Northern Ireland Assembly

Committee for Enterprise, Trade and Investment

OFFICIAL REPORT (Hansard)

Electricity Prices: Power NI Briefing

13 June 2013

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:
Mr Patsy McGlone (Chairperson)
Mr Phil Flanagan (Deputy Chairperson)
Mr Steven Agnew
Mr Paul Frew
Mr Alban Maginness
Mr Stephen Moutray
Mrs Sandra Overend

Witnesses:

Ms Kerstie Forsyth	Power NI
Mr Stephen McCully	Power NI

The Deputy Chairperson: Briefing the Committee today are Mr Stephen McCully, the managing director of Power NI, and Ms Kerstie Forsyth, the head of home marketing and communications with Power NI. You are very welcome to the meeting. Do you want to make a short opening statement, and then we will follow that with some questions from members?

Mr Stephen McCully (Power NI): Thank you, Chairman and ladies and gentlemen. We are very grateful for the opportunity to give you a little bit more insight and background to the recent price increase that will take effect for Power NI customers on 1 July. We circulated some slides, and I am not sure what time constraints you have, but we may spend just a few moments to go through them.

The Deputy Chairperson: We have between five and 10 minutes for your opening remarks.

Mr McCully: That is very much appreciated. To give you a bit of background to Power NI, we are a regulated electricity retailer. We retail to 580,000 domestic customers and 35,000 businesses. The majority of the customers that we serve are regulated or price-controlled; a little over a thousand are in the deregulated sector. We are price-controlled to a margin of 1·7%, and we operate within an increasingly competitive market. Competition entered the domestic market three years ago, and the business sector competition has been in play for the best part of 12 or 13 years. We employ 180 staff in offices in Belfast, Antrim and Omagh, and we focus heavily on offering good customer service. We only had one official Consumer Council Northern Ireland (CCNI) complaint in the 2012 financial year, and we are recognised by the regulator as an efficient business.

Slide 3 shows the structure of the market, which I am sure you are very familiar with. Essentially, there are three main parts of the market. There is the generation production, which is a competitive market and operates through the single electricity market. Then there is the transportation networks part of the market, which is a natural monopoly. The transmission and distribution systems are owned by Northern Ireland Electricity (NIE), which is also responsible for metering. Then suppliers retail electricity. They buy in the wholesale market, pay the transportation costs to NIE and then they retail electricity to customers. There are six active suppliers in the Northern Ireland market.

Slide 4 gives a bit of background to price trends before the winter of 2012-13. At Power NI, we were able to drop prices on 1 October last year. That was slightly against the grain when other suppliers in GB and the Irish market were increasing prices at that time. The question has been asked as to why we dropped prices for the winter period and are now putting them back up, but the value of that is very significant for the Northern Ireland economy and for Power NI customers. The reduction was worth around £40 million, so we think that it was the right thing to do. The specific drivers around this increase relate to generation costs and the Moyle interconnector. Slide 6 breaks down a typical household bill, from which you can see that generation is a major contributor to the price, with world fuel prices being a major input into generation prices.

Slide 7 provides a bit more insight into, specifically, gas prices, which has driven the most recent increase. Since the start of this calendar year, we have seen gas prices increase. They peaked in March, with a 70% increase in natural gas prices. That has had an impact on the spot market for electricity purchases and also on the forward market. As a supplier, we do buy ahead, and that has dampened the impact of the volatility of fuel prices for customers. As we look to the year ahead, gas prices and generation prices are expected to be at least 10% higher, and we have bought ahead a proportion of our generation requirement for the 12 to 15 months ahead.

You are probably familiar with the fact the Moyle interconnector has had some reliability problems and is currently running at half capacity. That is the other major component to the price increase. With the mutual model of funding for the Moyle interconnector, if its proceeds do not cover the costs, customers underpin the running of that business. That money is recovered via the system support services (SSS) levy from all suppliers and, ultimately, from all customers. The shortfall for the two financial years is estimated at around £32 million, and, for Power NI, it was an additional £12 million.

Slide 9 gives you a feel for Power NI's prices since 2008 and the various changes. It shows the increase that is due to take effect on 1 July. You can see the prices trending back to 2011 prices, but, even with the increase, prices in 2013 will be more than 11% lower than they were in 2008, which was the start of the recession. Slide 11 shows where prices in Northern Ireland are, relative to the GB average and to the European average. As of today, prices in Northern Ireland are slightly lower than the averages in GB and the EU, but, once the price increase takes effect, they will be slightly higher. They will still be around 17% cheaper than they are in the South. There is quite a range of domestic pricing throughout Europe, as you can see from the graph.

Hopefully, you found that useful. At Power NI, we were disappointed that we had to put prices up, especially as we reduced them in October 2012, but it really was not commercially sustainable to carry the increased costs of wholesale prices for much longer. It is a competitive market, and, as a business, the last thing that we wanted to do was put prices up. However, we are very sensitive to the impact of the increases on households, particularly those in which budgets are being stretched. We do a lot to help customers, from a financial investment perspective and from a practical help perspective. I will pass over to Kerstie to cover the final slide.

Ms Kerstie Forsyth (Power NI): As Stephen said, we understand how difficult it is for our customers. A lot is outside our control, but we can offer practical money saving and energy saving help and advice. I will highlight our track record. We were the first electricity supply company in the UK and Ireland to remove standing charges. That means that it is fairer for consumers such as older people who live in a small apartments and use fewer units. The charge is spread across that smaller number of units so that they do not pay as much for their electricity.

We were the first energy company in the UK and Ireland to give discount to our customers. We have been giving discount since 2000, which was way before the competition came to the market. Seven out of 10 of our customers already avail themselves of discounted electricity through one of our payment schemes. For example, we offer up to £60 discount if you are keen to go online. If you pay by direct debit, you can save up to £40 a year, or if you prefer to pay as you go along, we will discount every unit of electricity that you use. Recently, we launched a new scheme that gives our customers free electricity. If you pay with a keypad and buy bigger amounts of electricity — that is for those who can afford it — we will pass back the benefit of reduced transaction costs to our customers. If you pay £50, you get £1 free. We are always trying to think of ways to encourage our customers to save money on energy. A lot of our customers are still not on a payment scheme, and those 200,000 customers could help offset the increase by joining one of our discounted payment schemes.

You might be interested in some of the energy saving grants and offers that exist at the moment. Each year, we bid into the Northern Ireland Sustainable Energy Programme (NISEP), which I am sure you are familiar with. Last year, we helped over 3,750 households put in practical energy saving measures such as free insulation for lofts or cavity walls. We administered about £5 million worth of grants, and we will administer an increased amount this year. We also support local communities and charities, such as Age NI, which we work with. We financially support that organisation and support its winter warmth campaign. We also take referrals through a lot of partners across Northern Ireland for the likes of our free insulation scheme.

(The Chairperson [Mr McGlone] in the Chair)

We specifically look at rural communities. For example, for homes that are off the gas network, maybe have solid walls and whose occupants are on lower incomes, we work with the Department of Agriculture and Rural Development (DARD) and go into those homes to look at solid wall insulation. We have provided wood-pellet boilers and so on to help those rural communities. Energy saving grants and offers are available for commercial customers, ranging from lighting to things such as refrigeration.

One of our big successes has been our free in-home benefit entitlement check. We work with Bryson Charitable Group and send someone to the homes of people who are struggling to fill in benefit forms. We visited 850 homes, and that has meant that those people have been able to get additional extra benefits to, on average, the tune of £25 a week.

Lastly, we have been here for over 80 years and are an integral part of Northern Ireland society. We take the community in which we operate very seriously. We have a strong community ethos and work with a wide range of stakeholders and partners throughout Northern Ireland.

The Chairperson: Thanks very much for that. Do you have anything further to add?

Mr McCully: No, we had an opportunity to go through the slides. We are happy to take questions.

The Chairperson: I put this question to the previous people who were in: can you give me some indication of the percentage of your energy that comes from renewables?

Mr McCully: It is a growing percentage, but it is still quite small. In an overall market perspective, it is roughly 12% or 13%. We are purchasing more of our energy from a full range of renewables. We have a couple of thousand contracts in place with individuals who spill their electricity onto the network. There are some small-scale wind and larger wind and anaerobic digestion schemes as well. It is small at the minute, but it is growing.

The Chairperson: It is a theme that we have tried to explore with others as well. I read your press release and stuff. You said that the increase of almost 18% was down to fluctuations in the gas market. We will take that as read. How do you see renewables lending some sort of stability to the cost of energy supply and, consequently, to consumers?

Mr McCully: Renewables tick two of the three boxes from an energy strategy perspective. From the point of view of generation security, they reduce our dependence on imported fuels. They are also very strong from a sustainability perspective. In the long term, reducing the requirement for fossil fuels to generate reduces the requirement on the supply side. Over time, that should reduce the cost of fossil fuels relative to what they might have been if there had been no renewables.

The business model for renewables is very different from a fossil fuel generating plant. There is a much higher capital cost. They make their business case based on what they expect the cost of generation to be by the most efficient form of generation in the market at the time. They will very often track the cost of producing energy from a gas-fired power station, but slightly below it.

The Chairperson: Yes. That is exactly the point. You see fluctuations in the market due to exactly that. The market can be quite volatile and subject to other international things. A lot of us do not rate it as particularly fair that a firm that predominantly, or exclusively even, if it comes to that stage, sources its fuel from the renewables sector should then piggyback on crises elsewhere just to hike their prices. How can that be controlled, capped or regulated to make sure that that does not happen?

Ultimately, just because some firm sees the main chance, many people who fight with that and are the victims of that are having to choose between heating or eating.

Mr McCully: It is a complex situation. Volatility in end-user prices is not a good outcome for customers. We have seen quite a lot of volatility in recent times. There are ways in which suppliers can minimise that risk, such as by buying more of their energy when they believe that the price of that energy is at a lower level. The market for hedges is quite limited at the minute. Fossil fuel generation is still required, particularly when the major source of renewables is wind. When the wind does not blow, you still require fossil fuel generation to provide continuity of supply for customers. There ways to dampen and reduce the risks of volatility, and suppliers have been engaged with them for quite some time.

The reliability issues with the interconnector have created a problem as well. Another source of energy is the GB market. Access to that market has been limited by the reduced capacity of the interconnector. There are other aspects that would help to dampen the volatility.

The Chairperson: You mentioned ways of reducing the volatility of the markets, such as, of course, buying ahead and the like. Will you expand a wee bit further on — you referred to the plural there — the other methods that companies have at their fingertips to reduce the volatility of those markets and, consequently, prices?

Mr McCully: I think that diversity in the market is important. Having a good diversity of sources from different fuels helps to minimise the effect of having all the eggs in the one basket. Natural gas and coal-fired generation are the predominant sources on the island, but you have access to other forms of generation from the GB market as well. That gives good diversity of price. Renewables also provide another source of generation. The structure of the single electricity market sets the price for the last plant on to meet demand, and that is what sets the price for the entire market. That is the reality of that market at present.

Mr Flanagan: Thanks for the presentation. To your knowledge, is there any difference in the percentage of electricity that you use from renewable sources compared with that which the likes of Airtricity uses, or is that standard across all suppliers?

Mr McCully: I cannot comment explicitly on Airtricity. I know that it was established on the basis of investing in renewable wind farms initially and then building a supply business on the back of that. I have no real insight into the various percentages of the various suppliers. We would maybe be slightly lower than the average, so I suspect that others source a higher level of generation from renewable sources.

Mr Flanagan: When you take electricity out of the SEM, can you state whether you would prefer renewables? Does it work like that?

Mr McCully: It is a homogenous product when it comes out of the pool. You pay a spot price. What suppliers do is enter into contracts directly with generators to buy ahead. We enter into contracts with coal-fired and gas-fired power stations. It is more difficult; renewables cannot offer that hedge because they do not know when the wind will blow. There could be situations when the wind does not blow, and so they do not have that certainty of production. That is a problem in the market.

Mr Flanagan: What impact has the manner in which Power NI hedges the buy-in of energy had on prices for consumers?

Mr McCully: A good example of where customers benefited was in October 2012, when we actually reduced our prices while the rest of the market pushed theirs up. We moved opportunistically to hedge prices to the level that hedges were available. That benefited customers by an estimated £40 million through this winter. We had not bought any further ahead than this summer, and we were, therefore, exposed to that slightly higher underlying price of generation, which we expect to see into the future. We continue to purchase, and that dampens the impact on customers. Gas prices shot up by 70% in March. If that had worked its way right through to customers, there would have been a very serious impact on electricity prices.

Mr Flanagan: Are there any examples of where your hedging strategy has failed in recent times?

Mr McCully: It is very hard to assess after the event. You have to create rules around how you place hedges. You cannot speculate in the future. We have a model that a lot of suppliers use. You tend to buy more energy for the near quarters. We are buying quite a bit of our energy for the October to December quarter of this year. In about a month's time or six weeks' time, we will buy forward into quarter 1 of the next calendar year. That is a regime that we stick to. We do, perhaps, buy a little bit more if we think that the market, relative to history, is slightly lower. We would tend to push a little harder in what we would buy ahead because the forward market moves in sympathy with the spot market.

Mr Flanagan: You did very well to evade answering there, so I will try again. Hindsight is a great thing when you are hedging, and no one is really going to criticise Power NI if what you had done, thinking that it was going to be right for consumers, turned out to be wrong. However, if you bought a whole pile of energy in advance and it turned out that wholesale prices went down, would that be Power NI's risk or would any loss ultimately have to be borne by consumers?

Mr McCully: There is clearly a competitive risk if you hedge 100% of your energy at a high level and the market falls, because competitors could come in and undercut business significantly. Any loss of market share has a material impact on the business.

Mr Flanagan: I am not talking about market share. If you buy your electricity and then the price goes down and, effectively, you are selling it at a loss, would the regulator allow you to claw that money back from consumers?

Mr McCully: The price control model theoretically allows you to recover any losses. In the first three months of this year, we ran at a loss of £23 million, which was the burden of the increase in wholesale prices.

Mr Flanagan: Was that in the first financial quarter from April or was it from January?

Mr McCully: It was from January.

Mr Flanagan: So, you put your prices down last October, and by January you were losing £23 million?

Mr McCully: Yes.

Mr Flanagan: So, was it a mistake to put the prices down so significantly last year?

Mr McCully: No, because customers have benefited significantly —

Mr Flanagan: Customers benefited in the short term, but over the next price control period, they will have to reimburse you for the money that you lost. Consumers may well have benefited, but now they have to pay it back.

Mr McCully: Yes, those who are still with Power NI will see a rise in prices, but they have freedom of choice.

Mr Flanagan: Consumers who remain with Power NI will have to pay for those who have left as well.

Mr McCully: In effect, yes.

Mr Flanagan: Did you lose £23 million in the month of January or in every month?

Mr McCully: It was January, February and March.

Mr Flanagan: What was the story for the second quarter until prices go up in July? How much more are you talking about?

Mr McCully: Prices have settled back, but they are still higher. We had a proportion of our energy hedged; we had pre-bought about 50% of our energy. That exposure was just to the level of generation where we did not have our hedges in place. That is the way of it; suppliers are unlikely to be 100% hedged. It does not make sense because you can lock your customers into a very bad outcome.

Mr Flanagan: Do you have a rough figure for what you need to claw back from consumers from 1 July onwards for the first half of this year?

Mr McCully: It is slightly over £20 million for the nine months of this tariff year since we last changed our prices.

Mr Flanagan: Are you entitled to claw that all back from consumers?

Mr McCully: We are entitled to attempt to claw it back.

Mr Flanagan: I want to ask you about customers who owe you money. I think that I am right in saying that there is a European directive that your debt payback cannot be any higher than a maximum of 40%.

Mr McCully: That is correct.

Mr Flanagan: Is yours set at 40%?

Mr McCully: Yes.

Mr Flanagan: Why have you set it at the maximum possible limit? That means that of the £10 that someone owes you, £4 is taken to pay back the historical debt. Do you not think that 40% is very high for people —

Mr McCully: We have a very good track record in that regard. The keypad system, which was introduced by Power NI initially, is totally flexible. If certain customers are going through harder times, we will reduce that percentage. We do not set the maximum for every customer; we will negotiate, and where a customer is in difficulties, we would set the recovery rate at a lower level. We have total flexibility, on an individual customer basis, to negotiate that outcome.

Mr Flanagan: Personally speaking, I moved house and had a debt with Power NI, and the rate was set at 40%. There was no room for negotiation; it was set at 40%. I do not think that we should be allowing you to set the rate at 40% because that is the maximum level. There has to be greater flexibility; it should not be the case that it is set at 40% and then, if someone comes crying and begging, you may well reduce it to something else.

The Chairperson: Phil, without getting too much into the detail of your circumstances, that conversation could be had.

Mr McCully: I am happy to provide statistics on the ranges of different recovery rates.

Mr Flanagan: Could you provide the number of people on each band?

Mr McCully: Yes.

The Chairperson: From my constituency office, I know that you have been flexible where there are exceptional circumstances when it comes to the payment of arrears.

Mr McCully: We do not disconnect customers. We were the first supplier not to do so on a voluntary basis. We have a right to disconnect, but we introduced the keypad metre to avoid disconnecting the customer, which is a much more difficult situation. There is a fine line to be drawn, and I accept the point that you are making. We try to have an open mind and negotiate.

Mr Flanagan: Have you considered setting the starting rate not at 40% but at a reduced rate?

Mr McCully: We have to be fair to other customers. That rate has been defined in Europe as a fair one.

Mr Flanagan: Is 40% not the maximum rate allowed? It is not a fair level; it is the maximum allowed.

Mr McCully: Yes.

The Chairperson: That rate does not include any interest payment: it is just payment of the existing debt.

Ms Forsyth: Sometimes, a customer changes from being a billed customer to a pay-as-you-go customer. If that customer has an outstanding balance, for example £80, they may not want it hanging around for a long time and would prefer to pay the 40% and just to have the extra few months to pay it. Each case is treated on an individual basis if customers tell us that they are having difficulties.

The Chairperson: There are a couple of wee things that you mentioned that you could maybe give us some reassurance on. Obviously, there were difficulties with the 17·8% hike. Could you give me some sort of indication of the drivers from the gas markets that have pushed the price up and how that has affected or been balanced out by other factors in the company, such as the renewables that you receive? In other words, how did other markets bounce it up? How were the worst aspects of the market mitigated by renewables or other factors in the company?

Secondly, and this is the punchline, Phil was teasing out the issue of getting into the markets and buying ahead when you think that it is the best time to do so. You said that, in the next month to six weeks, you will be outsourcing. Is that outsourcing in the market giving you, and, more importantly, your consumers, some assurance that there will not be any further price hikes of the scale that we have witnessed in the past three weeks? I am hoping that you will say that there will be no price hike. That is the bottom line for a lot of people.

Mr McCully: I will take those questions in turn. The driver behind the increase in gas prices was a combination of two factors. There was a supply problem in the European gas network. There was a pipeline issue with a major gas field in Norway, which unsettled the market. Then, we had very cold weather, as you will remember, in March. Indeed, that weather did not just occur in Northern Ireland; it occurred throughout western Europe. That created a supply problem with gas, and those two factors combined to push the price of gas up very swiftly to record-breaking levels.

That tends to unsettle the market. Sentiment has an input to the price of gas and how markets change, but the forward market moved quite aggressively up for gas. So, any generators that were taking positions in the market would have faced a sharp increase in the price when buying their gas three, six and nine months ahead. It is quite a complicated situation. We have risk management rules, as a business, that the regulator scrutinises. We have a hedging policy statement, which is publicly available. I think that you can get it on our website; certainly, it is on the regulator's website. That sets out how we approach the hedging process and the stages and processes that we go through.

There has been a settling down of gas prices, which is useful. As we are buying for the rest of this calendar year and the following calendar years, to the levels that we can purchase, we have to rely very much on the generation sector coming forward and being willing to sell. However, what we have been able to tie into price-wise has been quite encouraging and would be supportive of a more stable price outcome. We are setting this price with an aim to have it running through to 1 October of next year. That is our clear intention. We hope that, via our hedging strategy, we can secure the underlying generation at the earliest opportunity that will deliver that outcome.

The Chairperson: And that outcome being?

Mr McCully: Holding prices through to 1 October 2014.

The Chairperson: OK. Thanks very much for that.

Mr Moutray: You are very welcome. Power NI markets itself as Northern Ireland's number one energy supplier. That is certainly not in relation to price because you are more expensive overall than any of your competitors. You are the largest supplier in Northern Ireland and historically have been. Why are you more expensive than the other companies?

Mr McCully: We are regulated. Our price to the majority of our customers is the regulated price. We are price-controlled. One of the slides indicated the regulated net margin of 1·7%. All our input costs are scrutinised by the regulator. We supply a fairly high percentage of customers in the domestic sector. Being the regulated supplier, we have a licence condition that we are not allowed to discriminate on price. Notwithstanding discounts for various payment schemes, we have to set a price for all customers. Our competitors can cherry-pick and target particular customers. Their business model is an introductory discount but they then tend to lapse back to the reference price, which is the regulated price that we offer.

Ms Forsyth: People looking to shop around may be able to make a saving in an introductory period, but our keypad prices are cheaper on an ongoing day-to-day basis in comparison with our biggest competitor.

Mr Moutray: I accept that you may be cheaper in one or two areas. However, in the Consumer Council's price comparison table for across the range, you are cheaper on only one or two of the many options. Generally, you are more expensive. I go back to the question that I asked you. Is it not the case that there is too much fat in your system? You changed your name about 18 months ago. What did that exercise cost? Generally, the amount of advertising that your company does —

Mr McCully: That re-branding exercise cost customers nothing. Our shareholder picked up the cost of that.

Mr Moutray: So, there was no cost to the consumer whatsoever.

Mr McCully: Of the re-branding exercise, no.

Mr Moutray: Of the re-branding exercise. Your customer base —

Mr McCully: We were mandated by Europe to change our name, but we did not pass any of the cost of the re-branding exercise on to the customer.

Mr Moutray: Generally, the customer picks up the cost of PR and advertising. Is that the case?

Mr McCully: Every cost in our business is scrutinised by the regulator. We are recognised in the recent consultation paper by the Utility Regulator as an efficient business, as benchmarked against our peers.

Mr Moutray: Yet, you are the most expensive provider in Northern Ireland.

Mr McCully: Because we supply the full range of customers. Our competitors can cherry-pick customers who they view as a slightly lower risk on a particular product or load shape that suits their requirements.

Ms Forsyth: We are cheaper on an ongoing basis after introductory offers, depending on what way you pay.

Mr Moutray: Is your customer base increasing or eroding?

Mr McCully: It is eroding.

Mr Agnew: Thank you for the information so far. I will follow up where Stephen left off. You say that other suppliers can cherry-pick customers. Are you suggesting that there is a vetting, almost, of customers? Are we talking about domestic customers or more about those in the commercial market?

Mr McCully: It tends to be volume. A supplier will target customers who will consume more, because the fixed cost of supply is spread over a larger number of units and they can offer a better deal on that basis. That is something that we are not allowed to discriminate against.

Mr Agnew: OK. So, it is not a case of them saying, "You're a risky customer; we don't want you, thanks very much". It is about —

Mr McCully: No, it tends to be volume, really.

Mr Agnew: OK.

Ms Forsyth: And we do not differentiate between attracting new customers and our existing customers. All of our customers get the same level of discount. Earlier, I mentioned £60 for energy online. We do not offer that to entice people; every single customer gets that.

Mr Agnew: To go back to the Chair's question about your renewable take-up: why are you lower? Are you locked into contracts with generation companies? You have been around longer than any other suppliers. Are you locked into contracts with fossil fuel suppliers or do you have business reasons for not going for renewables to such an extent?

Mr McCully: Historically, we would have been locked into the old regime, prior to SEM, where we very much relied on long-term contracts, which are slowly disappearing. As a business, we had a historical ban on investing in generation. When the industry was first privatised, generation was separated from networks and supply, and we were prohibited from investing in generation. That legacy stayed with us until recently, but it has now been removed. Within the wider Viridian Group, we are investing quite heavily in renewables, and we are contracting with many other developers. The level of what we source by way of renewables is increasing steadily.

Ms Forsyth: We also do a lot of work with individuals. About 2,000 of our customers are on what is called a microgeneration tariff. We are the only supplier in Northern Ireland to offer that. So, we will buy back electricity from them and encourage them to put photovoltaics (PV) on their house.

Mr Agnew: I asked why you had not invested in renewables to the same extent as some of your rivals. I will reverse the question to this: why would you invest in renewables?

Mr McCully: Renewables are an important part of the overall generation mix. We, as a group, invested not only in renewables. We have invested in gas-fired power stations as well. It is important for a group to have diversity and a good portfolio of options. That is also good for the sector. Renewables, particularly wind, require the safety net of fossil fuel generation, and gas is one of the more sustainable forms of fossil-fuelled generation. That is particularly true of the highly efficient power stations that have come onto the system relatively recently.

Ms Forsyth: It also supports our customers' choice. They are keen to go for renewables, and we want to facilitate them.

Mr Agnew: I think that you said that volatility in end-user price is not a good outcome.

Mr McCully: Yes.

Mr Agnew: I appreciate that you largely work in the domestic market, but we have just heard from Energia, which offers a fixed price.

Mr McCully: Yes.

Mr Agnew: Have you considered doing that? I am particularly interested because Energia seems to think that its high energy users are willing to take on the higher risk of volatility, but its low energy users largely seem to think that fixed price works for them. I do not know what the domestic consumer would conclude, were they given that option.

Mr McCully: It is an interesting question. Some suppliers in GB offer a two- or three-year deal at a fixed price. One of the downsides of our licence condition is that not being allowed to discriminate would prevent us from promoting a product that only a certain number of customers could benefit from. Technically, it is possible. You would go into the wholesale market, book that capacity and buy it ahead. There would be some risk if the volume that customers consume and what you take out as a hedge do not match, but that would be built into the overall price. It is possible.

Mrs Overend: Thank you very much for that information today. It has been a very interesting morning. I have a couple of small questions. Do you really feel that you can cover the cost of administering the various schemes that you have? Would it not be better to keep things simple?

Ms Forsyth: I am not sure that I follow.

Mrs Overend: You talk about the different schemes, such as keypads, online, etc, to help the consumer.

Mr McCully: We develop our different payment methods by listening to our customers. We do research. For instance, we surprised ourselves with the keypad system, but that was after quite a lot of research with customers. We sourced the system in South Africa, and it was completely new to the northern hemisphere. Customers really like it: it is an incredibly popular system. More than 40% of households in Northern Ireland pay for electricity using the keypad.

As for the other option, in which customers prefer to pay their bills online; not having to physically produce a bill and post it to customers is a saving for us, and we pass that benefit on to customers. So, we think that it is important for customers to have that choice and make that judgement.

Mrs Overend: Do you feel that some consumers are actually paying for the cost of administering schemes for other consumers?

Mr McCully: No. We have many license conditions, and one is that we must be cost-reflective, and be seen to be cost-reflective. That is something that the regulator will scrutinise in all the products we offer and, in particular, the discounts that go along with them.

Ms Forsyth: It is self-funding. In keypad reward, for example, we give free electricity. For a £50 top-up, customers get £1 of electricity free, and the amount of free electricity increases the more customers top-up. We can do that because every time customers top-up we have to pay a transaction fee. If we can reduce the number of fees that we pay, we can pass that benefit back.

Mrs Overend: Similarly, if you had been listening to the meeting last week, you would have heard large businesses saying that they felt it was unfair that they are paying for the energy saving grants that only domestic customers can avail of. What would you say to them?

Mr McCully: It is a fact that there are fixed costs for the network and levies that are passed on to customers in a non-discriminatory way. Those make up about 25% of the bill. The regulator decides how those costs are allocated across the various customer sectors. As a supplier, we have to take those costs in the way that they are presented to us. We have to be cost-reflective. We have no discretion, as a supplier, to allocate such costs in a different way. It would be, in effect, a cross-subsidy.

I know that, following on from the recent consultation, the regulator is going to look at how those costs are allocated across the market. That will include the energy efficiency scheme. Indeed, there is a general review of the energy efficiency scheme and whether we should move to something more akin to the GB market obligation system — that there would be an obligation on suppliers rather than a levy being raised.

Mr A Maginness: Your presentation was very interesting. Are you developing new keypad models, or is there just a standard model in existence? I am thinking about smarter uses of energy in the home. Is that facility being afforded through the keypad, or perhaps is it too basic for that?

Mr McCully: There is a drive to move to smart metering. It is part of a European directive.

Mr A Maginness: Can you do that through the keypad?

Mr McCully: The keypad meter is 90% smart. It ticks a lot of the boxes that are required under the European directive. The Utility Regulator is looking at a further roll-out of smart metering, and the keypad will come into that review as well. The technology is 11 or 12 years old, so it probably needs to be updated. There will be new functionality.

Mr A Maginness: Is the cost of the keypad borne by the customer?

Mr McCully: It is borne by the generality of customers.

Ms Forsyth: It is free for the individual.

Mr A Maginness: If you wanted a keypad, there is no cost.

Mr McCully: There is no extra charge.

Mr A Maginness: Would there be a cost to the individual customer for the smarter keypads?

Mr McCully: There certainly would be a cost to change all metering to a smart format. During the review process, the regulator will have to determine how that cost will be recovered: whether it is individually from a customer and linked to the particular meter that the customer chooses or whether it is spread across all customers.

Mr A Maginness: Are gas prices related in any way to the price of oil?

Mr McCully: Historically, there was quite a close connection, but they have drifted apart. There is not as solid a link, but there are periods when they can move in sympathy.

Mr Frew: Thank you for your information. The first thing that strikes me is the massive hike downwards and the massive hike upwards. I am sure that hindsight could apply, but do you feel that this is the right way to go on pricing; that you reduce very dramatically and, several months later, increase very dramatically? Is it better for the consumer to have a more regulated bill so that it helps with their planning?

Mr McCully: That is a good question. We hear different messages from our customers. Some pay by direct debit, and they really do not like to see their direct debit payment bouncing around. However, we consult with the regulator on that and it is all part of our price control process. There is an annual review of tariffs on 1 October every year. Some of our energy was pre-purchased, but not it all. With the agreement of the regulator, we could have continued on with the 2012 tariff right through into this period, but we decided that the opportunity was there to reduce them and that we should reduce them to reflect the underlying costs of the generation that we had secured for the winter period. However, we knew there was the risk that, beyond the winter, prices might have to go up again.

Mr Frew: You break down the cost of a typical domestic bill, and we know that generation, networks, levies and all the other regulation costs are in that and the actual cost of the energy itself that is purchased and used is a very minimal part of that bill. You go on to talk about the different cost factors and price drivers. One of them is the generation cost, which is easy to understand. I also understand and have some knowledge of the Moyle interconnector. How are you connecting the Moyle interconnector and its problems with the direct pricing of your bills? Surely, it will affect everyone purchasing energy.

Mr McCully: It does. All suppliers will have seen the increase in the cost of the Moyle interconnector. It was not factored into the price change in October 2012. We made the announcement in mid-August, I think, and, subsequently, we learned that there was going to be that under-recovery for the Moyle interconnector. We carried that additional cost through this winter. All other suppliers would have had to carry that cost —

Mr Frew: I am sorry; will you explain how you get costs? My understanding of the Moyle interconnector at the moment is that it is running at half capacity. So, it is more about security of supply and bringing in energy, rather than being a burden or a cost on the consumer at the moment. Surely the burden and the cost could well happen when the owners go to fix it.

Mr McCully: That is another cost. The cost that customers are seeing at the moment is actually the cost of financing the Moyle interconnector — the mutual funding arrangement that was put in place. There will be interest payments at a certain level, which should be covered by the proceeds of selling capacity for the interconnector. Because the interconnector is running at only half capacity, the sales are only at half the level that was otherwise expected. Therefore, there is a shortfall in the cash flow.

Mr Frew: OK; so that is how it is directly affecting the bills. What impact is the North/South interconnector having at the present time, and what will it do for the benefit of consumers when we eventually get it?

Mr McCully: I think it is estimated that the cost to customers throughout the island is around £20 million per annum. That is due to the various constraints that the lack of capacity in the North/South interconnection creates in the market. It forces less efficient generation to be used, whereas, if we had a free flow of generation North and South, that would support the most efficient outcome for customers on the island. Having that bottleneck creates an inefficiency in the overall coast of generation that has been estimated at around £20 million per annum.

Mr Frew: The final question is around the comparisons with the other EU states. The starting figure in your presentation is the difference between domestic bills here and in the Republic of Ireland. That, as we have been learning over the past number of weeks, is more to do with a policy decision by the Government there, rather than any difference in price with regards to competition or otherwise. What is your view on that?

Mr McCully: If you take the markets in their entirety and come up with an average price per year that customers overall in all sectors are paying, the price in Northern Ireland is very slightly lower than it would be in the ROI. There is certainly not a 17% difference. The price in Northern Ireland is 7% or 8% higher than the average price in GB. That is the unfortunate consequence of the transportation costs and smaller scale in Northern Ireland. This is a policy decision. We understand that the pricing structure across the various sectors is done to a recognised methodology and it is that methodology that would have to be reviewed again by the regular, so I do not have a strong view on that.

Mr Frew: You would agree, then, that it is not a like-for-like comparison between our bills and those in the Republic.

Mr McCully: No, it is not.

Mr Frew: Do you know whether Denmark, Germany and Belgium are cost-reflective, or is there more of a policy change there also? If there is, how can they get away with it when Europe seems to want everyone to go cost-reflective?

Mr McCully: I do not have insight into every country, but I do have some insight generally into the Danish prices. There is a higher level of carbon tax applied to domestic customers, which is something that they have freedom to do. Germany is slightly different. With the difficulties in Japan with the nuclear power station, they made a decision very quickly on the back of that to stop producing any of their generation from nuclear sources. They switched back and had to rely on previously mothballed, and perhaps less efficient, plants. That pushed up the price in Germany quite a bit. That is the background to those prices. There are local issues that are factored into prices and that really need to be taken into account in every case.

The Chairperson: I will ask you the same question that I asked the witnesses in the previous session. Given that some people are choosing between heating and eating, if you were in our position, what are the two or three things that you would do to try to bring down energy costs?

Mr McCully: With costs generally, minimisation of waste in consumption is a very important starting point. A lot of the schemes and initiatives that we focus on help customers, particularly vulnerable customers, to minimise their energy consumption. Competition in not just supply — we have six suppliers competing in the Northern Ireland market — but generation is good for the customer. Competition from not just different organisations but different sources of generation also leads to a good outcome for customers. Regulation bears down on the costs of running the industry and has always acted in the best interests of customers. A lot of good is happening in the market. The creation of the single electricity market made what drives cost a lot more transparent for everyone so that the market, collectively, can try to reduce prices. Competition leads to better outcomes for customers.

The Chairperson: OK. Thanks very much for that and for being with us today. It has been very useful.