Northern Ireland Assembly

Committee for Enterprise, Trade and Investment

OFFICIAL REPORT (Hansard)

Energy Review: Confederation of British Industry

19 September 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 Sydney Anderson
Mr Sammy Douglas
Mr Gordon Dunne
Mr Paul Frew
Mr Alban Maginness
Ms Maeve McLaughlin
Mrs Sandra Overend

Witnesses:

Mr Nigel Smyth	CBI Northern Ireland
Mr Colin Walsh	CBI Northern Ireland
Mr Declan Billington	John Thompson and Sons

The Chairperson: You are all very welcome indeed. I remind you and anyone with you to turn off mobile phones. We have a recording system for Hansard, and mobile phones have a tendency to interfere with that and make the recording not as good as it should be. We do not want anyone being misinterpreted because of that.

In members' documentation, there is a briefing paper from the Clerk and a response by the Confederation of British Industry (CBI) to the Utility Regulator on electricity pricing.

Before us, we have Colin Walsh, vice chairman of CBI Northern Ireland and chairman of Andor Technology; Declan Billington, managing director of John Thompson and Sons; and Nigel Smyth, director of CBI Northern Ireland. It is good to see you with us. Some of you are seasoned hands by this stage. We adopt the approach of asking you to make an opening statement, which will be followed by a question-and-answer session from members. The floor is yours to a make a submission for a maximum 10 or 15 minutes.

Mr Colin Walsh (CBI Northern Ireland): Thank you, Chairman. We will keep it brief and skip the introductions. Thank you for the opportunity to give you our views. We welcome the inquiry, which is very necessary. In my role as a member of the council of the CBI, it is one of the things that I am particularly concerned about. We have ended up in quite a dangerous place on energy costs, particularly for business and industrial users. I intend to take a minute or two and talk about a few high-level points.

One of the challenges with this topic is that the billing system and the nature of the arrangements that we have ended up with for electricity generation, supply and transmission are hideously complicated to understand, and I confess that I find it challenging to get my head around the framework we have ended up with. So, it is a very complex problem. Thankfully, Declan Billington from John Thompson's is much better on the detail than me; so, in true chairman fashion, I will delegate that one to him quite quickly.

As you mentioned, we submitted a report in response to the regulator in May. We think that it addresses the terms of reference of this inquiry. Today, we will update you on some of our thinking about potential ways forward and throw some ideas on the table. We all get the fact that we have ended up in a place where, although electricity costs to domestic users are quite reasonable compared with European levels, electricity costs to commercial users are at the highest end of the spectrum in Europe. This has obvious consequences for our ability to bring in inward investment from businesses that are significant energy users.

Traditionally, we think of those businesses as being older industries that are very heavy consumers of energy. We think of things such as heavy manufacturing, smelting, and so forth. Invest NI really will not have a prayer of attracting those kinds of businesses. In the new economy, it also covers things such as data centres, which we are also unable to attract. In the competitive race for such businesses globally, we are losing out all the time to other countries. Our nearest neighbour's electricity costs are a lot lower than ours, and we have lost several potential inward investment projects to the Republic on electricity cost alone.

As I said, I think that we have moved from a place in which, once upon a time, there was one electricity supplier on one side of the deal and a customer on the other. It was very straightforward. They made electricity and delivered it, and we paid so much per unit for it. We have ended up in a place where there are separate generators, transmitters and suppliers, and a costing system that is of labyrinthine complexity and has some quite lethal components in it whereby if demand drops here, prices continue to rise.

I think that this sets, perhaps, a fairly gloomy backdrop to what you are examining. I will leave it at the fact that we are in a difficult place with regard to costs and complexity of the system. There are all sorts of issues about security of supply and the headroom of availability that we have. In lots of different ways, we are boxed in here. So, it is timely that this is being examined. I hope that some of the ideas that we can put on the table are helpful in broadening the thinking on how to take this forward. With that, I will pass the baton to Declan, who will expand a little on this.

Mr Declan Billington (John Thompson and Sons): I have been in the CBI for, probably, 12 or 13 years. I actually joined because one of the challenges that I saw for our business — I worked for an American company at the time — was the cost of energy. Twelve years on, we still have a competitive disadvantage, and that is a threat to the businesses that are here. What we are doing today is giving you an update on where the world sits. I want to talk about the issues, and from your terms of reference, I think that the Committee understands them well. I want to talk about the costs and the cost differences that we are seeing with regard to the components of electricity cost. Then, I want to talk about the road map and the actions that the CBI is tabling to policymakers in the hope that, perhaps, we can move forward with some solutions.

The first issue is security of supply, and it is well known. In July 2013, the regulator produced a paper, which showed that, with the disappearance of the second Moyle interconnector, 250 megawatts was lost. With the imminent closure of Ballylumford power station, 400 megawatts will be lost. That will push Northern Ireland into a very dangerous supply-and-demand situation.

There is plenty of capacity in the Republic of Ireland. The problem is that we do not have the connections into the Republic to access the energy that is available there. There is also cheaper energy in England. However, we do not have access to take enough of it into Northern Ireland because of the Moyle interconnector. Security of supply will create problems for us if we do not solve the interconnection problems before Ballylumford power station goes down.

I will move on to costs. Just to give you a flavour; when we look at the regulator's benchmarking across Europe, we can see that large energy users in Northern Ireland face, probably, the second most expensive prices in Europe. In one respect, that comes as a big surprise to us, in that we share the same generation market as the Republic of Ireland. There is one market and one half-hour price every half hour of the day and night. So, how is it that, if we are accessing the same generation cost,

the delivered cost to the door of a large user is between 20% and 25% more expensive here than for a similar business sitting in the Republic of Ireland?

This takes us on to the transmission and distribution costs. If you were to ask for a breakdown — and the CBI has done a fair bit of work on this — then, basically, whether you are a domestic or business user, and whether you are North or South, the average cost for each megawatt is about £67, or 6·5p for each kilowatt. Therefore, there is a level playing field. When you look at the differences between Northern Ireland and the Republic, we are carrying about a £6 per megawatt extra cost for renewables, and I will get into the components of renewables later. We are also carrying a premium of £5 for each megawatt because of the way the costs of the distribution system are apportioned in Northern Ireland versus the Republic of Ireland. If you look at the regulator's report, you will see the way in which those costs are apportioned across the whole of Europe between large users and small users. Then, there is the public service obligation (PSO), which is another charge levied on businesses to generate an income that is spent in a sector that large businesses are not involved in. With regard to those issues, you are talking about a £13 per megawatt hour difference, £6 for renewables, £5 for apportionment and £1 for the PSO, and with a bit of rounding across the board.

There is an upside with regard to cost for business, and that upside is obviously gas into the west. We encourage the Committee to do whatever it can to encourage and accelerate gas coming into the west. It will deal with the heavy fuel oil cost to business, but it will not address the electricity costs of business. However, it is all cost, and anything that can be done to relieve the burden on business is appreciated.

I will go back to what the CBI road map talks about regarding security of supply. We are in the process of trying to put together a document showing the short-term actions that need to be progressed if we are to provide some relief in those costs. For security of supply, it is pretty obvious and pretty simple: we need the interconnectors, and we need them to be resolved very quickly. If the interconnectors are resolved in 2018, then we will have a problem, because we will have turned off a power station in 2016 and will have been struggling for two years. Therefore, there is a need to find out the issues that can be addressed in order to overcome the road blocks and get those connections in place quickly.

There are some short-term things that could be used to bridge the gap. About 15 or 16 years ago, energy was very expensive between 4.00 pm and 7.00 pm. but there was a mechanism that encouraged and incentivised businesses, through rebates, to get off the grid. History here has demonstrated that, if there are supply and demand issues, we can create incentives. As the domestic sector goes home, cooks dinner and puts the heat on, the business sector can move off the grid so that the overall spike is lessened. That mechanism existed about 15 years ago; the precedent is there. In fact, that precedent can be developed a bit more, and the Republic is already developing it, in that there are two mechanisms by which businesses can participate in the generation of electricity, instead of paying for it, and reduce their costs.

The first is called aggregation of units, which is where a lot of large business have a generation kit — standby generation. Fifteen years ago, they used that standby generation to manage the 4.00 pm to 7.00 pm period. However, there is the ability to collect all of that equipment through an organisation and bid that into the pool, so that you are treated like a generator: you get your half-hourly payment — your capacity payment. The kit is in Northern Ireland, so we are not restricted by the interconnector. Therefore, if we structure the market right, we have the ability to generate some of our own electricity at times. The businesses that do that get an income stream that they are currently not getting, which would help to relieve their overall costs.

The second thing is that they can take it one step further. Rather than bid generation capacity, they could bid a promise into the single energy market (SEM), which says, "I will shed load at particular times if you pay me to". There is no reason, in principle, why you cannot bid a reduction in demand, rather than bid additional generation. The Republic is already sitting down with businesses to look at that. It is called demand side management. Would it not be attractive if the capacity payments that are going to the generators could find their way to the large energy users in the short term in return for them stepping out of the market to avoid overloading the system? That is called demand-side management. The principles are there. The question that we do not have the answer to is whether the regulatory framework exists here to make it happen, but we know that the Republic is already pursuing it. There is clearly an opportunity for businesses, and we should be seeking the same opportunity. That is demand-side management and bidding generation capacity in.

I have already said that we need to get the interconnectors resolved. As they are not available, there are costs in the (SEM) called imperfection charges. This basically means that when you want to use the equipment that you want to use, you cannot do so, because it is the wrong part of the country and you cannot get electricity through the cable to the place where it is needed, so you have to go and use electricity that is generated elsewhere and is more expensive. This is called an imperfection charge, and if we sort out the North/South interconnector we will actually reduce the cost to everybody, domestic and business. So, there is a need to look at the cabling for security of supply, and it will help to reduce the overall cost of not using the most efficient resources at the right time.

In terms of generation cost, we would actually say that the all-island market is working pretty well, to be honest with you. It is a good market. There are one or two tweaks we would table with the Department of Enterprise, Trade and Investment (DETI) and the regulator on the SEM. In the next couple of years, capacity on the island of Ireland will shrink. You will have Ballylumford power station and some of the older plant in the South of Ireland disappearing. It does not affect the overall ability to support the market on the island; we just need the interconnectors for the North. There is a single pot of around £600 million for capacity payments. We say: watch the SEM carefully to see that, when capacity drops, the size of that pot drops, so that you do not end paying more for less because you did not scale the pot down at the rate that overcapacity was scaled down.

The second issue is that, if we want to encourage people to shed demand, then we should make sure that the real cost of generating expensive electricity at certain times is in the price. By that I mean that the SEM has two charges; the actual cost of generation and things called capacity payments, which are payments made to companies because they have equipment available if it is needed, but it is not always needed. That is fine. It is a very good mechanism, and it leads to long-term sustainability and security. The problem is that the charge is smeared across the year, so that we do not actually charge the businesses and the people that create the spikes. The cost of the capacity needed to manage the spikes is smeared across the industry, so those who do not contribute to the spike are paying for it throughout the rest of the year. We are saying that the capacity payments need to better match the time when the equipment is in use, so that the user pays.

Moving to transmission and distribution, and going back to the numbers; that is where the big 20% difference is. When you look at it, you look at the renewables first. There are two elements to renewable costs in Northern Ireland that are not charged to businesses in the Republic of Ireland. The first is the cost of the renewable obligation certificates (ROCs). That mechanism means that there are incentives in place to businesses to generate renewables. Those incentives generate a cost, and that cost is recovered through everyone's electric bill — both the consumer and business.

The second cost is a thing called the climate change levy (CCL), which was introduced many years ago. It is a straight tax on businesses. Here is the paradox: at least, with ROCs, we are trying to incentive and encourage new forms of renewable generation that, over the distance, will be of value to us, but CCL is a straight tax on business for no value. It is borne by the business sector and not by the domestic sector. We argue that it is reasonable and fair that businesses pay towards climate change, but should we pay for it twice? We think we should pay for one but not the other. That is the issue with renewables.

There is another issue in that, going forward, a lot of money is going to be spent on the grid to handle what we term inefficient renewables — the quarter- and half-MW equipment that is being put into the country. It is costing about £16 per megawatt in incentives, but there are larger-scale schemes that, for four or eight megawatts, would provide the same amount of energy. So, we have a policy that is actually bidding up expensive forms of renewables; and then Northern Ireland Electricity has to ask the regulator for authorisation to spend a lot more money on the grid to support the large number of small projects, rather than a small number of large projects. We are concerned about the long-term costs on the grid if we do not look at the big picture and manage the total cost of renewables. We need to focus on the lowest cost of renewables for Northern Ireland.

Moving on to apportionment, the Republic has a different method of splitting the cost between large and small users. Whatever it is the Republic seems to be very consistent with the rest of Europe. That is the only reason why you can have high cost for business and yet very low costs for the domestic sector. In Europe, there is a move towards what are called the regional markets. The island of Ireland is probably going to be connected to the north of France, and we are going to be trading in a regional market rather than an all-island one. That will require changes to the way in which the markets work and costs are apportioned. It is timely that we look at how our transmission and distribution costs are apportioned, because they are different from the rest of Europe. Entering into a

regional market, we need to make sure that we do not have distortions that further disadvantage business or the consumer.

The final comment is on the PSO. A cost of about £12 million is being levied across all users, including business, but it is going towards funding IT to open up the retail market. A business will not be buying from the retail market; it is already open for business. We have to pay a levy to invest in an IT system to manage a market that we will not be buying from. Another £10 million or so is tied up in energy efficiency schemes, such as solar panels and heat pumps that you see springing up on people's houses. As I drive into Belfast, I see nice photovoltaic cells on a number of houses. Those are all renewables, but the levy generating the grant is a levy on the domestic and the business sector under the PSO. However, businesses will not be taking advantage of that; it is largely targeted at the domestic sector. Again, we have a policy charge that is benefiting people who want to have heat pumps and hot water solar showers but is costing the larger businesses several thousand pounds.

In conclusion, there are a lot of issues around Europe that drive cost. Our nearest competitor, the Republic, has the same generation cost, but is 20% cheaper. We have to look at how we address policy issues that are giving rise to that difference.

The Chairperson: Thanks very much for that. You raised quite a number of issues that were running about in my mind, and you distilled them very well. You talked about the PSO and that going up on houses and the likes. I saw a proposal for photovoltaic farms as opposed to just individual homes advertised about four or five months ago. A company is advertising for those and is, by post, seeking to establish lands that might be available at, apparently, very lucrative amounts of money. Does that apply equally? I would be thinking that —

Mr Billington: The large photovoltaic farms are all about the renewable obligations segment, whereby it is a renewable energy and you get so many ROCs for generating electricity from photovoltaic cells. The business sector can invest in farms, generate electricity and get the ROCs. I cannot remember how many ROCs there are for it, but that is what happens.

In the domestic sector, DETI operates a grant scheme in which, if you install heat pumps, solar panels or photovoltaic cells, you will get a grant towards doing that. That grant is a cost coming out of the PSO.

Mr Nigel Smyth (CBI Northern Ireland): Most of that £8 million or £9 million a year is set aside to try to address vulnerable customers, energy efficiency, etc, on the back of that. The problem is with how it is structured. Businesses have to pay for that; large customers pay tens of thousands of pounds towards it but are actually not getting any benefit. We fully support the need to address vulnerable customers. The question is whether our large companies that we are putting under pressure should have to contribute to that.

The Chairperson: You referred to renewables. I think you said that, currently, many of them were expensive forms of renewables. I will take you a stage further than that: will you give me some examples of what you see as less expensive sources of renewable energy? Inevitably, that will inform our debates on why electricity costs from renewable sources should be keeping pace with other sources of energy, for example, as a result of gas hikes and the like.

Leading on from that; I picked up at constituency level that the renewables sector is entirely dependent on how good the network or grid is. The areas of potentially huge growth for renewables, or wind sector, are in the west, the Sperrins, in the mountains and the likes of that. However, even some very successful businesses, which are trying to expand, are finding it nigh on impossible to get a grid that meets their needs, or that will do so without huge costs on their part to even connect to it, which, in some cases, can make it economically non-viable for very successful businesses. Can you give me some indication of how you see that? I am sure that some of the businesses affected are your members, because they are on a bigger scale. Can you give me an insight into the less expensive forms of renewables, the issues they cause for the grid and how those can be overcome? Are there less expensive forms of renewables that do not need the same sort of investment in the grid? As you see it, is that option out there?

Are you picking up from the industry or, indeed, from some of your members whether, as a consequence of the difficulty with the grid and its capacity, we will, in fact, be able to meet our renewable targets? A lot of applications for individual turbines or turbine farms are in at the minute, but even if they are passed and the grid has the capacity for that level of electricity, I am picking up

that we will not be in a position to meet the renewable targets. Have you any views on that? I know that I have covered quite a bit of stuff there. On foot of the issues that have come my direction in the past six to eight months, those things are running through my head.

Mr Billington: I will share some thoughts with you. My business uses rather than generates electricity, but we struggle to understand the "why?" in all of this all the time, and we have asked the same questions that you are asking.

In one way, it is actually easy to identify the cheaper forms of renewables. Look at the value of the ROCs payment: for wind, it is 2 ROCs for each megawatt hour, and, in some cases, it is 1·8 ROCs. So, what we are doing is implementing an incentive. I think that a ROC is worth about £4 for each megawatt hour, so we maybe get a £4 to £8 subsidy for large-scale wind generation. If you put in a bio-digester, that will get four ROCs for each megawatt hour, so the subsidy there is £16. I would look at the level of subsidy for each megawatt hour generated and say that whatever requires the least subsidy per megawatt hour generated is the one that gives best value.

The second issue is that ROCs are creating a distortion in the agriculture market, because bio-digesters, which we refer to as concrete cows, are bidding with cows for grass, as the subsidy system provides a bigger incentive to put your grass into biodigesters than feed it to animals. Those small systems need to be connected to what is called the 11 kVA grid, which is already overloaded, in order to be able to sell it to the grid. So, you have a lot of small connections trying to be plugged into the 11 kVA grid.

There will be a need to harden the grid for larger generation, such as wind farms generating multiples of megawatts. A long time ago, there were thick cables in Belfast, because we made all our electricity there and then piped it to the rest of Northern Ireland. As you got further away, the cable became thinner. Now, we are putting generation at the thin end, so we actually need to put in a backbone. A lot of work is being done on that. I do not have all the detail, but the impression I get is that this is a simple one.

Large-scale generation of renewables and a solid backbone to support it will be required. I believe that that is the right way to go, because although there may be an incentive to make that happen now, energy costs keeps going up. We are investing now so that in five or 10 years' time, it will be a cheap form of fuel, even without the subsidies. So, it is the right thing to do; it is strategic. What we do not want to do is have a plethora of very small subscale plants that require very large incentives and then an even bigger investment in the grid to support their connection. If you strip away the subsidies and look at the renewables that cost least in the grid, you would surely be talking about wind; but then you start to add incentives and less efficient equipment, which places more strain on the grid. So, the answer to your question is to look at the ROCs to determine the forms of renewables that require the least incentives to make them happen. The second issue is a conversation with the grid provider, NIE, to understand where they rate the relative investments for a small number of large wind farms versus a large number of microgeneration facilities. It is best positioned to answer the question about the difference in impact on the cost of the grid, which we would all pay for through the transmission and distribution charges.

The Chairperson: Are there any thoughts from your members on meeting the renewables deadline?

Mr Billington: There is an issue about the pace. Pace is important, and it is about putting the infrastructure investment in place in a timely manner so that we are not paying a big premium in advance of when we need it. Those on the wind energy side believe that the pace is not fast enough. Those of us who buy electricity are concerned that we just cannot afford the price that goes on the grid at the moment. Therefore, it requires DETI and the regulator to take an overview of what is the best pace of roll-out that allows us to deliver the benefits without front-loading the costs and hurting businesses at their most vulnerable time. There is a debate between the generators who say that we need to be doing it and the users who say that they cannot afford any more costs on our system, at least for the next couple of years. It will require DETI and the regulator to take a view. We do not have the answer.

Mr Smyth: Ultimately, we have European targets to meet in all of this. A key driver is reducing carbon. We fully support that, but, as Declan has highlighted, we need to do that at the least cost. At the moment, the argument is around the fact that there is a range of costs in renewables and, because we are putting in some quite expensive forms of generation, business has to pick up the tab. At a time when we need more competitive costs, we need to be much more alert to that. I think that the basic

issue is that we need much better information around that to understand the consequences of what we are doing. If you speak to NIE as the network provider, you will see that a lot of the consequences of supporting relatively small renewables have quite a significant cost on the network, which everybody is paying for.

Mr A Maginness: I have listened very carefully to what you have said, and it reflects very much what Airtricity said to us before the summer break. I have great sympathy with what you are presenting to the Committee on the excessive cost, as you identify it, that businesses in Northern Ireland are paying. That must be addressed. The only problem is this: if I go back to my constituents, who feel hard pressed enough because of the domestic price, and tell them that business in Northern Ireland is getting a bad deal with electricity prices, they might tell me that they are terribly sorry about that but that they are struggling as well. To put it bluntly, would there be a knock-on effect on electricity prices for domestic users if there were some reform of the system? That is a basic political point that I have to put you.

Mr Billington: One of the recommendations is that that should be evaluated. First, gas is an example of policy where everyone is a winner: the people who are using heavy fuel oil for their businesses, the domestic sector that is using ordinary heating oil. That is an example of policy that will deliver benefits across the board. With regard to demand and the constraints on the system and businesses stepping in and generating electricity, it will, first, be lights-out unless we do something. Secondly, is it not better that the income stream flows to businesses rather than to some of the peak generators? The domestic sector will benefit, because the SEM works in such a way that the most expensive piece of plant called in that half hour sets the price. If we avoid creating that spike through shedding demand, the domestic sector does not pay for that spike. Therefore there is an advantage. There is a policy that is a win-win for everyone, but then you are into the tough choice policy.

Mr A Maginness: That is the aggregation that you are talking about.

Mr Billington: That is the aggregation and demand-side management. Then there are some matters that are purely hard choices. They are about whether the apportionment is fair and whether the decision is that you are not prepared to place any greater burden on the domestic sector. That is a judgement call that needs to be made, because you are trading jobs for fuel bills. We need to know the answer. We do not have the answer. What we do say is this: can someone do a piece of work and find out what the relative shift in burden will be if we replicate what is done elsewhere in Europe, where they are facing the same questions? Is it significant? Is it painful?

Mr A Maginness: Can I just interrupt you there? Business costs for electricity in the South are more reasonable. Can we replicate that here? You make a very good point about the common market in electricity generation, but could we replicate the system that pertains in the South without too much disruption to the current system?

Mr Billington: The answer is that I do not know, and that is why our road map states that that is a piece of work that the regulator and DETI need to do. We strongly recommend that they do that sooner rather than later, because what you will have as a result is information to help you as policymakers to decide and to let you strike the best balance. You cannot strike the best balance without that information.

Mr A Maginness: Are you getting a response from the regulator? I know that you presented your views to the regulator, and I know that a new boss is taking over, but do you find that you are getting some sort of response informally?

Mr Billington: We have raised it with the regulator and with DETI, and we have raised the issue that a piece of work needs to be commissioned. There has been some dialogue between them. To be honest, we do not need dialogue; we need a report to be commissioned very quickly that gives us the answers quickly and that will allow policymakers to make informed decisions quickly.

Mr Smyth: I would like to add a couple of things on the back of that, Chairman. We are arguing for a road map, and industry needs some idea of what is going to happen over the next two or three years. There is a realisation that this problem will not be addressed in the next number of months, but we need to know where we are going over the next few years. A number of the recommendations that we will be coming forward with — we will hopefully produce something in the next week or two — look at

constraint costs, the interconnector, capacity charges and extending gas. Those will all benefit the domestic consumer.

Fuel poverty is very high, as we are all aware. Much of that is because heating is mainly oil driven, so that is where the gas comes in. Fewer than 4% of domestic homes are heated by electricity, so the big challenge is getting the conversion from oil to gas, which is much more efficient. Yes; I think that there will be an issue and part of the focus is on cutting total costs so that everybody benefits, but there is a balancing act with the network. If that means a reallocation and larger users are going to pay less, the costs will have to be picked up by some other sectors, but we need to do the work to understand what the implications would be.

Mr Billington: I will make two other brief points. First, if we are an attractive place for large energy users to come, we will at least be on a level playing field with the Republic. More people would be on the grid, bearing a greater amount of costs and, therefore, we can lower the cost to everyone. The flip side to that is that if it is unattractive to business, you will have fewer people on the grid, and a number of businesses will look at self-generation because the policy burdens are so big that it is cheaper to make your own electricity. If that happens, then, by default, you have the worst of all possible results because there would be fewer people to spread the costs and the cost goes up for everyone. That is why we need someone to take a look at this and to give policymakers like yourselves the information that you need in order to make decisions.

Mr A Maginness: The cost of self-generation must be very high.

Mr Billington: I generate myself. I generate 5 MW of electricity. I buy around 10% of my need from the grid, and I am looking into investing so that I do not buy anything from the grid. When gas is brought into the west, it will be a very cheap fuel source to generate your own electricity, so policymakers have to be careful that they do not so overload the transmission and distribution system that people will self-generate. Businesses are looking at that critically at the moment.

The Chairperson: On the back of that, will you explain the distinction between self-generation and demand-side management? I should have asked you that earlier when you raised demand-side management but, now that it has come up, I am trying to get it clear in my mind. Are they two different concepts or are they one thing?

Mr Billington: They are two facets that might actually be the same. In my case, I self-generate because I can use the heat to cook the products that I make and I use the electricity to run the factory. It works very well for me. What I am looking at at the moment with demand-side management — what the industry is looking at — are two things. Sorry; I will take a step back. When our generation capacity was not enough to meet all our needs, we used to stop manufacturing on two production lines between 4.00 pm and 7.00 pm because there was an incentive to do so, and that benefited our business. We were able to switch off 20% to 30% of our need and we were incentivised to do it. A lot of businesses running two shifts can stagger the shifts to make that happen. So you can physically cut back production.

The second thing that you can do, if you have generation kit that is designed to run essential services once a year if there is a winter storm, is to turn that on between 4.00 pm and 7.00 pm. To the grid, it appears as though you have shed demand, so, again, that is demand-side management. You are not calling on the grid because you are generating your on electricity between 4.00 pm and 7.00 pm. It would not pay you to run it for 24 hours. It only pays you to run it when there is expensive electricity being charged to you.

The new wrinkle is when you stop and ask yourself whether you should get 10 businesses together, all with the same equipment, and bid it into the pool. Although it is only called twice a year, the business will get capacity payments for making them available, even though they are not being used. Therefore, I have a business asset that is not being used but which I can suddenly offer up and get payments for. That reduces my overall energy costs. Demand management, drop the demand in the business or self-generate, but we are aggregating demand and aggregating generation to bid in the pool and saying, "Give the capacity payments to us rather than the generators." That will help to offset our costs.

The Chairperson: I do not want to probe too much into the nature of your business, but can you give us a global figure on the scale of savings that you feel that your business has had from self-

generation? What is the reduction of costs compared with what you would have paid if you had been getting it directly from the grid?

Mr Billington: I am trying to remember the percentage. I have had a saving of 10% or 20% in my business, but I am not doing it in the most efficient way. There are other businesses that have invested in standby generation. I use mine, and they get capacity payments, and, once a year, they turn it on for four or five hours. It pays them to have it as backup for their own business, but then they get paid for it. You can think of all the utility companies that themselves need backup generation to supply telephones, lights and water and you then think that there is a huge amount of generation that is doing nothing and ask whether that could, in the short term, solve our security of supply issue. Could it be incentivised that those people bid it into the pool and, therefore, we get local income for local businesses? We have to create a framework where that can happen, and, right now, there is a belief that it will require a change in legislation in the North. It does not require a change in legislation in the South, and we are looking for clarity from DETI and the regulators on whether there is any legal impediment to businesses getting together and doing this.

The Chairperson: It is important that we as a Committee establish that too.

Mr Walsh: One of the key points to take away on this is that capacity already exists, but the capital investment and so forth has already been made, and you can utilise it if the framework is created to incentivise that. A few moments ago, you mentioned instances when we will face other crunch times, such as that relating to Ballylumford. If you are to avoid the plethora of microgeneration that Declan talked about and which causes great difficulties and challenges to the grid, and if you are to seek to utilise larger-scale producers of electricity, the timeline to plan for, invest and build one of those sites will take you beyond 2016. I am referring to units such as Declan's, at 4 MW or 5 MW, or the company that I am involved with, which produces 3 MW. Therefore, you are kind of already out of time. If the project has not already been announced for a plus-1 MW system, I contend that it will not happen this side of about 2016.

(The Deputy Chairperson [Mr Flanagan] in the Chair)

Finally, we have talked generally about the cost to consumers and to industry. I mentioned the threat from inward investment, the data centres and so forth. However, this affects every single user of energy in business in Northern Ireland. If you are a baker in Newry baking bread who is at a significant competitive disadvantage to the man in Dundalk baking bread, you do not need to be a rocket scientist to figure that out. We have lots of indigenously owned businesses in Northern Ireland that are high in the small and medium-sized enterprise (SME) scale. They are companies that employ a couple of hundred people, which have plants and operations in GB and Europe where their own energy costs are lower. Therefore, we are not an island in this. Indigenous businesses have the opportunity to transfer production to GB and Europe and, if the see-saw tips much further, it will not just be about inward investment but about the businesses that are already here.

The Deputy Chairperson: Gentlemen, you are very welcome. Patsy has had to nip out to engage with some of his constituents. He will be back in 10 minutes or so. Can I just clarify who you are speaking for? You are here representing the CBI, and, obviously, you represent a large range of businesses of all shapes and sizes, but you also represent some of the generators. Are you here, solely representing the wider membership base?

Mr Smyth: Not at all. We have an extremely wide membership, and that includes everyone from network users, generators, and suppliers, as well as consumers. Clearly, the vast majority of our members are consumers and users, but that is one of the strengths of the organisation. We consult them and come to a view, so we represent all of those members in our proposals. This response was widely consulted on and supported, as was the written submission and the road map that we will, I hope, produce over the next week to 10 days.

Mr Billington: It is probably also worth adding that the users of energy are concerned that they may not be here in a couple of years because of the price. The generators of electricity are concerned that they may not have customers in a couple of years, either on the grid or the generation side. Although we may argue sometimes about regulated returns and things like that, there is a consensus that it is better to have a framework for energy in Northern Ireland that encourages inward investment and creates a level playing field, so that we grow and overall costs are being spread over many more users, rather than the reverse.

The Deputy Chairperson: I suppose that most of those things are thrashed out in the large energy users' forum. Is that so? Is that where you mainly debate those issues?

Mr Smyth: There are various forums. We have a specific forum that involves not just large users but small users. There are some relatively small companies that are energy intensive users, particularly in the plastics sector. Likewise, there are other large companies which are quite low energy users. There are other groups out there too, but one of our strengths is that we have all these different organisations from different parts of the whole energy system. It is dominated by users but we feel that, because of that, we can understand what the issues are. As Declan has said, it is in everyone's interest to create a more competitive environment, attract more investment and grow the economy to create a win-win situation. It is very complex and there are significant challenges, but we believe, as we have tried to highlight, that a number of actions can be taken over time that could help to create a more competitive environment.

Mr Billington: It is also fair to say that we decide on a position after we consult with all of our membership, so that we have a consensus before we table anything.

The Deputy Chairperson: Can I suggest that the CBI considers extending an invitation to the members of the Committee to attend a forthcoming meeting of the large energy users' forum, so that they can sit in and listen to what is being said by the membership of that forum? I will leave that suggestion with you and see what you think. As for the single electricity market, is the CBI in favour of its further development? Do you think that it is working, successful and good for society?

Mr Billington: I think that the SEM in Ireland is in a better place than the energy generation market in England. There will be issues in a couple of years. One issue that we have is that we cannot access the equipment that is already in the Republic. It is in everyone's interests to use the most efficient equipment all the time, because the price, north and south of the border, will drop if we do so. The SEM has proved itself to be a good generator; the problems are with transmission and distribution and, largely, with the policy that attaches itself to the charges on transmission and distribution. There are different policies north and south of the border.

The Deputy Chairperson: Is that presenting any problems, apart from the fact that there are then disproportionate charges for businesses in the North that are trying to compete with businesses in the South? Is that the only problem, or are there other problems?

Mr Billington: Put directly, you will find that we will lose the opportunities for database server centres to the South, because its energy is cheaper when it comes through the door. You will lose those job opportunities. I have not considered the wider implications, so I cannot comment on that. I would have to go away and think about it to be honest with you. Right now, a distortion is being created, not because of the true economics but because of different policies that reign North and South.

The Deputy Chairperson: If you go away and think about it and come up with something, will you feed that back to the Committee as part of the ongoing review?

Mr Billington: Yes.

The Deputy Chairperson: You mentioned keeping the lights on and the problems with security of supply. The problem is that it has been looked at in a context of just the North and not on an all-island basis. That is coming in a couple of years. In your view, is the solution to put in additional generation capacity in the North or to get interconnection across the island up and running?

Mr Billington: To put extra generation in the North when it already exists in the Republic is simply to add an additional cost to the overall asset base, and somebody will end up paying for that. The regulator produced a report on security of supply in July this year, and it has a very good graph about the total capacity in Ireland, and, although it drops as old plants fade out, there are still more than enough. Why would we add costs that have to be recovered in the pricing when, if we put an interconnector in, we can better use the assets that are there and the price charged by the people who own those assets will drop because they are able to use them more times during the year?

The Deputy Chairperson: I presume that that was a rhetorical question.

Mr Billington: Yes.

Mr Smyth: To reinforce what Declan said earlier, there is a lot of capacity out there in companies through backup, and, if the market was working properly or we had the right incentives, we should be trying to encourage that to come into the marketplace to hit this shortage in around 2016. Strategically, the priority is to set up a North/South electricity interconnector. That has to go through a planning process, but it will need strong political support to make sure that we deliver. We understand that it will not hit the 2016 target. However, we need to go ahead and do that for the sake of efficiency in the market. The fact that we do not have that is costing consumers on the island about £30 million a year, which will only increase because of the constraints caused by wind. As wind continues to increase, the costs of those constraints will get higher, and, ultimately, all consumers, both domestic and businesses, will pay for that.

The Deputy Chairperson: There is strong political support for the interconnector. There are differences in how some parties think it should be constructed but, hopefully, that will be resolved in the time ahead. Is continuing resistance to further all-island cooperation in the energy field and in energy policy causing a problem?

Mr Billington: We are no longer looking at an all-island market. Europe is driving us to a regional market, and that means more interconnection to the mainland and also to France and places like that. It is not on our radar to consider any issue apart from a regional market. France has nuclear power, and nuclear power is on 24/7. We do not need to have it in our backyard to take advantage of the fact that it is very cheap energy; we just have to have access to it. It is amazing how much of Europe is run at night from France. At the moment, in theory, when France supplies electricity, it has to go all the way up to Scotland before we could get access to it, whereas a straight interconnector from the South of Ireland to France would enable access to cheap energy. The regional market provides the next opportunity, and we are looking that, but, right now, I am worried about the next two to three years.

The Deputy Chairperson: There is some talk about DETI trying to move the North closer to the system that exists in Britain and away from the system in the South. In Britain, they are looking to move closer to the system in the South. Do you have any information on what that is about?

Mr Billington: I do not. We need the Moyle interconnector, because it gives us access to cheaper generation costs than England and, even if the prices go up there, there will come a point when we will be able to sell them wind. So, with the second interconnector, security of supply gives us an opportunity, and the more wind we sell, the more it will reduce our costs in Northern Ireland, because the money paid for using the interconnector comes back to reduce our transmission and distribution costs. To answer your question, I am not aware of the specific issue you raised, but I know that, under European regulations, the United Kingdom, the Republic of Ireland, France and places like that are looking at a common market for energy where everyone has to live by the same rules.

Mr Smyth: My understanding is that the regulator that is driving a lot of that. There are various ongoing consultative groups. I was surprised by your comment; that is not what I would have perceived. Ultimately, this is about integrating more with bigger markets. At the same time, we need to ensure that those constraint costs or imperfection charges are minimised. We need a strategy to reduce those costs. It is in our interest to have access to as large a market as possible.

The Deputy Chairperson: Gas to the west was described as a win-win solution for everybody. However, the fact that gas to the west will further increase electricity costs for everybody is not a win-win for everybody.

Mr Billington: Sorry; in what sense?

The Deputy Chairperson: The extension of the gas pipeline will increase transmission and distribution costs, thereby putting up everybody's electricity prices because it will cost gas generators more to produce electricity.

Mr Billington: First, gas going into the west will displace heavy fuel oil and domestic heating oil. Anyone on the pipe network in the domestic sector will find a saving of, I think, around £700 a year if they are able to access gas. Businesses will no longer use heavy fuel oil to heat water to wash down their facilities. They will use gas, which is much more efficient. Our carbon footprint will also drop dramatically, and that is a plus.

The risk is that, if you continue to load cost onto transmission and distribution, you will encourage businesses to use gas to generate electricity, and then they come off grid. However, a business with a 5 MW generator cannot match a power station for efficiency of generation. So you have distortions created by policy that drive decisions rather than real economics driving decisions. No one would be investing in self-generation if it were not for the 20% premium that they have to pay versus the South for accessing the same electricity generated on the island.

Mr Smyth: We are conscious that we cannot extend the gas network everywhere because there are additional costs. Our understanding is that the Executive may set aside an amount of money but, at this stage, I do not know whether we can answer that question because it will be put out to tender. It is clear to us that there are areas, particularly in the mid-Ulster region, where that could be done at a modest cost and there is a significant load. It becomes more questionable as you go out into the very rural west. At this stage, we cannot answer that, but we would be sensitive to the need to be careful that we do not place an additional burden on all gas consumers — or, at least, not an overly significant burden.

The Deputy Chairperson: One phrase that you used about electricity generation was "expensive renewables". Are you talking about the cost of generating electricity from renewable sources or the price that renewable generators are paid?

Mr Billington: I am talking about the subsidy that they get to deliver a megawatt of renewable electricity. Indirectly, one would argue that it is expensive because it takes that size of a subsidy to make it happen, but the bottom line is that, if you have a choice of renewable sources and some require a £4 per megawatt incentive and some require £16, it is sensible for all users of energy that we encourage the £4 per megawatt solution.

The Deputy Chairperson: Is the big problem coming from the ROCs and the subsidies or from the fact that some renewable generators are bidding into the single electricity market at zero cost and getting paid the highest price in the market at that time? Is there a need for further regulation of how generators are paid for generating?

Mr Billington: I will try to answer the question in two parts. First, the expense of renewables is generated by the fact that it is sub-scale and not efficient. I am referring to the size of the ROCs needed to be paid to incentivise them. As for wind generators bidding in at nil, when the wind blows you are better getting as much electricity off the grid as possible. If they bid 100 MW more because the wind is blowing, that avoids an expensive 100 MW plant being switched on. So, yes; they get a premium because, effectively, they generate for free once they have made their capital investment. However, everyone benefits because you displace the oil distillate that was going to be burned to meet demand, which is very expensive and sets the price.

The structure of the all-island market is supply and demand. People bid in at different prices, and then you find out which kit you have to call on to meet demand. You strike a balance and set a price at that point. That incentivises people to invest in more efficient equipment so that you are always being called. Therefore, the incentive, long term, drives down price because you will make more money if you have more efficient equipment because you will be called on instead of someone else. The long-term structure of the market was always designed to drive the overall average cost down, because inefficient guys were never called. The efficient guys were always trying to chase that price premium, and it would drop. There is no issue with what is going on with wind. We have to watch that we do not need a huge amount of standby for when the wind does not blow, but we want to get as much wind used as often as possible because it lowers the average price for that half hour.

The Deputy Chairperson: We received a letter today from someone from whom we had heard previously, but I cannot talk to you about it because it is confidential. However, in part of the letter, the person talks about how their retail business is regulated and has a fixed profit margin. The person gives percentages and goes on to talk about the profits made from generation but does not talk about the percentage profit that their business has made. Even though the person disputes the figures that we outlined, they have not put figures on the table for us. Is there a need to set a fixed profit margin for electricity generators so that when they bid into the market, that is the price at which they are allowed to bid — their costs plus X% — to make it worthwhile for them but fair for consumers?

Mr Billington: Twenty or 30 years ago, Margaret Thatcher decided to offer what were called "golden contracts" to the electricity market when it was privatised. That meant that they were guaranteed a certain price for what they did. They then engineered a lot of inefficiencies out of the process and

made a great deal of money. That is because they had been given a fixed price, and there was never an ability to claw back the innovations that reduced their cost.

We have to be careful that, if we set a regulated price, it does not incentivise anyone to be more efficient. Why would they if they get a fixed price? However, if you are more efficient, you will have a bigger margin, so you can chase out the other guys, and then the price will come down. In Ireland, market forces have been very effective in driving down generation costs, and its model was copied from the Nordic countries, which were effective at driving down generation costs.

I am always worried that over-regulation and price controls end up disincentivising the behaviour that will drive down price. It is a challenging area to regulate in that way. The market is considered to be working a lot better on the island of Ireland than it is in England. There will shortly be a crisis in England because it does not have enough capacity.

The Deputy Chairperson: Did the recent dispute between Phoenix Gas and the Utility Regulator, which led the Competition Commission to determine that some of the savings should be passed back to consumers, not set a precedent, not similar to what Maggie Thatcher did but more in favour of consumers?

Mr Billington: I was a correspondent to that and have my own views on the matter. The Competition Commission decided that it was better to allow Phoenix Gas to have what it wanted. It did so because of this concern: if, in Northern Ireland, contracts and agreements were made and subsequently challenged, why would anyone want to invest in a country where they thought that they understood what the returns of their investment would be, but then, suddenly, the rug was pulled from under them?

I am speaking on behalf of the CBI, and the situation there is that there have been some recent issues with the Utility Regulator and the regulatory function that exists in Northern Ireland. There is, in principle, a good function there. The Phoenix issue has now expanded more and more because unless any bond holder who wants to lend money to utility companies in Northern Ireland feels sure that this is a safe place to lend money, they will demand higher premiums, and the price will go up.

So we need to strike a balance. Normally, the regulation is that, after five years, the regulator can take it back. You cannot argue with that; it is a good method. The issue with Phoenix Gas was that there was a rescue package many years ago, and the argument was whether, contractually, it was entitled to recover certain costs for the life of the package or for a five-year or 10-year period. The Competition Commission took the decision that it took.

The Deputy Chairperson: The decision that the Competition Commission took was still more favourable for consumers than that which Phoenix Gas had wanted at the outset.

Mr Billington: That is correct. There was some benefit to consumers of the referral to the Competition Commission. I am not quite sure what the question is. The issue —

The Deputy Chairperson: Neither am I.

Mr Billington: The issue in question in the Phoenix Gas dispute is that there was a dispute between a regulated body and the regulator. That went to the Competition Commission, which took a decision for the greater majority of people in Northern Ireland, and we accept that. The challenge is to try to avoid creating uncertainty for bond holders who lend to these companies so that we can borrow cheap money that works its way through to cheap energy costs. So we need to have a good constructive working relationship between the Utility Regulator and the industry. However, at the same time, we need to make sure that the industry is always challenged to drive down costs.

The Deputy Chairperson: It would not do for somebody who took a gamble to make a loss on their investment the odd time.

Mr Billington: Currently, a price determination is based on a planned cost. If there are some benefits for those five years, they flow to the company and have to be passed on to users. So companies are incentivised to do better all the time. The flip side of that is that, if they run into a problem, they have to consume that problem themselves until the next price regulation.

Mr Smyth: Some relatively new generators on the island of Ireland, which were built within the past 10 years, have been overtaken by other generators. They have gone down the pecking order. So there are significant risks. You are looking at hundreds of millions of pounds of investment on the back of that.

My only comment is really to reinforce Declan's point. We believe that the market has been working and that the regulator has a key role to monitor that. We have suggested that we are unique. We have a capacity charge on the island of Ireland. We need to be careful and conscious of what that does and ensure that we do not encourage inappropriate or additional capacity that would over-reward the generators. I think that that is on the regulator's agenda, and he is monitoring that.

The Deputy Chairperson: I want to clarify something. In answer to Alban's question about whether you wanted the cost that large users pay passed on to smaller business users and domestic customers, you said that you wanted the regulator and DETI to do a bit of work on that.

Mr Billington: You pre-suppose that we want the cost to be passed on to the domestic sector. We want to understand why the situation in Northern Ireland and England differs from that in the rest of Europe. We also need to understand the consequences of adopting any other model. It does not go beyond that. I think —

The Deputy Chairperson: Are you comparing that just with what happens in the South?

Mr Billington: The benchmarking paper produced by the regulator before the summer shows that, across Europe, we are the second most expensive for large users, but our domestic sector is one of the cheapest. If you have the same generation market, how can you have a situation in which large users find it very expensive to be here, yet it is the best place in Europe for domestic users to buy electricity? Something does not make sense, and it needs to be understood.

The Deputy Chairperson: Was our domestic price not somewhere in the middle?

Mr Billington: From memory, it could be middle or lower-middle, but it is significantly different. Also from memory, it is also cheaper than in England.

In answer to your question, I said that most of the costs that we experience versus the Republic, our nearest benchmark, are policy driven. It is for policymakers to decide the right balance of policies: incentivising businesses to come here and grow, whereby everyone benefits; and delivering policies for society, such as renewable energy and looking after those who are less well off. You cannot be as effective as you want to be unless someone gives you the facts on which you can make decisions. How much would a reallocation of costs mean to businesses? Would it be a significant benefit, or would it not be at the races? How much would it mean for the domestic sector? Are there other ways to solve the problem so that we do not have to try to deal with the toughest question because solving all the other ones delivered the outcome that we wanted? Let us get the facts on the table, do the work and gain an understanding of why everyone else does it differently. Let us try to understand whether it will make a significant difference or is not even worth talking about.

The Deputy Chairperson: Manufacturing NI provided us with a transcript of a debate in the Oireachtas, in which the Minister for the Environment said that the Government wanted to change how businesses were charged. They wanted to make domestic customers pay more of the cost in order to subsidise businesses. That is against the regulations set out by Europe.

Mr Billington: Agreed.

The Deputy Chairperson: I presume that you are not advocating that we do that.

Mr Billington: No. It is for policymakers in the Republic to answer to Europe if it believes that they are not following European policy, which is that charges should be cost-reflective. So we do not advocate anything like that. We are saying that the Irish Government decided that creating jobs was so important that they were prepared to pass a burden on to consumers. They struck a balance that every politician has to strike. All we are saying is that when you take decisions about how much renewable energy to put on to businesses and how much the tariffs should be, the first thing is to establish the cost-reflective charges. Maybe the charges that we have in Northern Ireland are right. If they are not right, we should establish whether there is anything that we should do about it or whether

there is no appetite to do anything about it. I keep coming back to the same thing: let us get the facts on the table quickly and make a judgement. However, the policymakers are the ones who will make the judgement.

(The Chairperson [Mr McGlone] in the Chair)

Mr Dunne: I think that most issues have been covered. You have given us a very informative briefing on self-generation and opened our eyes to a lot of the issues. Are you saying that gas will be used as a means to generate electricity?

Mr Billington: Some 15 or 16 years ago, heavy fuel oil was used in generators to generate electricity between 4.00 pm and 7.00 pm, and it paid people to use heavy fuel oil between those hours to avoid the high energy costs. Going forward, gas is a much cheaper source of fuel, so there is always a magic balancing point at which businesses will ask themselves this question: "If I look at the five-year plan for my energy costs supplying from the grid, what would it cost, and what would be the benefits if I had gas to do that?" Gas generators will never match a gas power station, but, if you add a lot of transmission and distribution costs, they would do it, but not 24/7; they would just target the most expensive times of day. You are more likely to use gas generation if you can use the waste heat to do something else. It is not a slam dunk. A lot of businesses would find that unless they could use the heat for something, it would not pay to generate the electricity, but as you go on and load more costs —

Mr Dunne: Is that combined heat and power (CHP)?

Mr Billington: CHP is an opportunity if you have gas and need heat 24/7. However, in answer to your question, it depends on the individual circumstances of a business. Some businesses need hot water for seven hours a day. It would not pay to have CHP for seven hours a day unless you kept loading the energy costs, in which case it might. So there is a lot going on. I am simply saying that a cost will reduce for people in Tyrone and the west, which may create opportunities for them to do something that they could not previously afford to do. It will not be a matter of everyone rushing to self-generate; some businesses that could not do it before will be able to do it now. The higher you raise the bar — the bar being the transmission and distribution costs — the more of them can make that switch.

Mr Dunne: It is not the case that, in the main, in the greater Belfast area, large businesses and commercial users have switched to gas where it is available?

Mr Billington: I am aware of three large generators. All three, and my organisation is one of them, have CHP, but it works only because all three need the heat. The Royal Group of Hospitals has CHP, but it needs to heat wards for patients 24/7, so you can see how it works there.

Mr Dunne: Generally, however, they have switched.

Mr Billington: Businesses will switch from heavy fuel oil, but no one will generate electricity for the sake of it unless the tariffs are very good.

Mr Dunne: I mean just for general use.

Mr Smyth: For general heating, there has been a good take-up.

Mr Dunne: That is to be welcomed.

Mr Billington: Yes, hugely so.

Mr Dunne: Gas has had an impact, especially in the greater Belfast area.

Mr Billington: From memory, 50% of the population of the greater Belfast area are on gas, each saving hundreds of pounds a year. With something like gas, you want to encourage as many people to move to it as quickly as possible. It solves fuel poverty, reduces the carbon footprint and you spread the capital expenditure on pipes over many more people.

Mr Smyth: The more people on gas, the more the cost is reduced.

Mr Walsh: The point is that people are switching for process heating — in a hospital environment or an industrial operation that requires heat for its process. Only a few of the many food businesses have crossed the line to generate because, as Declan said, it pays to self-generate only if you also utilise heat.

Mr Dunne: The Committee has been talking about trying to encourage uptake, especially in the domestic market in the greater Belfast area. Where the system exists, it is important that people use the opportunity. We are trying to get the Department for Social Development (DSD) and DETI to introduce incentives, which is difficult because of competition and so on, but we have been trying. Thanks very much.

Mr Walsh: You are welcome.

The Chairperson: I am conscious that we have another submission to come and that another Committee needs the room at 2.00 pm. So I ask members and witnesses to be succinct in their questions and answers. Thank you.

Mr Agnew: I will try to be brief. Thank you very much for your presentation. As Mr Walsh said at the start of the meeting, this is a complex area. Every time we get a presentation, I learn a bit more.

I am interested in the term "real economics", which you mentioned a couple of times. I think that I am right in saying — correct me if I am wrong — that you have been referring to policy interventions. I assume that you mean free-market economics. There is a sense that policy is shifting things away from where they should really be. Is that what you are getting at?

Mr Billington: I am saying that when you try to understand the burden of cost, there are two elements: the cost of generation and the cost of distribution. That is the first set of costs. I refer to those as the base, or real costs, of electricity. Then, there are policy costs, which are there because there is a belief that these are the right things to do. Renewables, for example, are the right thing to do, so how do we manage to encourage renewables? So there is a policy for ROCs and so on. We are saying that when you start to add up the policy costs incurred in achieving an objective, you find that you need to be careful that they do not start to frustrate one of your other objectives. We want inward investment, for example, but we are too expensive: our policy costs on renewables are such that people who need a lot of electricity would not want to come here. So I am not arguing for free marketeering or anything; I am saying that a significant proportion of the difference between us and the Republic is the policy on renewables. In the rest of Europe, there is an issue with apportionment, which would, probably, boil down to a policy issue. First, understand the real cost, and, secondly, understand the policy. All we are saying is that policymakers, therefore, control some of the key levers that could add a reduced cost to the energy market in Northern Ireland.

Mr Agnew: It works both ways. Another policy driver has been to extend gas to the west. With that comes a £30 million-plus subsidy. So it is not always the case that policy adds cost.

Mr Billington: Agreed.

Mr Agnew: You talked about expensive renewable sources — again, it comes down to this question of policy — and you referred to a lot of the small-scale renewables. I argue that there is democratisation of energy production there. That is policy, too, but I see it is as positive. There is also tidal energy, which is, of course, large-scale generation. I think that the current proposals are to bring 200 megawatts on to the grid off the north coast. If you will pardon the pun, that is only a drop in the ocean of what we could generate. Tidal energy is considerably expensive. I cannot remember exactly, but I think that it is up around the 4 or 5 ROC level. Is there not a danger that, if we put all of our eggs in the less-expensive-renewables basket, we risk not only the diversity of supply; we risk not driving the innovation that we need in renewables. Indeed, once upon a time, the capital costs of wind energy were prohibitive, and, again, policy drivers were required.

Mr Billington: To be brief, the short answer is yes. My point is that policymakers need to take a view on whether, in the long term, small generating plants will be effective. You are quite right in saying that, initially, wind energy was expensive. Technologies advanced, and it became less expensive. That is reflected in ROCs.

You mentioned tidal energy. I am not wedded to any form of renewable energy; I am wedded only to the concept that, over the short and medium distance, we have a good, cost-effective mix. So, if policy believes that tidal energy is expensive now but will come into its own in the way that wind energy did, that is fine — that is an investment. However, if we are encouraging such things as microgeneration, where there is no possibility for it to become cost effective at any point and it is costing 4 ROCs, policy seems to be spending quite a bit to achieve a certain outcome. We need to make sure that near market does not require a large subsidy. Innovation may require a large subsidy initially, but if, as the technology advances, we believe that it is worth supporting, we should do so. We have always to bear in mind that we are deciding a certain burden on businesses today, and we have to strike a balance.

Mr Agnew: Is that where you would draw the line? For you, is it not so much the distinction between expensive and cheap but what represents positive investment?

Mr Billington: I would draw the line by ensuring that we do not spend more than we need to in order to encourage the renewables that we want. We must not spend so much more up front that the businesses paying for it today will not be here tomorrow to benefit from it.

Mr Agnew: A brief question has occurred to me. We talked about getting gas to the west, and you stressed the importance of that. We discussed the importance of the Moyle interconnector. Is there any reason why we could not, or should not, put public subsidy into that infrastructure? Obviously, any investment in infrastructure tends to be passed on to the consumers. With getting gas to the west, we have reduced the cost with a subsidy. Is there any reason why we should not do something similar with the Moyle or North/South interconnectors?

Mr Smyth: When the Moyle interconnector was created, and I stand to be corrected, European structural funds were available for it. That may have added something. I cannot answer the question about where it stands at present. There have been problems with it — quite expensive problems involved in creating them. So I do not know what may or may not be available on the back of that. I would be surprised if any European funding could be used.

Mr Billington: I think that the principle is that we need to go back to where it was: 500 megawatts. I have not thought about the mechanism, and, therefore, to be honest with you, I cannot express a view on it.

Mr Walsh: May I answer your question in another way? Declan very articulately described how there is an all-Ireland market and the chance to move to a larger market. If we leave ourselves restricted from being able to trade in the market, we are in exactly the same circumstance as any other economy that wants to become introverted. The attitude is, "We will just look after ourselves, and we can neither buy nor sell, whether it be food, goods, services or electricity." Every time you create a barrier around your market, you limit your ability. On the days when we have lots of wind, we cannot sell it; on the days when we need what they have, we cannot get it. So our costs can go only one way.

Mr Agnew: For clarity, let me say that I absolutely support greater interconnection. How we achieve that definitely needs consideration.

Mr Billington: I think that the answer is that, if there appears to be a barrier to a quick resolution, and that barrier is money, subsidy should be considered. However, if the barrier is not money, we should just get this sorted as quickly as possible.

Mr Anderson: I will be brief. I thank the gentlemen for their presentation.

I want to go back to the domestic market and the charging of businesspeople. Declan, you said that you simply wanted to have a debate on that. I would like to get a feel for that.

Mr Billington: Actually, I want the facts. The facts have to be debated because it may be that there is not a great deal of value to be achieved. We have two scenarios: fewer businesses buy our energy because they are not here or create their own, and that is a disaster for everyone; or more businesses come here and buy energy, in which case the cost drops for everyone. We need to understand whether we have struck the right balance, as required by Europe, and, if not, what the consequences are. Then you can have the debate.

Mr Anderson: I think that you said that our electricity was 25% more expensive than that in the Republic.

Mr Billington: We are more expensive by about £13 per megawatt, of which about £5, by our analysis, is to do with a different apportionment model.

Mr Anderson: That is what I am trying to get at. If this particular renewable levy, which is £6, were taken out, how would the price then compare with that in the Republic?

Mr Billington: There is a gap of £13 between our price and that in the Republic. Remove that £6, and you have a gap of £7. Of that £7, roughly £1·50 is PSO. You must question whether business should be paying for a subsidy from which only the domestic sector benefits. The final and most difficult decision is whether we want to address the remaining £5. If we do, we might encourage more businesses and spread the cost; if we do not, we may lose businesses and jobs. How much of the £5 could be saved: is it 50p or £5? Really, someone should do the analysis and tell us before we get too excited about it.

Mr Anderson: So it is the analysis that you want.

What is that as a percentage of a business's overall bill?

Mr Billington: Of the what?

Mr Anderson: Of the extra cost.

Mr Walsh: On energy?

Mr Anderson: Yes.

Mr Smyth: It varies greatly from sector to sector.

Mr Anderson: Do we not have any idea?

Mr Smyth: Typically, in a commercial office or building, energy, or electricity, accounts for around 0·3% of costs. In manufacturing, it starts at anything between 1% and 5% and rises to probably between 15% and 20% for energy-intensive companies, and there are relatively few of those. That is as a percentage of turnover. For a company making a 5% or 8% margin, all of a sudden, this is a very significant proportion. Ultimately, these companies compete on the basket of costs, and energy is a significant part of that cost in manufacturing.

Mr Billington: I will just add that the companies for which energy is a much greater proportion of cost than Nigel outlined are those that are not here today for precisely that reason.

Mr Walsh: Another way to look at it is that there is a spectrum of businesses. There are some whose energy costs are quite low because of the nature of their activity, so their sensitivity to energy costs is not very material. Even if energy costs were increased, those guys would not move. For jobs in serviced offices and such, electricity is a tiny component. At the other end of the spectrum is, for example, intensive food processing that involves a lot of heat. Dairies, for example, which may operate to low margins in a very competitive market may be low margin and very competitive, are right at the other end of the spectrum, and a very little bit can pop those guys off the edge. In fact, I contend that the recessionary environment over the past couple of years has restrained some of those companies in making the decision to shift production. They have not been able to finance a move to somewhere where they would be more economically viable. As the economy continues to improve, we will see some of those guys start to walk.

Mr Anderson: We could have this debate all day. You are quite right, Declan, that a lot of issues have to be taken in the round to see whether what people are suggesting would be viable or otherwise. I know that we are pushed for time, so I will leave it at that.

The Chairperson: Gentlemen, thank you very much indeed. That has proven a very useful session. I apologise that I had to leave for a while to attend to some other business. Thank you for giving up

your time. I found the session very useful and helpful. Inevitably, we will revisit many of the issues in more detail, and I hope that there will be some product at the end of the process, which is the important bit. I look forward to seeing you again, perhaps in a different guise or in different circumstances.