

Mr. James Curtin,
Commission for Energy Regulation,
The Exchange,
Belgard Square North,
Tallaght,
Dublin 24.

10 February 2012.

via e-mail only

Dear James,

Re: Market Monitoring in the Electricity & Gas Retail Markets

Vayu welcomes the opportunity to comment on the Commission for Energy Regulation's ("CER") consultation paper "Market Monitoring in the Electricity & Gas Retail Markets" – CER/11/221, which considers proposals the CER would like to implement that, it believes, would promote effective competition and ensure Customer protection in retail energy markets. These two functions are specifically referred to in the EU's 3rd Energy Package. Aspects of this legislative package have been transposed into Irish law, through the enactment of S.I. 450 of 2010 and S.I.'s 463 and 630 of 2011.

Summary

At the outset we would like to point out that these proposals represent a significant step change in the level of oversight of the market. In our opinion not enough time has been spent at industry level discussing the various proposals; particularly those that have the potential to create most reaction e.g. supplier retail margins to the level of Earnings before Interest and Taxation ("EBIT"); Customer arrears and diversity of tariffs and contracts.

In some instances the proposals will not result in the desired objectives being achieved; in others they appear to exceed the powers granted to CER under applicable law and require more detailed justification in the context of the information now sought from suppliers. For example the thrust of the 3rd package is aimed at household Customers

and this is reflected in the ERGEG Guidelines of Good Practice paper. We believe there is merit in examining a two- tiered approach to monitoring the market.

The paper outlines other indicators as part of the market monitoring framework such as barriers to entry, product innovation and wholesale market liquidity. These are fundamental to market structures and should be included in the framework from the outset. In prior reviews of retail competition the CER analysed these aspects of the market in great detail.

At the recent industry workshop meeting on 27 January 2012, it was clear that a majority of participants do not agree with the proposals covering retail margins, Customer arrears and tariffs / contracts diversity as they are currently outlined.

Scope of Activities

In the 3rd Energy Package of legislation Article 37 of Directive 2009/72/EC and Article 41 of Directive 2009/73/EC outline the primary monitoring provisions within the duties and powers of the regulatory authorities:

- (j) *monitoring the level and effectiveness of market opening and competition at wholesale and retail levels, including on electricity exchanges, prices for household customers including prepayment systems, switching rates, disconnection rates, charges for and the execution of maintenance services, and complaints by household customers, as well as any distortion or restriction of competition, including providing any relevant information, and bringing any relevant cases to the relevant competition authorities*

The specific parameters noted in this paragraph should form the central platform of the CER's market monitoring function; however further analysis will need to be carried out in respect of the costs to deliver the required information for each. Typically this will include changes to IT systems and processes, as well as the costs of hiring additional analytical resources. The ERGEG guidelines detail specific indicators to deliver on these requirements and we believe the CER should not go further than these in assessing the level of competitiveness in the market.

It should also be noted that para. (j) above is directed towards the household Customer. Again the ERGEG guidelines follow this very closely, but clarify that if the local regulatory authority decided to expand this remit it should only extend to the small and medium business sector. This lends further weight to our earlier suggestion that a two-tiered approach should be applied to market monitoring. This would also be aligned with the proposed decision of the CER to split the supplier handbooks and codes of practice between household and non-household end-users.

The level of granularity proposed in the paper is far greater than is warranted to assess the depth and degree of competition in the market. We doubt very much if any supplier

would be in a position to give the CER the detailed information it expects; it is disproportionate in the context of the size and structure of the Irish retail market.

The major elements of a retailer supplier's Selling, General and Administration ("SG&A") costs comprise headcount, IT costs, communication and facilities expenses. Splitting these costs below the gross margin line is a significant issue because suppliers will have different views of how these SG&A costs should be allocated to business segments. The CER should appreciate that this exercise, if applied, will require suppliers to analyse individual expenses within line items of expenditure.

A cost benefit analysis of this obligation must be carried out before proceeding. It is inevitable that the added costs of carrying out this analysis for very little benefit will result in higher costs to end-users.

Also, at a gross margin level, suppliers / shippers in gas and electricity will have a range of input costs; some of which can be directly attributable to Customer segments, but in other cases suppliers will adopt different allocation bases for the cost of portfolio products and this will drive very different results from supplier to supplier. This allocation mechanism should remain a supplier decision. The CER is not best positioned to adopt a direct control approach to analysing business performance.

We would question the capacity of the CER's own limited resources to take on the huge increase in workload to analysing this proposed substantial increase in data from industry. Given the depth of feeling and opposition from industry evident at the initial workshop, but also that the CER's proposals will look for supplier retail market information under Option 1 (DG Groups and RTF, MBU, SBU & domestic gas group) and Option 2 (Eurostat configuration), it is clear that further workshops are required to ensure common understanding of agreed requirements.

The CER has been afforded significant new powers by recent amendments to existing legislation. S.I. 630 of 2011 amends Section 9(1) of 1999 Electricity Regulation Act which deals with expanding the functions of the CER thus:

- (m) to carry out investigations into the functioning of the electricity and gas markets, and*
- (n) to decide upon and impose effective and proportionate measures to promote effective competition.*

This gives wide ranging powers to the CER to carry out all and any investigations so required if it believes that the energy market is not operating as it should be. We believe this authority should be used by the CER to obtain information on an as needs basis to assess if the market is working; rather than the control approach being proposed. It should be borne in mind that in GB, ofgem carried out a recent probe into the retail market and noted nothing untoward occurring, but it took industry stakeholders a significant period of time and resources to carry out this exercise.

Implementation Costs

In the current consultation timeframe it has not been possible to estimate with any degree of accuracy the marginal implementation costs. We have already mentioned that the costs to suppliers in terms of IT system changes, processes and resources will not be insignificant which would likely, if implemented, end up costing Customers more for their delivered energy. These costs simply could not be absorbed.

Commercial Sensitivities and Confidentiality

There is little doubt that the information being sought by the CER is clearly commercial and extremely sensitive. We are concerned that the recent changes to Conditions in the electricity and gas licences overstep the authority granted to the CER via EU and domestic legislation. Section 40, sub-section (2), para. (n) of S.I. 630 of 2011 transposes Article 41, para. 16 of Directive 2009/73/EC and Article 37, para. 16 of Directive 2009/72/EC into domestic legislation. It clearly states that the CER will preserve the “confidentiality of commercially sensitive information” in respect of any decisions made.

Also, Article 30, para. 2 of 2009/73/EC and Article 30, para. 2 of 2009/72/EC notes that Member States, including regulatory authorities, “may provide for the disclosure of such information where this is necessary in order for the competent authorities to carry out their functions”.

At no point does this legislation point to the CER being given absolute discretion and determining rights as to what constitutes commercially sensitive. In our view the wording in the licences should be reworded to reflect the actual rights, duties and powers given to the CER.

Forcing suppliers to divulge critical information such as EBIT and Customer arrears information by business line may contravene certain confidentiality agreements with respective lenders, shareholders and other vested interest stakeholders. This needs careful consideration in the context of what information is being requested and the benefits derived therefrom. The consultation paper proposals exceed the disclosure guidelines in the ERGEG report.

Albeit certain safeguards are legislated for through the 1999 Act, suppliers have genuine concerns over the access to data to be given to the CER as part of this process, as well as unauthorised disclosure of such data. In the past we have made the CER aware that we disagree with the ability of CER staff being able to move directly into the retail business of a supplier in Ireland. This remains a risk and one that will need to be addressed in this process to the satisfaction of suppliers.

Timing

The paper covers a very broad range of measurable indicators and we believe it is not possible to deal with such a wide remit within the proposed timelines. In order for the process to be followed in an orderly way the following should be considered:

- a) An extension to proposed timelines of at least 4 months
- b) The extension should allow for examination of significant work streams to be grouped and allows for a greater level of examination of each issue at the required granularity.
- c) Suggestions in respect of grouping is that each item falling within the existing consultation be categorised under the following headings:-
 - i. Market Intelligence
 - ii. Business Operations
 - iii. Sales / Marketing &
 - iv. Retail Margin (EBIT) & Arrears to be given group status. This is necessary in order to provide reasoned opinion for eliminating them entirely.
- d) Each group to be accompanied by its own workshop to discuss issues in sufficient detail.
- e) Subject to outcomes/clarifications from workshops each supplier to be given adequate time to estimate, plan for and execute any agreed changes to be delivered.
- f) A phased approach to implementation will be necessary. Some of the changes required may be easily achieved and can be delivered quickly, whilst others will require more detailed assessment and possibly more extensive time for delivery over the medium to longer term. Suppliers are already dealing with substantive matters like Harmonisation, Intra-day Trading, East-West Interconnector etc. All internal business deliverables necessary for ongoing operations must continue in a stable manner during a monitoring implementation programme.

Customer Complaints and Enquiries

The proposed wide definition of customer complaint follows the ERGEG practice (i.e. expression of a customer's dissatisfaction) and if adopted, would prove meaningless in establishing the level of actual complaints within the industry.

The sub categories of Customer complaints and enquiries, if applied across the proposed customer categories included in Annex 2 in the paper, will require material changes to current processes and systems and, at the detailed levels proposed, are not likely to deliver valuable results.

Summary

In conclusion, there are certain merits to be gained from analysing the market with a view to developing, improving and promoting competition in the retail energy market. However, there are certain areas that the CER must seriously consider in what it is trying to achieve. In our view:

- a) A two-tiered approach should be adopted which splits households and non-households. This is the thrust of the Directives and the ERGEG good guidance principles.
- b) We do not believe the retail supply margins should be analysed under the proposed structure to EBIT level and at a minimum should cease at gross margin level. Even then as we noted previously there will be differences of interpretation from supplier to supplier as costs of a portfolio nature are analysed.
- c) The CER should produce a cost benefit analysis of the proposals, into which suppliers can beneficially provide input. The CER must agree a programme to engage with suppliers for an industry wide or bi-lateral discussion on the individual issues arising.
- d) At the heart of this is that Customers should not have to bear the ongoing cost of i) developing, ii) implementing and iii) maintaining these disclosure requirements.
- e) The timeframe envisaged to implement these proposals at supplier level is unrealistic. The CER is well aware of the length of time it takes industry to make changes to the gas and electricity market message systems, to test these changes and to roll these changes out to market. It demonstrates a limited appreciation of the scale of their proposals.

We would be grateful if the CER considers these views and we are happy to discuss these further.

Yours sincerely,
Bryan Hennessy