions, and as such defining the retail market on an all-island basis. However, while the retail market systems in Ireland were implemented in 2007 with full market opening, the retail market in Northern Ireland is only beginning to fully open to domestic competition, and as a result there is a disparity between the development of competition in both jurisdictions.

On this basis the CER takes the view that currently the relevant geographic market for the markets considered in this review is the State of Ireland. This definition of the geographic market will be reviewed again once the CAG is fully developed.

[13] Roadmap to Deregulation (Electricity)
[14] Commission Notice on the definition of relevant market for the purposes of Community competition law: [Official Journal C 372 , 09/12/1997 P. 0005 - 0013]

## 4.4 Relevant Retail Markets for Gas by Customer Category

In analysing any market by customer segments there is a need for clear definition. The CER considers the gas retail market to be defined by customer demand/consumption. The CER continues to consider that there are three specific market sectors that remain in the regulated NDM retail gas market, with those being:

| Market Sector | Form of Regulation | Structure of Tariff |
|---|---|---|
| **FVT** | Formula | Commodity, shrinkage, fixed rate, transport capacity & own supply cost charges |
| **NDM I&C** | Revenue | c/kWh + standing charge |
| **NDM Residential**[15] | Revenue | c/kWh + standing charge |

Q. The above are the current defined relevant retail markets. The CER see no reason to move away from these retail markets. Do you agree? If not what do you propose?

[15] Note: We have referenced the standard residential tariff here, alternative tariffs are also available.

# 5.0 Relevant Market Analysis

## *5.1 Introduction*

Having defined the proposed boundaries of the relevant markets for the supply of gas in terms of product definition, the geographic boundary and the individual customer defined markets, it is necessary to analyse the level of competition in each individual NDM market.

## *5.2 Assessing Competition in the Relevant Markets*

When assessing the level of competition within a particular market, it is necessary to review both the empirical evidence of competition, such as the number of suppliers in a market and market share but also the more qualitative indicators of a functioning market including customer switching behaviour and barriers to potential new entrants. The CER is proposing to review a range of quantitative and qualitative measures when assessing whether competition has developed in a particular relevant market, or the market as a whole. The key indicators include:-

- the number of suppliers active in a particular market;
- individual market shares of the incumbent and independent suppliers;
- potential barriers to entry, expansion and exit including;
    - sunk costs
    - switching systems and processes
    - branding
    - non-discriminatory network access
    - access to wholesale product
    - customer switching rates or evidence of inertia

In reviewing the market conditions as evidence of competition, the CER first considered the quantitative metrics including the number of suppliers active in each of the relevant markets and the market share trends in each of the relevant markets for each of the suppliers.

## *5.3 Competitors in the Retail Gas Market*

The CER has overseen the gradual liberalisation of the gas supply market which culminated in full market opening in July 2007 with independent companies now supplying about 30% of the gas consumed (by volume) in the Irish retail market. There are currently four main independent suppliers actively competing in the NDM retail markets. However not all of these suppliers compete in all segments of the market and this may be due to commercial/strategic reasons. The full breakdown of the suppliers and the market segments in which they are active in September 2010 is shown in table 5.1 below.

| Supplier | FVT | NDM I&C | NDM Res |
|---|---|---|---|
| **Airtricity** | ● | ● | ● |
| **BG Energy** | ● | ● | ● |
| **Energia** | ● | ● | |
| **Flogas** | ● | ● | ● |
| **Vayu** | ● | ● | |

Table 5.1 Market segments in which licensed suppliers compete as of September 2010

## *5.4 Market Share*

All of the relevant NDM segments have seen the entrance of a number of independent suppliers over the past number of years. One of the key indicators of activity in the retail market is the level of market share achieved by these new entrants. Due consideration must be given not only to the current market share, but also developing trends and what is likely to happen given the prevailing regulatory environment and the effectiveness of competitors in a particular market.

The following section of the paper reports on the trends in market share for all suppliers and look specifically at the BG Energy market share reduction over time. All of the data used in the calculation of the market shares in this paper are based on information drawn centrally from the retail market system managed by the Gas Point Registration Operator (GPRO). Customer switching is discussed in the next section.

### 5.4.1 FVT

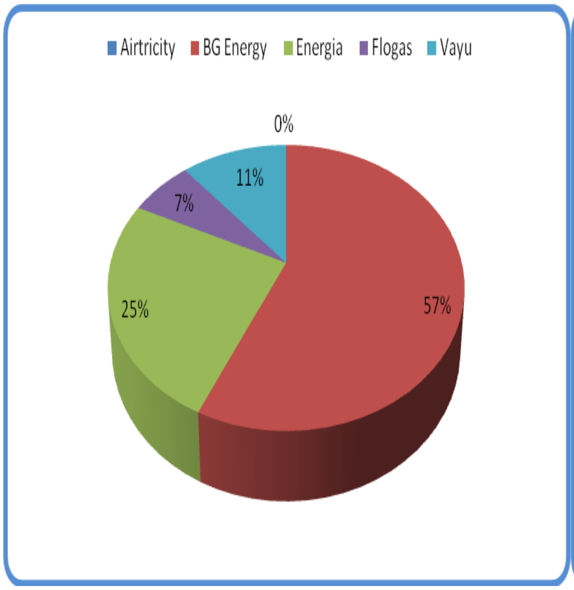
The FVT market was the first open to supply by independent suppliers in October 2007. The FVT market covers approximately 1,700 customers. Table 5.2 shows the market share of all of main suppliers[16] over the period 2007 – Q3 2010.

| Year | 2007 | 2008 | 2009 | Q3 2010 |
|---|---|---|---|---|
| **BG Energy** | 100% | 96.3% | 71.77% | 57% |
| **Energia** | - | 2.5% | 18.46% | 25% |
| **Flogas** | - | 0.1% | 2.47% | 7% |
| **Vayu** | - | 1.2% | 7.31% | 11% |

Table 5.2 FVT Market Share (GWh) 2007-2010

Since the introduction of the FVT tariff into the NDM customer sector, independent suppliers have steadily grown their market share. 2008 marked the beginning of customer movement in this sector, although not huge this could be primarily due to the relative newness of the product, the huge volatility in wholesale prices at that time and customers being unwilling to switch supplier. Since the start of 2009 and more recently in the first half of 2010 BG Energy market share has declined steadily as independents gain a proper foothold in the sector. Figures 5.1 and 5.2 below show the market share for this sector at the end September 2010.

[16] Airtricity entered the FVT sector in Q3 2010 but are not shown as volume is less than 0.01%



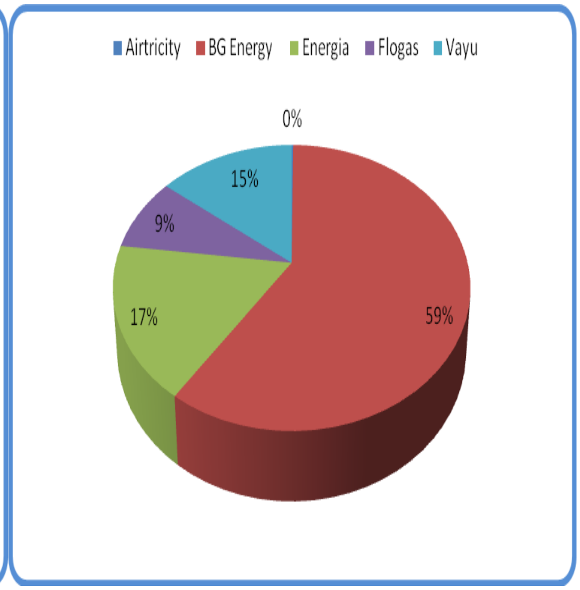




Figure 5.1 FVT Market Share (GWh) at end September 2010

Figure 5.2 FVT Market Share (customer numbers) at end September 2010.

### 5.4.2 NDM I&C

The I&C sector covers approximately 22,000 customers. These customers can be categorised as small and medium business users. Traditionally the bulk of these customers have resided with BG Energy. However, since 2009 a large amount have moved supplier[17], mainly due to the entrance of alternative competition. Table 5.3 below shows the market share over the last three years.

| Year | 2007 | 2008 | 2009 | Q2 2010 |
|---|---|---|---|---|
| **BG Energy** | 100% | 99.6% | 70.91% | 49% |
| **Energia** | - | 0.4% | 24.75% | 40% |
| **Flogas** | - | - | 3.16% | 8% |
| **Vayu** | - | - | 1.19% | 3% |

Table 5.3 I&C Market Share (GWh) 2007- Q3 2010

[17] Airtricity entered the FVT sector in Q3 2010 but are not shown as volume is less than 0.01%

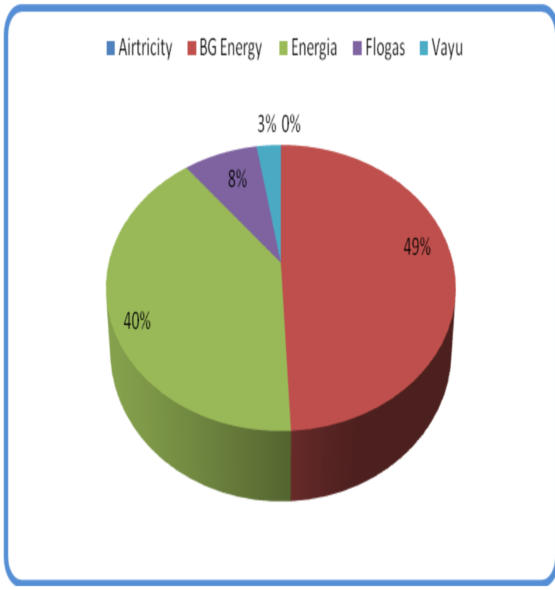



Figure 5.3 I&C Market Share (GWh) at end September 2010.

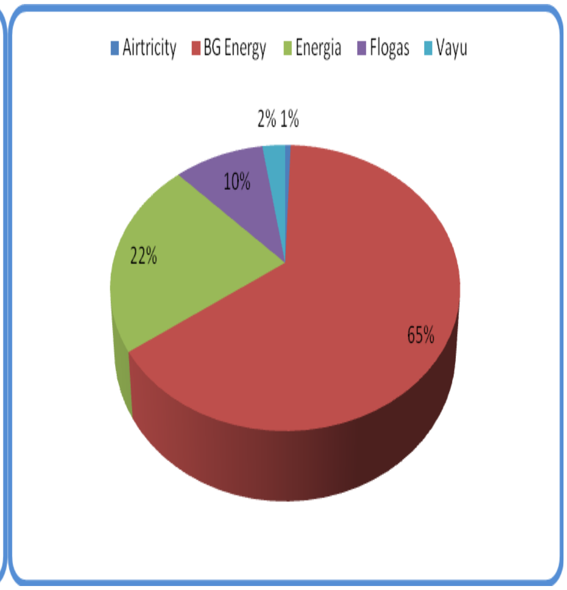



Figure 5.4 I&C Market Share (customer numbers) at end September 2010.

At the end of September 2010 BG Energy continued to lose market share while independent suppliers have steadily increased their customer base.

### 5.4.3 NDM RES

The majority of customers in the NDM sector reside in the residential sector. There are approximately 622,000 residential customers. Table 5.4 shows the market share of all of main suppliers over the period 2007 – Q3 2010. Out of all the sectors in the retail gas market this has been the last to see competition develop. BG Energy and Flogas have been the only suppliers to this sector until the entrance of Airtricity in May this year. Although the market share is residing mainly with BG Energy it must be noted that Airtricity's arrival into the market has seen over 45,000 customer move to them since they entered the market. Their market share (regardless of customer numbers) will be low this year ('09/10) as the majority of gas has already been consumed.

With the entrance of a major new player and with the possible arrival in the near future of another major energy provider, competition in the residential sector is likely to develop rapidly. Overall, however, competition in the residential segment of the market is still very tentative and it would be unwise to extrapolate future switching rates from a few months experience. Table 5.4 below shows the competitors and the respective market share over the past few years.

| Year | 2007 | 2008 | 2009 | Q3 2010 |
|---|---|---|---|---|
| **Airtiricty** | - | - | - | 0.6% |
| **BG Energy** | 98.7% | 98.7% | 98.7% | 97.3% |
| **Flogas** | 1.3% | 1.3% | 1.3% | 2.9% |

Table 5.4 NDM Res Market Share (GWh) 2007- Q3 2010

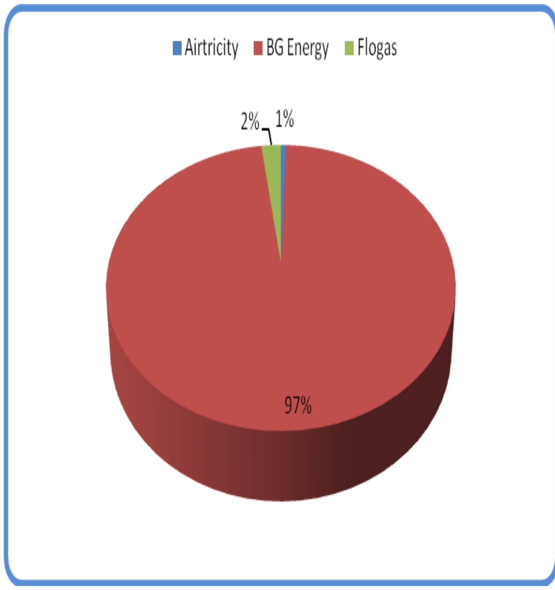



Figure 5.5 NDM Res Market Share (GWh) at end September 2010.

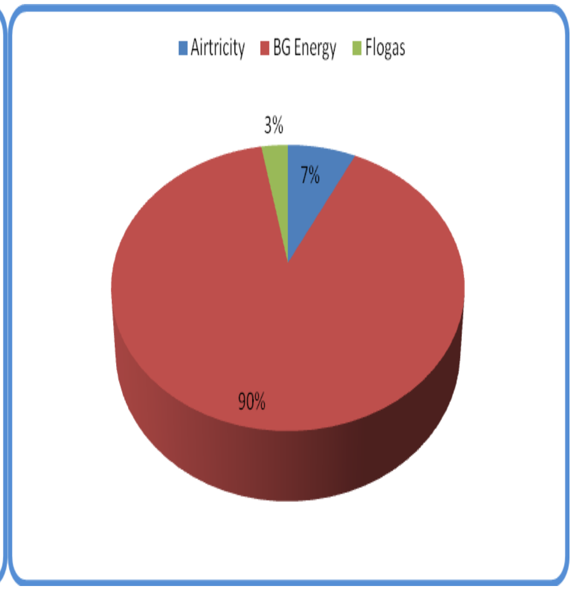



Figure 5.6 NDM Res Market Share (customer numbers) at end September 2010.

### 5.4.5 Market Concentration

The Herfindahl-Hirshman Index (HHI) is a commonly accepted measure of market concentration. It is calculated by squaring the market share for each supplier in the market and then summing the resulting squares. The HHI can range from close to zero to 10,000. A result of 1,800 or greater is sometimes considered to be a highly concentrated marketplace, though this judgement is usually in the context of assessing whether a merger is likely to damage competition.[18]

[18] The Competition Authority: "Notice In Respect Of Guidelines For Merger Analysis": N/02/004

Employing the Herfindahl-Hirshman Index (HHI) to provide an indication of competition in the Residential consumption sector at end of September 2010:

$$HHI = (\text{Airtricity}\%)^2 + (\text{BG Energy}\%)^2 + (\text{Flogas}\%)^2$$

$$= (0.6\%)^2 + (97.3\%)^2 + (2.9\%)^2$$

$$= (0.36) + (9{,}467) + (8.41)$$

$$= 9{,}476$$

While the HHI total of 9,476 shows that the market is highly concentrated, it must be remembered that up until nearly the middle of 2010 there have only been two suppliers in the sector. The entrance of Airtricity and the potential of another major energy company expected in the near future could lead to BG Energy's market share declining significantly within a short space of time. The HHI for the I&C sector is 4,074 and 4,044 in the FVT sector.

The CER would like to add a note of caution with regard to HHI. Although considered an appropriate tool for market concentration it is not the sole determinant of the level of competition in the market. In particular, key issues include how easy it is to switch supplier and whether are not there are significant barriers to entry. Therefore, the HHI cannot be considered in isolation.

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

# 6.0 Other Criteria for Determining a Competitive Market

## *6.1 Introduction*

Market share data, and the developing trends in market share, provide significant measures of the relative strength of competition in a market. The progressive erosion of the incumbent customer base across the different customer segments could indicate that markets are, at the very least, prospectively competitive. Market share data alone does not, however, provide indisputable evidence of dominance, or lack thereof, and so market share should be considered in context. In considering the case for full deregulation the regulatory authority must also take account of the broader market conditions which would enable the development of effective and sustainable competition.

## *6.2 Barriers to Entry, Expansion and Exit*

One of the fundamental aspects of assessing the competitive environment is the ease with which new competitors can enter the market, which is one of the main potential competitive constraints on incumbent firms. The entrance of new competitors to a market, or even the serious threat of new entrants, can have an impact on the strategies and pricing levels adopted by existing market participants and may prevent a dominant incumbent from raising prices above competitive levels. However, if there are barriers to entry, expansion or exit, then the threat from competition will be reduced. The relatively small scale of the gas market with 620,000 domestic customers versus circa 2.1m domestic electricity customers could be a barrier to entry implying lower deregulation percentage thresholds. For a given set of set-up and operating costs the margin available in the market may not be deemed sufficient to cover off the risks.

### 6.2.1 Sunk Costs

The retail gas market does not have high barriers to entry through, for example significant levels of sunk costs. It is different to the electricity retail market in this regard where integration between retail and upstream generation and associated sunk costs are often seen as a commercial advantage or even necessity to market entry. Equal access to a highly liquid NBP means there is no need for huge capital investment to gain entry into the market.

Acknowledging that deregulation triggers have been set for electricity it is important to consider differences between the gas and electricity markets when setting the gas deregulation triggers. Potential suppliers have access to a highly liquid market at NBP with volumes traded 14 to 20 times prior to consumption. Gas can be bought from numerous counterparties on the prompt in day ahead, working days, weekend etc and gas can be bought further out in months, quarters, seasons and years. In the electricity wholesale market the System Marginal Price (SMP) could be considered a very liquid market, however, the contracts or forwards market (where suppliers can hedge their prices) is a very small market, in approximate terms, the volumes traded on these markets amounting to one half of the total traded in the pool and there is currently a limited number of counter parties available. Therefore if a supplier wishes to hedge their supply contract it may be necessary for them to have a long term contract with a generator or indeed to have their own generation facilities. Either of these options would likely involve large sunk costs/ a barrier to entry.

Sunk costs are costs which are required to enter a market, but which cannot be recovered on exit. Therefore a new entrant must consider whether there is potential to cover sunk costs as well as costs of service provision, whereas an incumbent has already covered its sunk costs. Sunk costs inevitably create a market power asymmetry between existing suppliers and potential new entrants. This asymmetry can deter efficient market entry. On receipt of a supply licence, new entrants must sign up to a number of market agreements to enable them to secure network access and interface with the retail market systems. The process does require a certain level of legal and technical knowledge with regards to the processes and procedures involved in the market, but all the approvals and processes are transparent and fully documented.

### 6.2.2 Switching

Customers should be at the centre of any successful development of competitive retail markets. According to ERGEG "*The possibility to switch to a new supplier within a short period of time and without obstacles and disadvantages for the customer is an essential pre-requisite for a functioning and efficient market*."[19] Low barriers to switching would indicate that, even when market share may still be high, market power is reduced. The relative ease with which a customer can switch supplier (i.e. form filling etc) will influence customer switching behaviour.

Currently all gas customers in Ireland can avail of a supplier switching process which is timely, efficient and free of charge.

The switching process itself has been designed in consultation with the gas industry and is approved by the CER. The change of supplier process is overseen by the Gas Point Registration Operator, the GPRO, which is a function of Bord Gáis Networks (BGN). The change of supplier process for NDM customers is communicated between suppliers and the GPRO through a market messaging solution called the Gas Messaging and Processes system; Gas MaP.

Whilst the change of supplier process on the Gas MaP system has been operational since December 2008, the change of supplier process was further developed by the gas market forum to make the process more flexible. The revised process became operational in July 2010.

In both the electricity and gas markets, there is an outstanding issue in relation to the change of supplier processes and the administration of the Free Energy Allowance (FEA) by the Department of Social Protection. While in both markets, there are arrangements established so that a customer can move to an independent supplier and still receive their FEA benefit, it remains the case that there can be differences in the administration of the allowance between the incumbent and independent suppliers. The gas and electricity industries are currently working with the Department of Social Protection to develop an enduring solution for its administration in the competitive market.

[19] ERGEG Position Paper "Supplier Switching Process Best Practice Proposition" E05-CFG-03-05. P3 Section 5.

### 6.2.2.1 Total Customer Switching

Customers switching from one supplier to another are a useful measure of how open and competitive a market is. The more intense the competition is the higher the level of switching may be. Although, there can be exceptions to this, particularly where there are relatively few large customers and their current supplier offers significant discounts to ensure they remain with them. The VaasaETT[20] Utility Customer Switching Project reviewed switching rates in liberalised markets. VaasaETT[21] has defined switching supplier as:

*“a switch is essentially seen as the free (by choice) movement of a customer (defined in terms of an overall relationship or the supply points and quantity of electricity or gas associated with the relationship) from one supplier to another. Switching activity is defined as the number of switches in a given period of time”.*

Taking account of the rapid growth in the number of competitive markets, and increasing variance between market switching activity and maturity, VaasaETT has defined the levels of activity in five categories; Dormant (<1%), Cool Active (1-3.5%), Active (3.5 – 9.5%), Warm Active (9.5% - 15%) and Hot (>15%) markets.

Levels of activity are defined as follows:

**Hot Markets**: Annual switching approximately 15% or higher. Typically, switching activity is so intensive that competitive positioning becomes one of the utility’s most strategic issues. Switching momentum is usually high, constant, needs little encouragement and easily flares up.

**Warm Active Markets**: Annual switching is between 9.5% and 15%. Typically, switching activity is sufficient that utilities risk losing significant numbers of customers if they do not actively compete, or if they make loyalty-related errors. Switching momentum is significant but mainly related to occasional stimulants in the market, such as price rises or profit announcements.

**Active Markets**: Annual switching is between 3.5% and 9.5%. Typically, switching activity leads to competitors becoming more customer-focused, but switching does not

[20] VaasaETT is a Global Energy Think Tank which develops and envisions best practice for global utilities industry.

[21] The Utility Customer Switching Research Project: www.vaasaett.com/projects/switching-project/

pose a major threat to utilities' pricing or profitability. Entry into this level of activity often acts as a wake-up call for utilities. Customer awareness can also gain momentum.

**Cool Active Markets**: Annual switching is between 1% and 3.5%. Typically, switching is noticeable and measurable, but insufficient to affect any substantial change in the attitudes or behaviour of utilities. Competition is barely visible and customer awareness poor.

**Dormant Markets**: Annual switching less than 1%. Typically, switching and competition exist only in theory. The markets may be officially open to competition, and customers are able to choose their supplier, but in practice only larger consumers are motivated or able to do so.

| Sector | FVT | NDM I&C | NDM RES |
|---|---|---|---|
| **2008** | 117 | 166 | 65 |
| **2009** | 354 | 5,752 | 2,361 |
| **2010 Q1 - Q3** | 178 | 2,461 | 54,099 |

Table 6.2.1 Retail switching by sector 2008 – Q3 2010

Looking at the switching figures in the table above we can clearly see that in 2008 there were relatively low levels of switching in the Irish retail gas market with total switching of less than 1%[22]. The market in this case would have been considered dormant according to the VaasaETT scale.

2009 saw a step up in switching activity with most moves in the I&C segment of the retail market. Customer switching also increased in the residential sector but not on the same scale as seen in the first nine months of 2010. This relates primarily to the entry of Airtricity into the residential gas market in mid May 2010. The residential sector is the largest sector of the retail gas market, containing 96% of all customers in the Irish retail gas market. 8.8% of customers switched supplier in the retail market in the first nine months of 2010, according to the VassaETT scale the market in this case could be considered Active which is an improvement.

While switching in the retail gas market is improving, it would be premature to call the market competitive. If current trends in switching away from BG Energy

[22] Total retail customers in 2008 was 628,458

persist, BG Energy's market share in the retail sector will diminish significantly (see latest Market Update CER/10/204).

### 6.2.3 Non Discriminatory Network Access

Access to the networks used to transport gas is based on transparent and regulated terms and prices. There is no discrimination amongst shippers by the network operator.

### 6.2.4 Branding

Branding can be a complex issue in the context of market deregulation and maximising customer welfare.

Looking at the issue firstly from a purely legal perspective, the EU Third Package Directive 2009/73/EC provides as follows

*" …vertically integrated distribution system operators shall not, in their communications and branding, create confusion in respect of the separate identity of the supply branch of the vertically integrated undertaking."*

It is clear from this that the onus rests with the DSO to avoid confusion among customers between the system operation business and the supply business of the same parent company by means of deployment of the brand.

In any case, the CER's concern on this issue is to ascertain the extent, if any, to which BG Energy could, if it were to deploy the BG brand after deregulation, enjoy a further advantage over competitors by virtue of the historic association of the BG brand with the monopoly network business, if so this would, prima facie therefore, constitute a further market barrier to new entrants. To the extent that such is deemed to exist, it could affect the market share thresholds deemed to be necessary to trigger tariff deregulation. This was the CER's thinking in the Roadmap to Electricity Deregulation and it was supported by market research carried out on behalf of the CER.

ESB was offered the choice of rebranding its retail business if it wished to deregulate at a threshold of 60% and this, in turn, allowed for this higher market share threshold to be adopted as one of the triggers for deregulation.

It might, of course, be argued that the barrier to entry consideration does not, or will not, apply to the same extent in the gas sector because, arguably :

- the BGE brand is not as strong in gas as the ESB brand
- the public association of the ESB brand with network activities is greater than that of the BGE brand with its network activities
- customer confusion between networks and retail activities could have reduced as a consequence of the assumed successful launch of the new ESB brand.

**Q.** Respondents are invited to comment on the assessment of the barriers to entry, exit and expansion within the retail NDM gas market including the branding issue.
Comparing gas to electricity, is the higher level of liquidity in the gas market sufficient reason to have a higher deregulation percentage threshold than in electricity?
To what extent does the smaller scale of the market in gas suggest thresholds should be lower percentage thresholds in gas than in electricity?
Is branding as big an issue as it was in electricity? Should there be a different threshold for deregulation depending upon whether BG Energy changes its brand or not, and if so, what difference should it be?
Outline any suggestions to improve the situation for existing suppliers and new entrants.

# 7.0 Triggers for Deregulation

## *7.1 Introduction*

The CER has set out proposals to review the development of competition in three relevant retail markets; FVT, NDM I&C, and NDM residential markets. A review of the market share data and trends for each of these markets in sections 5&6 revealed that the incumbent market share is declining in FVT and I&C markets since 2008 and is subject to increased residential customer losses since mid 2010. The CER also considered the barriers to entry in the respective markets and proposed that the appropriate market structures are in place, with sufficiently low barriers to entry, expansion and exit, to support continued customer switching in a fully functioning deregulated retail market.

The next question is what are the appropriate trigger points at which price regulation can be removed?

This section sets out proposals for the quantitative criteria that would need to be met in a particular market segment before it could be deemed to be competitive, and therefore appropriate to remove price controls. It proposes thresholds for the number of players in a market, thresholds for market share and a timetable for a market status review when market share would be measured.

## *7.2 Criteria for a Competitive Market*

The CER is proposing (similarly to those in CER/09/189[23]) that in coming to a view that a particular market is competitive, it must meet a number of specific requirements, including the following;-

- Number of suppliers in the market
- Independent supplier market share
- Incumbent supplier market share
- Switching rates

The CER considers that not one, *but all*, of the requirements set out below should be met before price controls can be removed.

[23] CER/09/189 Electricity Proposals on a Roadmap for Deregulation

*No. of Suppliers in the Market*

There should be a minimum number of suppliers active in each of the relevant markets where BG Energy supplies customers. The CER is proposing that there should be a minimum of three suppliers active in the market prior to the removal of price controls to provide a minimum of range of offers to consumers.

*Independent Supplier Market Share*

Alternative suppliers should have achieved a minimum scale of operation and must be reasonably well established within the market and in a position to compete before price controls are removed. Otherwise the incentive on the incumbent to engage in anti-competitive behaviour could see such tactics as margin squeeze or predatory pricing to weaken or damage new entrants. Therefore the CER is proposing that there is a minimum of 2 independent suppliers in a particular relevant market, each with at least 10% share of consumption (GWh). The CER is seeking views on the proposed level of market share that the leading competitors should be expected to achieve before controls are removed.

*Incumbent Market Share*

Section 3.3 discussed setting the appropriate thresholds for the removal of price controls in a particular market, and 40% is referenced as the benchmark figure for the presumption of dominance. The CER is proposing the following threshold ranges for the level of market share that BG Energy serves (or will serve within a defined period). These thresholds are set against the background of the Electricity Roadmap decision published in April this year CER/10/058, where the threshold for the business markets and residential market were set at 50% and 60% respectively. Table 7.1 sets out the proposed thresholds for the relevant markets in the Irish retail market as 45-55% for FVT customers, 45-55% for NDM I&C customers and 55-60% for residential.

| Market | Proposed Thresholds for % Market share |
|---|---|
| **FVT** | 45 – 55% |
| **NDM I&C** | 45 – 55% |
| **NDM Residential** | 55 – 60% |

Figure 7.1 Proposed Thresholds for Calculation of % Market Share (GWh)

As noted earlier in the paper, the traditional threshold for dominance is approximately 40% of market share, but firms with more than this level may be considered non-dominant if barriers to effective competition are low.

The residential market appears to exhibit different characteristics to the FVT and NDM I&C markets. It may be that residential customers switch supplier more slowly than business customers generating a degree of inertia in the residential market. The "stickiness" of certain classes of residential customers means that switching in the market is less prevalent than in business markets, and that a higher market share threshold should be used in residential compared to the business markets. Evidence from other jurisdictions that have seen retail deregulation would suggest that certain classes of customers are very unlikely to switch at all. Thus an argument can be made that a portion of the residential market is in practice un-contestable, and has not, or is not likely to switch. At this stage, the CER's preliminary view is that a higher threshold for residential markets could be appropriate. We are particularly interested in submissions that can adduce any evidence in this area and whether the issue of branding is a contributory factor. Note that if branding is considered to be a significant factor in the assessment of competition in the market, it is likely that the thresholds suggested may be lower, all other factors being equal.

These proposals represent the CER's initial views on the appropriate thresholds. It should be noted that they are only indicative at this stage and may change as a result of consultation and any further market evidence. The CER is seeking the views of stakeholders on why, or why not, these thresholds should apply.

*Switching Rates*

The CER is proposing that there should be a minimum 10% switching rate in the residential sector prior to the removal of price controls. The CER is not proposing a switching rate as a requirement for removal of price controls for the I&C or FVT customers as the near majority of these customers have switched already, a churn[24] rate may be more appropriate but the CER is not proposing this as a requirement for removal of price controls.

## *7.3 Practical aspects of Deregulation*

The retail tariff year is from 1st October – 30th September. It is essential that the timing of any review and potential changes to the regulatory framework must be known by all market participants in advance. By completing the assessment in advance this will enable suppliers to plan hedging and risk management strategies for the forthcoming tariff year, assuming price controls will continue in 2011/12. If that decision has not been reached in advance, then the implementation of any change may have to wait until the subsequent tariff period.

Given that there are currently twice yearly tariff reviews for all relevant markets the CER is proposing to conclude a market status review twice a year in January and July to assess market shares and review market conditions at that time. Each review will assess;

- each supplier's actual market share, as calculated from latest available GPRO data
- switching rates in the residential sectors

There a number of options for how the CER could implement any subsequent changes, based on the outcome of the status review, and these are set out below.

> **Option 1 Historical Assessment**
> Where the threshold for a relevant market, is found to have been met and maintained for a period of time (duration to be defined), the CER would remove the appropriate price controls effective from the start of the next tariff period.
>
> **Option 2 – Prospective Assessment**
> Where the threshold for a relevant market is likely to be met and maintained within 6 months from the date of the review, the CER will remove the appropriate price controls effective from the start of the next tariff period.

---

[24] If customers churn between different companies that provide a particular service, they change repeatedly from one to another.

For each of the options there is an assumption that annual regulated tariffs are still in place.

As part of the Electricity Roadmap to Deregulation[25] (21st April) the CER decided that all business sectors in electricity had met the criteria for deregulation and would be deregulated from the beginning of the next tariff year (1st October 2010). Similarly in residential CER decided to implement an Maximum Allowable Revenue (MAR) form of regulation from the 1st October 2010.

In the process of deregulation in gas a similar approach could be followed whereby any sectors not deregulated on the 1st October 2011 could move to price cap regulation (as discussed below). This would take account of any potential K factor issues and could allow for more timely deregulation.

The market reviews would not cease with deregulation but would be required as an ongoing measure. Should the reviews identify that the thresholds have been breached and that breach is material and sustained the CER may have to take appropriate remedial action to ensure that competition is not undermined and consumers are protected. This could potentially see the re-introduction of price controls albeit in an ex-post capacity. This is not an ideal situation it has to be acknowledged but it is hard to see how it can be avoided. Again the CER is seeking the views of stakeholders on the merits of these approaches and the preferred options.

**Price Cap Regulation as an interim measure?**

Over the last period several suppliers have suggested as part of the roadmap to deregulation that rather than deregulation moving from the current regime to complete deregulation, the current regime could be easily modified to introduce a form of price cap regulation. The existing RCF format could be used but rather than setting the allowed revenues it would set a price cap. A key change in this regime would be that there would no longer be any ex post-K factor. A forward looking price would be set using the benchmark, the T&D costs, cost to serve, Capex and Margin (to be determined). This price would be a cap above which BG Energy would not be allowed to charge, but below which they would be allowed to charge. It is important to note that as there would be no K factor to allow for over/under recoveries there may be a need to examine the allowable margin. The price could be reset either quarterly or twice yearly. This form of

[25] CER/10/059 Electricity Retail Market Competition Review Q1 2010

regulation could commence in advance of deregulation. This price cap would allow the incumbent to compete on the road to deregulation while protecting customers from abuse of a dominant position.

A key concern with this form of deregulation is the risk of below cost selling, for example, could electricity sold by BG Energy as a dual fuel supplier be used to allow below cost selling in gas? This concern is somewhat tempered by the likelihood that electricity will be deregulated by the time this regime would come into place and it may be unlikely that any such cross subsidisation could occur.

**Q.** Do you agree that switching rates should only be considered as a threshold for deregulation in the residential sector?
Respondents are invited to comment on the proposal of a price cap as an interim measure.
CER seeks views regarding the timing and practical aspects of deregulation.

# 8.0 Proposed Changes to the Regulatory Framework – Removal of Price Controls

## *8.1 Introduction*

As market structures evolve and competition is established to the level where independent suppliers are actively competing for customers and challenging incumbent market power, so too should the approach to regulation. The following sections set out the proposed changes to the regulatory framework with respect to the removal price controls to be adopted in the FVT, I&C and residential markets once those thresholds have been met.

## *8.2 Removal of Price Controls for all NDM Customers*

The existence of price regulation can act as a constraint to the development of full competition and can work against the customer's long term welfare. The primary objective of this review is to set out a clear plan for how defined markets can be deregulated, if and when it is deemed appropriate to do so. However, the obligations on the incumbent supplier, with respect to price controls cannot be removed without careful consideration and examination.

An important issue is what happens if any thresholds ultimately chosen result in some markets being de-regulated at one stage while others are not. For example, suppose after a review, the I&C customer segment meet the thresholds but the sector above i.e. the FVT does not. Views on this possible issue would be welcome.

## *8.3 Regulatory Monitoring*

The CER is proposing that should deregulation of tariffs be introduced, the following monitoring provisions will apply;

i. The CER would regularly review the operation of these arrangements.
ii. The CER would carry out bi-annual reviews of market share of every supplier in each market (calculated on a consumption basis) in January and July. These reviews will be based on actual market information from GPRO.

The CER accepts that there are risks in removing regulatory controls. If, after the removal of any price controls, there is either a sustained increase in general retail prices which cannot be justified by changes in underlying costs or a marked reversion in market share patterns and corresponding decrease in the level of competition as the former incumbent reverts to a dominant position, then the outcome for consumers may be negative. There are possible measures to prevent this.

Firstly, it is possible that if competition suffers and/or prices rise unreasonably then some form of regulation could be re-imposed by the CER. This could include a transitional response such as a price cap. However, such a measure would be cumbersome and might represent a reversal of any benefits realised by removing price controls. Secondly, in a market no longer marked by ex-ante price regulation, there is still the remedy of ex post competition law to remedy any problems. It has been often noted that the application of ex post competition law takes more time than regulation. The CER is interested in the views of stakeholders, should deregulation proceed at the suggested threshold levels, as to how ex post competition law might be utilized to prevent or address any problems in the retail gas market.

**Q.** Respondents are invited to comment on how the price controls should be removed in the context of only a portion of the relevant markets reaching the threshold for the removal of the price control. Is there another course of action that you would be in favour of? Outline reasons for agreement or disagreement.

# 9.0 Consumer Protection

## *9.1 Introduction*

The proposals in this paper and the issues that have been raised for consultation with respect to the removal of price controls are intended to bring benefits to consumers through a more competitive market. Regulated tariffs are intended to provide a proxy for competition in the retail market, setting a benchmark for 'cost reflective' prices. The CER is seeking the views of stakeholders on what additional measures should be introduced to ensure that consumers continue to be protected and equipped to make informed choices in a competitive market.

## *9.2 EU Third Package Requirements*

One of the main provisions of the 3rd Package looks at retail market measures. In terms of the retail market the key themes are; (i) consumer protection measures and (ii) the operation of the retail market. The key points of the Directive with respect to the retail market are set out below.

*(i) Consumer protection measures*

- *Complaint handling measures;*
- *Single contact points (possibly sub-national);*
- *Ombudsmen;*
- *Protection of consumers;*
- *Member State definition of vulnerable consumers that may refer to energy poverty;*
- *Prohibition on disconnection at critical times;*
- *Interaction with other social policy measures.*

*(ii) Operation of the retail market*

- *New provisions for the operation of the retail market;*
- *Published rules on the roles and responsibilities of all market players;*
- *Information for consumers: European Energy Consumer Checklist;*
- *New deadlines on switching, 3 weeks, and receipt of final bill, 6 weeks;*

- *Consumer access to consumption data in sufficient time periods;*
- *Implementation of Smart Metering*
- *Promotion of Smart Grids.*

This renewed focus on retail issues and consumer protection provides the framework within which to address consumer issues and also issues which may arise as a result of the removal of price controls.

## *9.3 Special Protections on Tariffs*

While the achievement of competition milestones in the bi-annual reviews may indicate that the market has reached the appropriate stage of development to relinquish regulatory controls, the CER has concerns that an immediate and unqualified cessation of regulation could cause market difficulties, and in particular leave vulnerable customers exposed to onerous pricing arrangements in an open competitive market. ERGEG has stated that protecting "vulnerable customers" remains necessary in competitive markets but that the tools used for the protection of vulnerable customers must work in line with and support the pre-requisites of open, competitive markets. It is necessary to set out what conditions should apply to ensure that competition is sustainable but also that consumers are protected. The CER notes that there may be other, narrowly defined, groups of customers that may also merit these special protections.

The CER notes the experience of retail market deregulation in Great Britain. In 2007 there was full market deregulation in the gas sector which eventually led to the development of a retail market with six large suppliers and a number of smaller, "niche" players. Ofgem has conducted a number of reviews and surveys of the retail market and has raised the possibility that some customers may not be fully benefiting from competition. In particular, Ofgem has suggested that vulnerable customers are not likely to switch from their established supplier, even if significantly cheaper prices are being offered by other suppliers. Such customers may need special protection, whether through being provided with easily understandable and accessible information or even through specific requirements on suppliers as to the prices they charge such customers.

Any additional requirements in respect of vulnerable customers (or other residential groups) should apply to all suppliers, and not just BG Energy. Therefore the CER is proposing that for vulnerable and or other groups of residential customer, as defined by the CER, BG Energy and ***any other supplier*** may be required (through licence) to offer tariffs on principles acceptable to the CER. The CER is not, in this paper, attempting to analyse this issue in detail or suggest specific proposals. It does wish, however, to raise the issue for comment and consider any responses on it. Any specific proposals in this area will be consulted on and developed in the future.

# 10.0 Conclusions and Next Steps

## *10.1 Summary*

The CER has set out its Roadmap which identifies the milestones to a deregulated market. This paper contains a number of proposals for consultation. The CER is keen to receive the views of stakeholders with respect to these proposals, the specific questions raised and other issues relevant to the deregulation of the market.

## *10.2 Next Steps*

The CER is requesting responses to this Roadmap consultation no later than close of business, 28$^{th}$ January 2011 and intends to publish its Decision paper in Q2 2011.