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## Competition Authority Submission

Submission to the Green Paper on Energy Policy in Ireland

July 2014

S/14/05



**The Competition Authority**  
An tÚdarás Iomaíochta

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## **1. INTRODUCTORY COMMENTS**

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- 1.1 The Competition Authority welcomes the opportunity to make a submission to the Green Paper on Energy Policy in Ireland (Energy Green Paper). The price paid for energy is a determining factor in the competitiveness of the entire economy. The landscape of the energy market has also changed considerably since the publication of the last Green Paper in 2007.
- 1.2 Energy policymakers face an entirely new set of challenges from those faced in 2007. At the global level, geopolitical uncertainty in the energy rich regions of the world, the rise of new sources of fuel such as shale gas, and the realisation of the challenges presented by climate change have triggered a fundamental rethinking of energy policy.
- 1.3 In Ireland, the Single Electricity Market (SEM) has been successfully established, retail electricity and gas markets have been deregulated and considerable investment has taken place both in renewable and conventional generation. The principal concern in 2007 was a shortage of energy supply to meet ever increasing energy needs. However, the economic recession – with its deleterious effect on economic growth and the surge in renewable generation – mean that Ireland now has considerable spare capacity.
- 1.4 The Authority's focus in its submission to the 2007 Energy Green Paper was primarily on the supply-side reforms which were needed to stimulate competition. Now that competition has been established in electricity and gas, policy makers face a new set of challenges to ensure consumers reap the benefits of a truly competitive market.
- 1.5 This submission addresses three main issues:
  - the need for targeted interventions to promote consumer activity;
  - vertical separation to enhance competition and secure investment; and
  - a review of policies that promote investment in renewables.

## **2. PRIORITY 1: EMPOWERING ENERGY CITIZENS**

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### **Question 6**

*Is there further scope for switching in the Irish retail electricity and gas markets to enable customers to avail of alternative price and product opportunities, or do the numbers indicate that Irish switching has plateaued? If there is indeed further scope for switching for consumer benefit, are there barriers that need to be overcome, such as availability of information or consumer difficulties with the switching process?*

### **Competition has taken hold**

- 2.1 All market segments in electricity and gas are now deregulated. There are 7 active suppliers in the electricity retail business and 7 active suppliers in the gas retail business and domestic markets.<sup>1</sup> Earlier this year the CER announced its decision to lift tariff regulation on BGE which deregulated of the domestic gas market.
- 2.2 When tariff controls are removed at the level of retail supply, the benefits of market liberalisation depend on the ability of consumers to actively search for and switch to better deals. However, according to European Commission research, consumers often fail to take advantage of potential gains available from switching supplier in liberalised energy markets.<sup>2</sup>

### **Consumers are exercising their right to switch**

- 2.3 Irish consumers have shown an appetite for switching both electricity and gas suppliers, with switching rates well above 10% per annum in both markets since Airtricity first offered an alternative to ESB in domestic retail electricity supply in 2008.
- 2.4 The CER's annual report on the electricity and gas markets shows that there were 2,233,370 electricity customers in Ireland in 2013.<sup>3</sup> The total number of switches completed in the electricity market in 2013 was 266,224, representing 11.9% of customers. In the gas market, 117,002 switches were recorded out of a total customer base of 634,692, representing 18% of customers.
- 2.5 To put the level of activity into context, VaasaETT, a global energy think tank, defines "Warm Active Markets" as ones in which annual switching is between 8.5% and 14% and "Hot Markets" are those in which annual switching is between approximately 15% and 20%. By this benchmark the electricity market is warm and the gas market is hot.
- 2.6 In the VaasaETT index of switching activity, Irish energy consumers were ranked the second most active in the world in 2009 before

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<sup>1</sup> Airtricity, Bord Gáis Energy, Electric Ireland, Energia, Pinergy, Pre Pay Power and Vayu.

<sup>2</sup> European Commission, "The functioning of retail electricity markets for consumers in the European Union", November 2010.

<sup>3</sup> Electricity & Gas Retail Markets Annual Report 2013, CER/14/134, June 2014. [www.cer.ie](http://www.cer.ie)

falling to fourth in 2011. Switching rates have cooled since then but Irish consumers remain among the most active in the world.<sup>4</sup>

### **Have some consumers been left behind?**

- 2.7 The CER's monthly change of supplier reports suggest a high level of consumer mobility but according to a CER consumer survey published in June 2014, 63% of people have never switched.<sup>5</sup> The survey finds that younger and older customers are the least likely to have switched electricity suppliers. Farmers and blue collar consumers are also less likely switchers, as are those living in the Connacht and Ulster regions.
- 2.8 There are behavioural explanations for low consumer activity in energy markets, such as a status quo bias toward the incumbent firm. Some consumers lack experience in searching and switching to better deals, others may lack interest and some may expect prices to be similar regardless of the supplier they choose.
- 2.9 Research conducted on behalf of the National Consumer Agency ('NCA') into Irish consumer behaviour has shown that the strongest driver of consumer activity is the anticipated gains from switching.<sup>6</sup> Research conducted into the specific conduct of consumers in the UK retail electricity market found similar results regarding anticipated savings.<sup>7</sup> The most consistent finding of consumer research into switching behaviour is that the more consumers believe they can gain by switching, the more active they will be and, conversely, policies which reduce the price differentials will deter switching.
- 2.10 Classic models of price competition assume that consumers are rational and have unlimited ability to track down the best deals. In reality, consumers don't monitor the market all the time for the best deals, especially if the savings on offer are perceived to be small relative to the cost of switching. Research in consumer behaviour shows that even a small degree of tariff complexity can lead to difficulty in choosing the lowest prices.<sup>8</sup>
- 2.11 'Switching costs' refer to all the expenses incurred when changing suppliers. It is not confined to switching charges which do not exist in Ireland for switching energy supplier. Although customers are not charged for switching, there are both real and perceived costs

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<sup>4</sup> VaasaETT World Energy Retail Market Rankings Report 2012.  
[http://www.utilitycustomerswitching.eu/wp-content/uploads/2011/09/USCRP\\_Definitions\\_Explanations.pdf](http://www.utilitycustomerswitching.eu/wp-content/uploads/2011/09/USCRP_Definitions_Explanations.pdf)

<sup>5</sup> CER Residential Electricity Results 2014,  
Prepared for CER by Behaviour and Attitudes June 2014

<sup>6</sup> National Consumer Agency, Market Research Findings: Consumer Switching Behaviour September 2013. Available at: [www.nca.ie](http://www.nca.ie)

<sup>7</sup> Consumer behaviour in the British retail electricity market  
Miguel Flores, Catherine Waddams Price Centre for Competition Policy,  
University of East Anglia CCP Working Paper 13-10.

<sup>8</sup> Choices, Values, and Frames, Kahneman D. and Tversky A. (2000)

related to switching, including fees, search costs, and psychological costs.

- 2.12 Switching is associated with costs for consumers because they have to find out who is operating on their market, make price comparisons, in some cases change direct debit accounts, cancel contracts and sign new ones. The concept of switching costs also includes uncertainties and so-called "psychological costs". Factors such as lack of confidence in new suppliers, anticipated problems in connection with the transfer or worries that security of supply could be affected come under this heading.
- 2.13 The literature in consumer behaviour has developed the notion of "rational inattention".<sup>9</sup> The idea is that the processing of price information is costly and so not paying attention to all prices at all times is fully rational because the costs of doing so outweigh the benefits. While cost comparison websites are used by some consumers to compare prices other methods of communication should be considered to reach those consumers without internet access or those who face other search costs.

### **Help consumers make better choices**

- 2.14 A consumer who is confident about the level of gain is more likely to search and switch than another who is less certain. Consumers with access to online price comparison sites can scan the market much more quickly and thoroughly than those without. Irish Consumers now have two CER-accredited cost comparison websites [www.uswitch.ie](http://www.uswitch.ie) and [www.bonkers.ie](http://www.bonkers.ie). However, there is a sizeable group of consumers who do not have internet access or are uncomfortable in using cost comparison tools. Other forms of communication should be considered to meet the needs of these groups more effectively.
- 2.15 After initially high rates following the arrival of competition, switching has fallen slightly from high levels. This is not surprising. There are 6 retail electricity suppliers and 5 retail gas suppliers competing for domestic customers and switching between them is relatively easy. Given some encouragement, consumers can find better deals and switch energy suppliers. There are legitimate concerns that some consumers who are inactive in the market receive less favourable deals and may include a disproportionate share of more vulnerable households. If consumers wish to switch and are unable to do so then actions should be taken to identify and remove the barriers to switch. However, it may be the case that many people are happy with their current supplier or perceive that switching is not worth the hassle or that the savings on offer are too small to merit a detailed search, in these cases regulatory action is unnecessary.
- 2.16 Consumers are a diverse body of people with different tastes and motivations. Policymakers need to identify the different incentives of various types of consumers if they are to develop effective instruments to stimulate consumer choice and activity.

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<sup>9</sup> Implications of Rational Inattention, Sims C, Journal of Monetary Economics, April 2003.

- 2.17 As competition continues to develop it is worth pointing out the steps that should be avoided. Regulators should not interpret a decline in switching as a competition problem. Consumers appear to be most motivated by the potential gain from switching supplier therefore policies which reduce the price differentials will deter switching and this will ultimately lead to a reduction in competition. The experience in the UK where OFGEM introduced non-discrimination clauses led to a sharp fall in switching and higher prices for all consumers as energy suppliers were prevented from offering better deals to attract new customers.<sup>10</sup> Curtailing the ability of suppliers to attract new customers does not make inactive consumers better off, in fact the evidence suggests that all consumers are worse off if companies cannot offer deals to active switchers.

### **Conclusion**

- 2.18 Instead of focusing on the overall level of switching activity the Competition Authority recommends that the CER should develop a more nuanced understanding of what motivates consumers to switch and the kind of barriers (if any) faced by different consumer groups. More research should also be conducted into identifying why people do not switch despite the potential for savings. If barriers to switching are identified, this may require more targeted interventions aimed at particular groups.

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<sup>10</sup> UK Quarterly domestic energy switching statistics: <https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-switching-statistics>

### **3. PRIORITY 2: MARKETS, REGULATION AND PRICES**

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#### **Question 9.**

*Given the success of Government policy in increasing competition to create downward pressure on prices, are the extent and effectiveness of competition and of competitive behaviour, in both the electricity and gas markets (wholesale and retail), sufficient, and are there any strengthening measures required, at regulatory and or Government level?*

#### **Next steps in competition**

- 3.1 Competition among electricity companies is now a reality in Ireland. Since 2007 Ireland's electricity generation capacity has grown significantly, with additional investment in both conventional and renewable generation and increased interconnection with the larger British market. Interconnection on the island of Ireland in 2007 was limited to a maximum import capacity of 400MW and a maximum export capacity of 80MW but has risen to 950MW export/import capacity today.
- 3.2 Consumer reaction to the entry of alternative suppliers to Electric Ireland into the retail electricity market has been very positive, as demonstrated by the level of switching. However, unlocking the potential for competition at retail level also requires a competitive wholesale electricity market where all suppliers can:
  - purchase electricity at prices that reflect the cost of generation, and
  - manage market risk by entering into contracts for hedging purposes.

#### **Addressing market power in the SEM**

- 3.3 The creation of the Single Electricity Market (SEM) has delivered wholesale prices that reflect the short run marginal cost (SRMC) of production.<sup>11</sup> However the SEM remains quite highly concentrated and while the regulatory authorities may be satisfied that no significant market power has been **exercised**, the persistence of significant market power is a concern.
- 3.4 Given that it is the biggest generating company in the SEM, ESB, continues to have a pivotal role in the determination of market prices. The market power mitigation strategy formulated by the regulators, the CER and NIAUR (the 'RAs'), prior to the establishment of the SEM is primarily a reflection of their concern at the time that concentration in generation ownership posed a potential threat to the development of a truly competitive wholesale market. In their 2006 decision paper "Market Power Mitigation in the SEM", the RAs stated;

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<sup>11</sup> Devitt et al, Goldilocks and the Three Electricity Prices: Are Irish Prices "Just Right"? ESRI Working Paper No. 372 January 2011.



*"In proposing a market power mitigation strategy for the SEM, the RAs acknowledge that there is a problem with generation ownership concentration in the market. The RAs see a reduction in ownership concentration through a divestment of certain generation assets as the preferred approach for tackling this problem rather than a regulatory scheme to prevent market power abuse."<sup>12</sup>*

- 3.5 Given that the option of divestment was not available to the RAs at the time of the establishment of the SEM, the market power mitigation strategy has had to rely on regulatory measures to mitigate the threat of market power abuse. These measures are:
- the *Bidding Code of Practice* which stipulates that bids must reflect Short Run Marginal Cost;
  - ongoing market monitoring;
  - directed contracts;
  - ring-fencing of each of the generation and retail businesses of ESB and Viridian; and
  - local market power mitigation measures.
- 3.6 Market monitoring reports published by the regulatory authorities show that the market power mitigation strategy appears to be working well.<sup>13</sup> However it is also clear that market power mitigation instruments have been employed as a second-best option in addressing the issue of high concentration in generation and vertical integration.
- 3.7 Although the SEM has been successful in ensuring that wholesale prices are reflective of short run marginal cost, the structure of the SEM as a gross mandatory pool (or spot market) with limited possibilities for forward trading and other hedging activities favours vertical integration. This is because only market participants with both generation and supply businesses can efficiently hedge their exposures.
- 3.8 High concentration in generation acts as a barrier to entry if non-integrated downstream retail suppliers cannot acquire energy of sufficient volume and shape to meet the demand requirements of their customers. Following a consultation on the issue of market power and liquidity, the RAs concluded in 2012 that mandating contracts from generators was not necessary as SEM liquidity was developing 'organically'.<sup>14</sup> However, there may be a case for proceeding with such an approach in the future, in the context of the integration of SEM into European markets.
- 3.9 The International Energy Agency (IEA) took a less sanguine view of the wholesale market in its review of Irish energy policy in which it

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<sup>12</sup> Market Power Mitigation in the SEM, Decision Paper AIP/SEM/31/06, 7 April 2006

<sup>13</sup> SEM Market Power & Liquidity, SEM Committee Decision Paper, SEM-12-002, 1 February 2012.

<sup>14</sup> Ibid.

noted that a lack of liquidity may constitute a barrier to entry as electricity suppliers may be unable to sufficiently mitigate risks.<sup>15</sup>

- 3.10 In particular, the IEA's review of Ireland's energy policy recommended that the Government should "reassess the competitive landscape of the electricity sector, with a focus on the appropriateness of the depth of state activity in the sector and the unbundling of incumbents' vertically integrated assets, in line with EU legislation. In addition to selling Bord Gáis Energy, the Government should pursue its plans for disposal of some of ESB's non-strategic power generating plants".
- 3.11 In its February 2011 submission to the CER's consultation on Market Power in Wholesale Electricity the Authority stated its support for directly addressing the issue of market power by the sale of certain plants owned by the ESB.<sup>16</sup> The purpose of any sale should not be to maximise revenue on the sale of State assets. Instead any asset sales should be aimed at increasing the competitive rivalry in electricity generation.

### **Address structural problems with structural remedies**

- 3.12 A regulatory approach, based on curbing the behaviour of market participants, necessarily imposes a second-best solution on the market. Structural remedies on the other hand, provide long term solutions in circumstances where market concentration and the *potential* for exploitation of market power, is of primary concern.
- 3.13 The Competition Authority reiterates its support for structural remedies rather than regulatory intervention to address market power issues in the wholesale electricity market.

### **Question 15**

*Given that Government policy has sought to increase competition to create downward pressure on prices, are there unrealised opportunities in the pricing and regulatory framework for ensuring further price improvements and if so what are they?*

### **Ireland is a price taker of fuel**

- 3.14 A number of independent organisations such as the ESRI, the Sustainable Energy Authority of Ireland, Forfás and the IEA have all studied the Irish energy sector and they have all come to similar conclusions as to the main drivers of high electricity costs.<sup>17</sup> The main drivers of high electricity prices in Ireland are cited as (input)

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<sup>15</sup> IEA, Energy Policies of IEA Countries, Ireland 2012 Review (Ireland Energy Review, 2012)

<sup>16</sup> Mitigating market power in wholesale electricity: <http://www.tca.ie/EN/Promoting-Competition/Submissions/Market-Power-in-the-SEM-.aspx>

<sup>17</sup> Sustainable Energy Authority of Ireland, Electricity and Gas Prices in Ireland, [http://www.seai.ie/Publications/Statistics\\_Publications/Electricity\\_and\\_Gas\\_Prices/](http://www.seai.ie/Publications/Statistics_Publications/Electricity_and_Gas_Prices/)

fuel prices, network costs and the costs of accommodating renewable energy.

### **Policy choices affect prices too**

- 3.15 While fuel prices are determined elsewhere, network costs and the costs of promoting renewable generation are the result of policy choices and as such are within the control of the Irish Government. For example, our dispersed population resulting from our planning laws means that the cost of distributing electricity is large for a small country. Connecting single residential units in sprawling suburbs and remote rural areas requires more kilometres of wire, poles and underground cable per kilometre than other, more densely populated EU countries.
- 3.16 Recent work by the ESRI found that the wholesale price of electricity in Ireland broadly reflects the long run cost of production which is necessary to ensure future energy security.<sup>18</sup> Market prices in the SEM reflect short run marginal cost of electricity production while the capacity payments mechanism reflects the additional long run cost of production.
- 3.17 Electricity prices are set by the cost of the last (marginal) generation unit required to meet the level of demand at any given time of the day. Gas-fuelled generation usually provides this marginal unit so electricity prices have tracked changes in gas prices. Increased interconnection with GB has increased convergence between prices in Ireland and GB and the proposed changes to the Irish wholesale electricity market design should further serve to bring together electricity prices across the two islands and across the wider EU, which is the key purpose of the moves towards a single, integrated European electricity market.

### **Network costs must be contained**

- 3.18 Network costs are likely to account for an increasing proportion of Irish electricity prices in the future as the cost of reconfiguring the transmission network to transport wind generated electricity from remote areas to urban centres will have to be paid for by Irish consumers.
- 3.19 Ireland's electricity infrastructure is in need of large scale capital investment to reconfigure the electricity transmission system to carry the increasing volume of renewable energy being produced along the west coast of Ireland. This means that the cost of the new investment will have to be paid by Irish consumers over the next decade whereas in many other EU countries the cost of the necessary infrastructure has already been substantially paid off. As the cost of building gas and electricity networks are ultimately passed on to customers, delays in the delivery of these projects are paid by consumers.
- 3.20 The cost of networks will become an increasingly large element of consumers' energy bills in the coming years as the cost of connecting and transporting electricity from wind farms in remote

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<sup>18</sup> ESRI, A Review of Irish Energy Policy Research Series No 21, April 2011.

areas of the west of the country to the demand centres in the east will become apparent. While the development of renewable energy sources meets the objective of sustainability, it will carry with it a considerable price tag which will have to be paid by consumers.

- 3.21 The increasing reliance on wind generation will also have significant effects on the stability of the electricity transmission system. Intermittent wind energy requires conventional power plants to ramp up and down more frequently to meet any sudden shortfalls in supply. This adds considerably to the cost of operating Combined Cycle Gas Turbines ('CCGTs') and Open Cycle Gas Turbines ('OCGTs') that are designed to operate within a tight range of output. New highly reactive forms of conventional generation will be required to replace the ageing peakers which are due to be mothballed in the near future.<sup>19</sup> The high co-variance between the wind generation assets in Ireland (which means that when the wind doesn't blow over the island all turbines are affected) exacerbates the problem of intermittency.
- 3.22 The technical challenges of maintaining an instantaneous balance between supply and demand on a system with a high proportion of power coming from an intermittent source of supply are considerable and will require significant investment in networks and new forms of ancillary services to maintain security of supply. These technical demands coupled with the cost of maintaining a network of wires to every house in the country regardless of its location will inevitably result in a considerable increase in network costs from their current levels.
- 3.23 Unbundling between network activities (which are natural monopolies) and activities which are exposed to competition is important for a truly competitive market to work for the benefit of consumers.<sup>20</sup> The Competition Authority is concerned that the current system of legal unbundling is not sufficient to ensure that the TSOs and DSOs act in a neutral manner nor that this arrangement ensures that the necessary network investment can be carried out at the lowest cost. The most efficient way to prevent any discriminatory behaviour would be ownership unbundling.
- 3.24 In July 2012 the Government reaffirmed its intention to retain the gas and electricity networks in State ownership as national strategic infrastructure.<sup>21</sup> The stated objective of this decision was to ensure the networks are developed and maintained in the national interest. The Government mandated the relevant State owned networks companies to "deliver the State's network investment programmes in the most cost-efficient and timely way possible in the interests of

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<sup>19</sup> A peaker is a supplemental power plant that operates only when demand for power is high. These plants often run on oil or natural gas.

<sup>20</sup> Pollitt M., The arguments for and against ownership unbundling of energy transmission networks, CWPE 0737 and EPRG 0714, August 2007. <http://www.eprg.group.cam.ac.uk/wp-content/uploads/2014/01/eprg0714.pdf>

<sup>21</sup> Government Policy Statement on the Strategic Importance of Transmission and Other Energy Infrastructure, approved by Government 17 July 2012, at <http://www.dcenr.gov.ie/NR/rdonlyres/7900740B-E0BC-4ED9-966C-7366DD04A08D/0/TransmissionandOtherEnergyInfrastructure.pdf>

all energy consumers who need the investment and who also pay for it".<sup>22</sup>

- 3.25 The development of the electricity and gas networks should be carried out in the most cost efficient manner possible. However, given the considerable capital costs involved in upgrading energy infrastructure, the cost of capital could be reduced if the transmission networks were unbundled from the existing vertically integrated firm structures and regulated as natural monopolies.

### **The costs of renewable energy**

- 3.26 Adding more wind to the electricity system is not costless. Ireland's target for renewable energy generation is set at 40%.<sup>23</sup> The method chosen to incentivise investment in renewable electricity generation is a system of support payments known as the Renewable Energy Feed-In Tariff (REFIT).
- 3.27 REFIT has been designed to incentivise the development of wind powered electricity generation by paying a direct subsidy to the generators. Under the current REFIT 2 scheme a total of 4,000 MW can be supported covering renewable projects constructed between the start of 2010 and the end of 2017. The current reference price per megawatt hour for onshore wind is €69.23 for installations above 5 MW and €71.66 for installations equal to, or below, 5MW. REFIT operates by offering minimum guaranteed prices for up to 15 years, thus providing certainty to project developers of a minimum price for electricity exported to the grid over that period.
- 3.28 Renewable generation technologies have high fixed costs and almost zero marginal costs. When the wind blows, renewables could eventually cover total demand for periods of the day. The result is a zero or even negative wholesale price. This means that a new gas station may have to be switched off when the wind blows so new gas generators are increasingly dependent on capacity payments to stay open as they cannot be assured of running base load. The knock-on effect of increasing renewables on the system is that investment in gas generation becomes more risky or as the UK energy economist, Dieter Helm, succinctly put it: "Intermittent renewables render everything else intermittent too".<sup>24</sup>
- 3.29 When wind is plentiful some wind farms have to be curtailed to allow a stable system, as a surge of electricity will overload the network and lead to blackouts. However, under the system of subsidies for wind generation, wind farms must be paid a guaranteed minimum price if the energy that they are producing is not needed. Electricity cannot be stored in any cost effective way so when wind is scarce conventional plants have to be turned on and off more frequently and this raises the operating costs of conventional generation plants.

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<sup>22</sup> Ibid

<sup>23</sup> The renewables target was raised for 2020 to 40% of electricity consumption on 15 October 2008 in the Carbon Budget.

<sup>24</sup> Helm D., Electricity and energy prices, Energy Futures Network Paper, 13 February 2014.

- 3.30 The cost of the REFIT scheme is passed on to Irish consumers in the form of a Public Service Obligation (PSO) levy, which includes not only payments for renewable energy, but also payments to peat generating plants and plants that were built to maintain electricity reliability standards.
- 3.31 The level of the PSO levy is set by the CER so as to recover the additional costs to electricity suppliers as a result of purchasing energy from these sources.<sup>25</sup> When fossil fuel prices are high the scheme is less costly, adding up to 6.8 % to wholesale electricity costs. On the other hand, when fuel prices are low, the wholesale price of electricity increases by up to 17.2 % due to the REFIT scheme.<sup>26</sup>
- 3.32 The future direction of wholesale electricity prices depends upon the future direction of gas prices, and this is clouded in uncertainty. In 2007 the consensus was that fossil fuel prices would inexorably trend upwards as fossil fuel supplies diminish. Since 2007, new developments in the transport of LNG and the discovery of shale gas has dramatically increased the potential supply of gas on world markets and the scale of new gas and oil discoveries has if anything increased in recent years<sup>27</sup>. If fossil fuel prices stabilised and even fell over the coming years this would not necessarily make electricity less expensive as the gap between conventional and renewable generation will have to be made up by an increase in the PSO.

## Conclusions

- 3.33 While the price of fossil fuels is determined by world markets the price of electricity in Ireland is also driven by policy choices in relation to competition, network regulation and support of indigenous energy sources.
- 3.34 The Competition Authority reiterates its support for a structural, rather than a regulatory, approach to addressing market power issues in the energy sector. A regulatory approach, based on curbing the behaviour of market participants, necessarily imposes a second-best solution on the market. Structural remedies on the other hand, provide long term solutions in circumstances where market concentration and the potential for exploitation of market power, is of primary concern.
- 3.35 Structural remedies, like full unbundling of the natural monopoly elements of the electricity system such as the transmission network, from the competitive elements such as generation and retail supply, promote competition and reduce the cost of regulation. Structural separation reduces the potential for dominant firms to exploit their market power and ensures network access to all firms on the same terms. Structural separation also reduces the cost of regulation making network costs more easily identifiable.

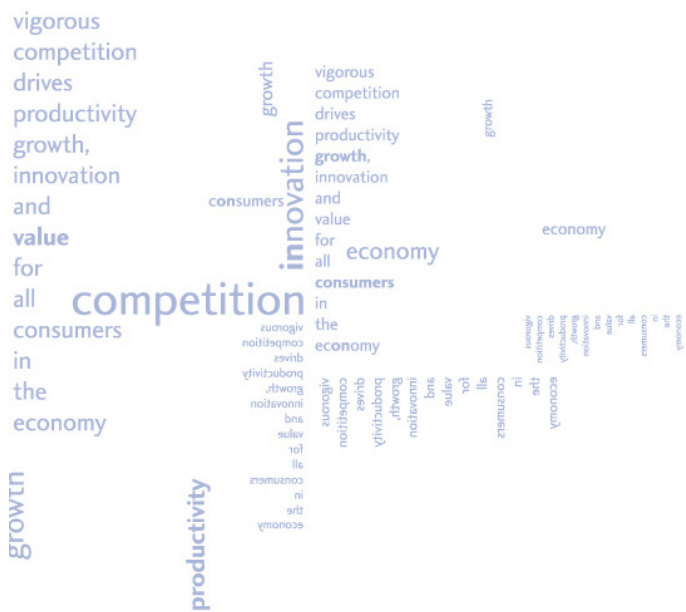
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<sup>25</sup> CER Decision Paper, Public Service Obligation 2014/15, 28 July 2014.

<sup>26</sup> Based on estimates contained in ESRI Working Paper No. 374, "The Effect of REFIT on Irish Electricity Prices", February 2011. <http://www.esri.ie/UserFiles/publications/WP374/WP374.pdf>.

<sup>27</sup> International Energy Agency, World Energy Investment Outlook, June 2014

3.36 Renewable generation of electricity through wind turbines provides sustainable energy from an indigenous source, but it is not without costs. While renewable energy can provide cheap wholesale energy prices, it can raise the cost of conventional generation, which will always need to be available for days when wind doesn't blow. The approach to subsidising renewable energy could be fine-tuned to prevent over investment in wind projects which may not be necessary. For example, the length of the guaranteed price of 15 years under REFIT seems very long as technology can change a lot in that time and the long period can increase costs. The cost implications of individual policy decisions should be recognised in the formulation of future energy policy.



The Competition Authority, Parnell House, 14, Parnell Square, Dublin 1, Ireland  
 Tel: +353 (0)1 8045400 LoCall 1890 220224 e-mail: info@tca.ie

[www.tca.ie](http://www.tca.ie)