Northern Ireland Assembly

Committee for Enterprise, Trade and Investment

OFFICIAL REPORT (Hansard)

Electricity Policy Review: DETI Briefing

10 October 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 Sammy Douglas
Mr Gordon Dunne
Mr Paul Frew
Mr Fearghal McKinney

Witnesses:

Ms Alison Clydesdale	Department of Enterprise, Trade and Investment
Mr Fred Frazer	Department of Enterprise, Trade and Investment
Ms Fiona Hepper	Department of Enterprise, Trade and Investment
Mr David Sterling	Department of Enterprise, Trade and Investment
Mr Bill Stevenson	Department of Enterprise, Trade and Investment

The Chairperson: With us today are the permanent secretary, Mr David Sterling; Ms Fiona Hepper, head of energy division; Alison Clydesdale, principal in renewable electricity policy and legislation; Bill Stevenson, principal in energy markets external; and Fred Frazer, principal in energy markets domestic. You are all very welcome. Thank you for attending today. Do you want to make an opening statement first, or would you prefer to go straight in?

Mr David Sterling (Department of Enterprise, Trade and Investment): I will say a few words, and Fiona will follow up. Would you like to put a limit on the length of time that we speak for?

The Chairperson: Yes. I think that you should have been advised that your contribution is restricted to 10 minutes. We have all new sorts of efficiencies brought in here, too.

Mr Sterling: Is it 10 minutes for the two of us?

The Chairperson: Yes, and then members will contribute. They are restricted to a total of five minutes each. We can take it from there.

Mr Sterling: Will you give us a two-minute warning?

The Chairperson: I am giving you a warning, anyway. I hope that questions will be succinct. Responses should be succinct and precise.

Mr Sterling: I will be brief. I am here simply to reflect the fact that electricity policy is a very high priority for the Minister and the Department. Energy in general is probably the most challenging policy area that we have. There are all sorts of complex technical and regulatory issues. The Minister has responsibility for policy, but she has very few levers. Almost all the delivery is outside her hands. The role of the regulator is pivotal in all that. As you know, regulators, by law, have a high degree of independence, but we seek to influence regulation so that it reflects the policy goals of the Executive. Much of the industry is privatised and operates in markets over which Governments have little influence. Indeed, European policy is very much to free markets from regulation and, in doing so, drive competition.

The starting point for us is the strategic energy framework (SEF). In simple terms, that was the Executive setting out a strategy with four main things: competitive markets and the desire to keep tariffs low, now and in the future; security of supply and making sure that we keep the lights on; sustainability, protecting the environment, reducing carbon and increasing our energy mix; and making sure that we have a robust energy infrastructure for investment now and future generations. Achieving all those aims requires a very careful balance. We found — I am sure that you have found this also — that, if you do something in one area, it can have consequences, often unintended or negative, in others. I liken it very much to the fairground game where you whack the frog, and, all of a sudden, a frog jumps up in another place. We have five frog bashers here this morning. We saw that with the carbon price floor; a policy that was developed in Whitehall had unintended consequences for us. Thankfully, we were able to resolve that.

We very much welcome the role of the Committee and the advice that you are going to give us, because it is a complex area. We look forward to hearing your advice. The Minister is seeking to balance a range of competing priorities, but the strongest priority at the moment is the impact of tariffs on large energy users. We have particular concerns about that because of the impact that it can have on our manufacturing companies and jobs in particular. We want to try to resolve that but, in so doing, not to mitigate the impact on large energy users in a way that impacts on other users.

Ms Fiona Hepper (Department of Enterprise, Trade and Investment): David mentioned the paper that we sent through. Hopefully, you have all had a chance to look through that. It covers the main elements of energy policy and the overarching domestic, national and European legislative framework that impacts on the Northern Ireland market. David also mentioned the SEF, so I will not go into any detail on that, other than to say that it was set as a 10-year strategy. The SEF is trying to balance the many social, economic and environmental issues and the costs and associated risks. In approving that, the Executive and stakeholders were very aware that there are tensions, not least between the initial cost implications for all consumers of moving to an energy mix with a greater proportion of renewables and the challenge presented by social policy issues such as fuel poverty. However, in producing the SEF, it was absolutely clear that inactivity was the biggest risk of all and that putting off difficult decisions would only add more cost to consumers in the long run. As David mentioned, we are very much focused on the consumers of today but also have an eye on consumers in the future.

As I said, it is a 10-year strategy. It was set as such to give certainty to investors, particularly around the renewables agenda but also in relation to longer-term planning of infrastructure. That said, we always made it clear that there will be a mid-term review of the SEF to check on progress and delivery of the main objectives, in particular, and costs. I will say a little bit more about that in a minute.

The paper before you lays out the main pieces of legislation and the recent directives that we have had to transpose. It also says something about the cost of current and future renewable support. You are aware that, currently, support comes through the Northern Ireland renewables obligation (NIRO). However, since the SEF was published, there have been a number of important developments, including considerable progress in the overall level of renewable generation, which has increased from under 8% pre-SEF to 15% today; the Crown Estate's work on the leasing round and the development rights for up to 800 MW of offshore; and, under electricity market reform (EMR), the decision to close the NIRO to new applicants in 2017 and introduce a feed-in tariff (FIT).

Those of you who have been on the Committee for a while now will have heard a number of briefings from us on EMR. However, to refresh memories, I will say that it is a UK-wide reform with three policy objectives: to ensure security of supply; to drive long-term decarbonisation of electricity generation; and to minimise the cost to the consumer. At the core of EMR is the incentivisation regime in the form of the feed-in tariffs with contracts for difference (CFDs). That provides more efficient long-term support for all forms of low-carbon generation.

The purpose of the FIT is to give greater certainty and stability of revenues to the developers but also to protect consumers from paying for support when electricity prices are high. It consequently makes the development of low-carbon generation cheaper for both investors and consumers. It is suitable for all forms of low-carbon generation. The FIT CFDs will be available across the UK. You will, hopefully, recall that Northern Ireland is retaining the powers to set our own strike price and our own level of support. We can talk about that in questioning if you wish.

It is estimated that, as a result of the reforms, from 2016 to 2030, household electricity bills will be, on average, approximately 9% lower than they would be if we decarbonised under the existing policy instruments. Of course, the very significant benefit to Northern Ireland consumers is that the cost of the new incentives will be socialised across the whole of the UK rather than just spread across Northern Ireland consumers.

The Committee Clerk specifically asked that I mention the onshore and offshore plans. In short, those are the outworkings of the SEF and the 40% target. They do not, in themselves, introduce any additional costs or have implications for security of supply. They are brought forward as a result of implementation of the strategic environmental assessment (SEA) directive, which mandates that strategic environmental assessments have to be carried out on major plans. The focus is on the impact on the environment. Critically, it does not require that a socio-economic analysis is undertaken.

This is probably a good point at which to quickly mention the new piece of work that I trailed earlier. We have developed a set of terms of reference for a comprehensive analysis of the costs and benefits of renewables in a Northern Ireland context. That will update the work undertaken to shape the SEF. It will provide updated and essential information on the impact of the 40% renewable target, which will then feed into the mid-term review of the SEF. Our intention is that it will look at incremental costs of meeting the 40% target; that is, how much it has cost to get from 8% pre-SEF to 15% today, and what it will cost to get to 20% by 2015 and then to 25%, 30% and 40%. We will look separately at the cost of small and large scale renewables. We will also look at the cost impacts on small and large commercial consumers and domestics and the impact on the grid. It is a substantial piece of work that I am sure that you will be interested in. It is important to ensure that we get to that 40% target at best value.

Other work that is under way includes the piece of work that the Northern Ireland Authority for Utility Regulation (NIAUR) is undertaking. There are also a couple of investigations being undertaken by Brussels that will be of interest.

A progress paper on the NIAUR work is pending. While we have been waiting for that, the Department has had a look at the public service obligation (PSO) charges. The Confederation of British Industry (CBI) has been very keen for the whole of the PSO charge to be moved on to domestic consumers. We have had a look at the impact of that; that is shown at annex B of the paper. This is entirely theoretical. No decisions have been made on this. So, theoretically, what would it mean to domestics if that were the case? Annex B of your paper shows the PSO set at £22 million. That was the most up-to-date figure that we had when we did the analysis. In the most recent figures, the PSO reduced to £14·3 million. However, even if you remove that amount from the industrial and commercial customers (I&Cs) and spread it across the domestics only, that will result in nearly a 2% rise in electricity bills for domestic consumers.

The Department is aware that a number of member states have implemented measures that are now attracting the attention of the Commission, which is keen to ensure that such measures do not distort competition across member states. The key measure that you may be aware of is the exemption in Germany of large industrial and commercial customers from network charges. That exemption, which was estimated to amount to approximately €300 million in 2012, is financed by other electricity consumers who pay a special levy on top of their tariff. The Commission has opened an in-depth investigation to consider if that is a state aid and whether it is anti-competitive.

The other piece of work that it is looking at, which will hopefully be ready by the end of this calendar year, is an analysis of the composition and drivers of energy prices and costs in member states. It will have a particular focus on households, small and medium-sized enterprises (SMEs) and energy-intensive industries.

I will briefly mention demand-side management, particularly the aggregated generator units (AGUs) and demand-side units (DSUs), which you will have heard of in previous briefing sessions. I will make the position clear. The Department is very supportive of maximising the use of aggregation and demand-side measures in the electricity market. We are currently working with the regulator to see what the best way to do that is. A legislative change is possibly required. However, as that takes time, we are very keen that the regulator looks at alternative measures short of that to get those in place even as an interim measure. I am happy to talk a bit more about that.

As David mentioned, as part of our oversight of energy matters in general, in the last two years or so, we have had notable success in intervening to avoid additional costs for consumers, not least in making the case to Treasury for Northern Ireland to be exempt from the carbon price floor — and, in doing so, keeping the £20 million to £40 million additional cost off consumers' bills — and in overturning the Irish carbon levy, which would also have impacted on Northern Ireland consumers by raising prices by about 3%.

If I have a minute, I will mention security of supply because I know that that is the other wing of your investigation. We are working very closely with the regulator and the Systems Operator for Northern Ireland (SONI) on that. SONI's most recent security of supply and generation capacity statement highlighted some tightness in capacity from the end of 2015 and more after 2021. However, the issue is that the island as a whole will have a surplus of generation capacity for the next 10 years. The issue for Northern Ireland is access to that capacity, which immediately brings into play the importance of the North/South interconnector. If that were in place, the problem would dissipate significantly. The current time frame for the building of the interconnector is around the 2017 mark at the earliest.

The next issue is the Moyle interconnector, which, as you know, is currently operating at half capacity. However, a number of strands of activity are already under way in respect of both short- and longer-term fixes. We want it back to full capacity. The regulator has already published an agreement on an option to restore it to 500 MW. Mutual Energy is working on an option for two new low-voltage cables. In addition, two interim options are being pushed forward: a seabed fix of the break on the Moyle interconnector and reconfiguring the existing two cables in an engineering and bipole solution. The cost of each of those fixes is between £2 million and £4 million. If all goes well, the time frames are for the seabed fix by May 2014 and the bipole solution by the end of 2014.

The purpose of the EU industrial emissions directive (IED) is to limit power stations' emissions. That would curtail the operation of some older generation plant, particularly in respect of Ballylumford and the running hours of the coal-fired station at Kilroot. Compliance with the IED is a requirement across all of Europe. Like other regions, we have to meet the compliance date. Together with the regulator, we have explored the possibility of a derogation with the Department of the Environment (DOE) emissions regulator. No appropriate derogation is available. The Minister of the Environment has confirmed that in writing to the regulator. The Committee has had a briefing from AES Corporation, which is undertaking engineering evaluations of its affected plant and the cost of compliance. Detailed discussions are already under way with NIAUR on that, but obviously those are commercially sensitive and the Department is not party to all of the discussions.

I will finish by saying that there is no complacency on this matter, either in the Department or in NIAUR. We have a number of irons in the fire. With respect to security of supply, the Department of Enterprise, Trade and Investment (DETI) has the legislative powers to direct that new generation capacity is provided, should it be needed. We are not yet at that point. The key thing is to be aware that new investment in new generation plant would put extra cost onto bills and we would be less reliant on that additional capacity once the interconnector is in place. So, that is a decision that would not be taken lightly. Let me just say that it is something that we are aware of.

The Chairperson: Thank you very much for that. Has the Department done any sort of scoping exercise, through or with Invest NI and with its potential clients, to establish where the under-capacity of the network is inhibiting economic development?

Ms Hepper: We have not done anything detailed like that. The build-out of the grid is a matter for the regulator and NIE. However, we are aware and have had discussions with some companies about where they want to upgrade their abilities and apply for an enhanced connection with NIE. They have asked us to feed in some views on that. However, we have not done a specific piece of work on it. We know from our work with the regulator where there are some pinch points in the system, but those are looked at on a piece-by-piece basis for individual companies, whether they be Invest NI client companies or new investors on the renewables side. That is where we have a view. The build of the grid is a matter for NIE and the regulator. It involves licence conditions and the money that is available under price controls.

The Chairperson: It is, up to a point, but where that inhibits and indeed prevents economic growth and development in an area, it is surprising that you have not done a scoping exercise to establish just where those difficulties and problems are and what should be done. They prevent economic growth and jobs, particularly to the west of the Bann. Another aspect is meeting the target for renewables. I hear from the industry that the lack of capacity in the grid inhibits the ability of the renewables sector to grow and feed into the grid. So, you have it at both sides. You have to meet the targets for renewables, and that work is being held back by the under-capacity of the grid, particularly west of the Bann, where there are mountainous areas and the like. The flip side of that is that, in some towns and villages, lack of capacity in the grid inhibits economic growth. Do you not think that that would be a valuable issue for the Department and Invest NI to focus on?

Ms Hepper: My point is that the Department does not need to do that work. It is done as part of the planning that NIE does with the regulator. They look at where the grid needs to be strengthened, and we feed in on that. We are already getting that information, so we do not need to redo it. We have access to the information through NIE, and we have discussions with NIE about its plans and about bringing work forward. For example, one piece of work that we have on the stocks at the moment, using European funding under the competitiveness programme, is developing a project to bring forward investment in aspects of the grid to draw forward renewables. We have potentially upwards of £50 million of competitiveness fund money that could be matched with money from RP5 to draw forward the build of the grid and, particularly, to focus on areas where there are points of weakness, particularly for the renewables agenda.

The Chairperson: You said "potentially".

Ms Hepper: I said "potentially" because the money is there in the programme and we are working to shape the project. We are getting input from the regulator side, and its board will have a view on that. We are getting proposals from NIE on where line build would be helpful, and it is providing that to us. I say "potentially" because it all has to go through an economic appraisal and we have to make a state aid case.

The Chairperson: So, no application is in yet?

Ms Hepper: No. All the potential projects that would come under the proposal are on the stocks in NIE for RP5, and we would pull them forward to do them quicker. However, the reason I used the word "potential" is that this will be a state aid matter, and I do not want to pre-empt any decision on that. The state aid paper is pretty much drafted and should be submitted within the next month or so.

The Chairperson: I need to get it clear in my mind: is an application in for this money yet or not?

Mr Bill Stevenson (Department of Enterprise, Trade and Investment): Fiona is referring to the 2014 to 2020 ERDF programme, which is still in the development stages.

The Chairperson: It is the new raft of EU moneys.

Mr Stevenson: It is.

The Chairperson: So, do you anticipate having that ready to go into the application system in January next year?

Ms Hepper: We hope to get the state aid paper in by the end of this calendar year or early next year, and NIE has already had a number of discussions with us and the regulator about a range of potential individual projects. In due course, they will all be subject to regulatory scrutiny. So, on a strategic level, we want to get the state aid application in to say, "The money is for £50 million matched with £50 million from RP5" and to get the approval for that, and the detail of individual projects will then come forward in the period 2014 to 2020.

The Chairperson: What is the time frame for that? I am looking at businesses that, as of this moment, need extra capacity, whether they are in the renewables sector or are businesses that want to grow and need a better electricity supply.

Ms Hepper: If all goes well, that range of projects will be delivered in the 2014 to 2020 period, but NIE will do other build-out and grid reinforcements as part of its normal business, depending on what investments it gets under RP5. It will prioritise.

The Chairperson: Thanks for that. We will move on to a few other questions. When Manufacturing NI was with us, it said that the Utility Regulator estimates that renewables would add 113% to the network costs. Given the current high charges to larger industrial and commercial users resulting from renewables and transmission and distribution charges, would a review of the strategic energy framework consider a possible reduction of the 40% target for renewable energy consumption? Is it scheduled to look at that? Are you thinking about looking at that?

Mr Sterling: The work that we are about to undertake will help to inform that thinking, but, at the moment, the Minister has no plans to reduce the 40% target. It goes back to the points that I made at the start. If you reduce the 40% target, certain things will happen. It would have an impact on those who had plans to introduce renewable energy and on jobs, and so on. The other side of the argument might be that, if you decide that you want to reduce the target or take longer to get there, you could argue that that might reduce the impact on tariffs for customers. Those questions and considerations will go into the mix.

The Chairperson: I will put this to you as a preamble to a more technical question. Power NI bumped its costs up, and its reasoning for that is the fluctuations in the international gas markets and the like. Airtricity, for example, which gave us evidence, subsequently bumped its prices up by the same margin. Can you give us any sort of indication as to why that should happen? People are asking, if we hit the 40% renewables target, whether that will mean that some of the firms that are sourcing from wind will bump their charges up, just because they can. Should that mean some form of extra regulation to control firms? The only reason that I can see for the companies who take some of their energy source from the renewables sector do so is because they can. We looked at the profit margins for some of those companies, and they are quite large.

Ms Hepper: Power NI is regulated, so the regulator's office would look at that in a lot of detail. As to the profit that comes from wind, wind has a very low operating cost, mainly because of the zero marginal cost of the fuel. However, we also need to bear in mind that wind is still a relatively new form of technology. It is not as new as it was, but it is still relatively new. A lot of the equipment is new, and there is a high level of depreciation on it. High maintenance and financing costs are involved in getting these projects up and running, and that builds into the margins that companies have. If you strip all that out of some of the profit figures that you may have seen, the level of profit for those companies is around the average, perhaps a bit above.

With the single electricity market (SEM) being a pooled market and priority dispatch being given to wind and renewables, over time, when more wind comes on to the system, it is taken first. What is left is for gas, and cheaper gas will be taken first, so, as more wind comes on, it displaces more expensive gas and other fuels. That means that, over time, you get renewables, particularly wind, suppressing the system marginal price (SMP). Both SONI and the Northern Ireland Renewable Energy Industry Group (NIREIG) have told you in the past that the impact on that wholesale price of gas is a downward pressure of around 11·5%.

The other side of that — again, I am no expert on market matters, and I know that you have had experts in — is that the retail price has to include the price of the grid. While there is a downward pressure on the wholesale price caused by wind and renewables, more new grid needs to be built to take that on board. That comes into the other part of the retail price, so you start to get a bit of a balancing-out. That is why you do not get the full impact of the downward pressure on the wholesale price feeding through.

The Chairperson: You referred to wind generators, and you made a very good case there for more profits. However, those were not the profit margins that we were hearing. Granted, companies receive capacity payments and the system marginal price, which rewards generation at the cost of the highest-cost generator, and they receive renewables obligation certificates (ROCs). Invest NI has termed those receipts as being at a very generous level. When the CBI briefed us, it stated that the larger industrial and commercial users are paying around £6 per megawatt more for renewables here than their counterparts on the rest of the island. Why would that be?

Ms Hepper: The price of the renewables in the South is largely through the PSO, if I am correct. Overall, we have a figure of — Alison, what is the price that it pays?

Ms Alison Clydesdale (Department of Enterprise, Trade and Investment): The Republic of Ireland funds renewables through a renewable energy feed-in-tariff (REFIT), and other policies through its PSO, and the cost to domestic consumers there is around €42 a year. For small and large commercial users, it is around €129 a year, which is around €10 a month for a small commercial user, and it bills its large industrial consumers on a kVA basis. It bills on demand, so —

The Chairperson: Sorry, on what basis?

Ms Clydesdale: A kVA, which a measurement of electricity consumption.

The Chairperson: What does kVA stand for? Forgive my ignorance.

Ms Clydesdale: It stands for "kilovolt-amp". It is a measurement term for a unit of electricity. The point is that it is done on a demand basis, so the more that an industrial consumer uses, the more that it pays. That is consistent here in the North as well.

The Chairperson: Thank you for that. I will pick up on a few other issues, but a few other members want to come in now.

Mr Flanagan: Thanks for the presentation. You have a very strong delegation here.

The Utility Regulator informed the Committee that generator profits go up, particularly for renewables, when gas prices go up. He stated that it is about striking a balance between a reasonable, but not excessive, rate of return for investors and consumers getting a fair deal. Does the Department feel that renewable energy generators are making excessive profits?

Ms Hepper: The generators, whether they be thermal, fossil fuel or renewables, get the level of profit that the market and the market design allows them to take. Therefore, from that point of view —

Mr Flanagan: It is not a free market, Fiona.

Ms Hepper: No.

Mr Flanagan: It is an interfered-with market.

Ms Hepper: But from that point of view, the market design and how it is set up allows generators to take that level of profit. From that point of view, it is all above board.

With the move that SEM has to make to comply with the target model in GB, all those issues will be looked at in some detail by the regulators in the high-level design that they have just started working on now.

Mr Flanagan: Will you run that by me again?

Ms Hepper: Yes. As part of opening and integrating markets across Europe and better coupling with markets, a new target model of a market has to comply with a set of principles. The EU is driving that through the Agency for the Cooperation of Energy Regulators (ACER), which is the overarching body for regulators. All markets across Europe are having a look at that model and at what changes they will have to make in order to be compliant. Most markets have to be compliant by 2014. We are a small, isolated island market, so we have a derogation until 2016. In Northern Ireland and ROI, the two regulators and the two Departments are working jointly on a project to see how the SEM needs to be reconfigured to match the target model. One of the things that we and the Department of Communications, Energy and Natural Resources (DCENR) have said to the two regulators is that, in bringing forward the high-level design, we want a thorough cost-benefit analysis to be done to look at all aspects of the market, options for how it is to be redesigned and what impact that will have on consumer groups.

Mr Flanagan: Is the purpose to make the SEM operate more like the British electricity trading and transmission arrangements (BETTA) in Britain?

Ms Hepper: No. It is to make the SEM, BETTA and whatever is in France and Germany better integrated and better coupled. We all have to work to the same principles and guidelines. It is not as though SEM is turning into BETTA or BETTA is turning into SEM. There is a set of guiding principles that have to be complied with. One of the things that we looked at in that was costs, how things are operated and how we are going to achieve better coupling through the interconnectors with GB and on into Europe. Obviously, if all those interconnectors can work and trade well, there is potential for the cheaper forms of energy, like nuclear, to come across in greater quantities.

Mr Flanagan: Yeah, that is what we really need.

I will take you back to my original question, which you danced around very well, in fairness to you. You said that it is "all above board". Are companies making too much profit?

Ms Hepper: I am honestly not qualified to say. The example that I gave when I answered the Chairman's question is that I am aware from the Single Electricity Market Committee (SEMC) report that there is a figure of 79% for wind. When you distil that to the fact that turbines have high depreciation, maintenance costs and financing costs, and you strip all that out, their profit levels come down to closer to the average of what some of the thermal plants are getting. Moreover, if I recall correctly from that report, during the past few years, the levels of profits that all generators are getting over time in the SEM has been reducing. There are other generators who would say that one of the issues that they are having in BETTA is that, owing to the way in which it is balanced, there is insufficient profit, which means that generators are unable to drive the new investment that is needed with some of the older plant retiring.

The Chairperson: Phil, if I could just come in on that point, please —

Mr Flanagan: The Member will get an extra minute?

The Chairperson: Yes, indeed. Perhaps I missed it, but I do not recall you responding to the issue of regulation and the company — Airtricity in this case — raising its charges just because it could. You referred to Power NI being regulated. Does that make the case for further regulation? I think that that is the specific question that I asked.

Ms Hepper: Certainly, the part of the market that has the largest share — Power NI — is very well regulated. The other parts — Airtricity and the other smaller companies — are not regulated, and they take their lead from the others. I do not think that I can say off the top of my head whether that is a signal that you should impose regulation on all parts of the market. Actually, regulation is a proxy for competition. When you do not have enough competition in the market, you regulate. We have five or so companies in the market. Bear in mind that we are quite a small part of the market in Northern Ireland. We have five on the domestic side and eight-plus on the commercial side. That is actually quite a lot of competition in a small market.

The Chairperson: The Department is saying that free market rules regulate? I hope that is not what I am extrapolating from that.

Mr Sterling: We would look to the regulator to make a judgement on whether the market was working or not. At the moment, as Fiona said, we have five suppliers in the market, and only one of them is regulated. The hope is that, as it improves, competition should encourage downward pressure on prices. We would look to the regulator in the first instance to give his assessment on whether the market is working.

Mr Flanagan: I would not really be that concerned about greater regulation of retail electricity. I am much keener to explore the possibility of regulation at generation level. As a consumer and a political representative, I think that many generators are paid far too much. We had a report from the Utility Regulator that stated that some generators are making 79% profit. We then had a letter from SSE — Airtricity — which was highly confidential and had to be handed back. We still have not got to go through that letter in any detail. Poor old Airtricity always gets the blame because it is one of the largest customer-facing companies, but it also claims that it generates an awful lot of electricity from renewable sources. I think that it is very hard for Airtricity or a company like it to justify putting its domestic prices up because the price of wholesale gas has gone up, even though it generates a substantial amount of its electricity from wind, the price of which has not gone up. Do you find it strange that a company such as Airtricity, or any other company that generates a lot of electricity from renewable sources, uses the rising price of gas, which actually gives it more profit on its generated electricity, as a reason to put prices up for domestic consumers?

Ms Hepper: I suppose —

Mr Flanagan: A yes would do.

Ms Hepper: I do not want to get into territory in which I am not the expert. Those would be largely —

Mr Flanagan: Stay where you are and do not join politics, then.

Ms Hepper: Absolutely. I think that you are safe on that one. That is a question that the regulator and the people who know the market would be best placed to answer. The way in which the SEM works is that gas is the price-setter and wind is a price-taker. As I said before, wind does have the opportunity to put downward pressure on the wholesale price. That is one of the reasons why, in the longer term, it is good to get more renewables on to the system. That downward pressure on the price also gives us that extra security of supply in the mix. There will always have to be gas or some sort of thermal plant in the system for backup. I would be straying too far outside of my competence to give a strong yes or a strong no.

Mr Flanagan: David, do you want to give it a go?

Mr Sterling: No, David is going to tackle it from a slightly different angle. I will simply say that, if your inquiry produces evidence suggesting that people are making unreasonable profits, we would have to look at that in conjunction with the regulator.

Mr Stevenson: Fiona alluded to this in the comment that she made about the market design and the arrangements that will have to be put in place to be target model-compliant by 2016. The regulator's paper reflects that 72% of the revenues that are being picked up by the generators are picked up through the pool mechanism and a further 17% through the capacity payments mechanism. Therefore, you have almost 90% of the revenues that are attributable to the market design. It is a market design that the regulators put in place for a number of reasons when establishing the SEM at the outset, with security of supply and development of competition being among the key objectives.

Mr Flanagan: This is my final question, Chairperson.

The Chairperson: We are a bit pressed for time.

Mr Flanagan: Renewables have a downward impact on prices. If there were to be a change in, or a review of, the way in which the system works on price and the way in which capacity payments are made, and of the fact that renewable energy generators are paid for carbon prices, would that have a greater downward impact on prices that domestic and industrial consumers pay?

Ms Hepper: Capacity mechanisms are there for a purpose, which is security of supply. If they were removed out of the market, either partially or totally, the price would come down. It is a live issue at the moment across Europe. The European Commission is working on papers and finalising its view on capacity mechanisms and whether they should be allowed to operate in the new target model on a fixed-time basis or not at all.

That is something that the regulators will have to keep at the forefront of their mind when they put through the new high-level design. The Commission has not formulated a position on that yet. It may take the position to allow capacity mechanisms, but it would require a state-aid case being made in order to do so, along with an exit strategy. We will see that evolving over the next year to 18 months. I am sure that the Committee will be very interested to hear more about that.

Mr Douglas: Thank you for your presentation. I note that SSE has increased its gas and electricity prices this morning by 8·2%. That will certainly cause David Cameron some problems.

Ms Hepper: That is in GB.

Mr Flanagan: It has caused Ed Miliband more problems.

Mr Douglas: Fiona, you mentioned the review of the strategic energy framework 10-year strategy. Can you give us some more details about that review?

Ms Hepper: We will tee up the review in the early part of next year, and it will kick off formally later in 2014. We were very keen to do the initial piece of work first. Obviously, the 40% renewables target is at the core of the SEF. The whole electricity market reform is about bringing forward lower carbon generation at the best price to consumers. We are very keen because we have set a stretching target for renewables at 40%. All the stakeholders agreed, and all the information at the time was that that was entirely doable.

As time moves on, however, and there are pressures on electricity prices, and so on, we think that it is the right time to do a thorough piece of work to toss that about and look at the costs of the different types of technologies, the costs of small-scale generation versus large-scale generation, and the impacts on the various consumer groups. That does not mean that a policy decision will be made at this stage. It is about gathering good-quality, up-to-date and robust information to help frame the review. That will feed into the large-scale review of the SEF, but it will be a fundamental part of it.

Having said that we are doing this piece of work — I hope that you will agree that it is the right thing to do — reviewing energy policy too frequently or sending the wrong signals to markets is a bad thing to do. You get people stalling on investments that are perhaps needed. They want to wait and see what will happen in a year's time, because they are not sure what might happen.

We have to be very careful and walk a very narrow line. We have to collect all the information to make an impact and review the target while not upsetting the market on either the thermal side or the renewables side, preventing investors from coming forward. Obviously, the key thing about energy policy is that it is not just about energy; it is an economic, social and environmental policy. There are very important carbon savings that have to be made by the Executive and the Minister of the Environment, on which the SEF is going to deliver. The economy needs jobs and investment, and all that has to be measured.

Mr Douglas: I will go on to the renewable target that you and the Chair mentioned. Manufacturing Northern Ireland told us that that renewable target is the biggest cost driver in public policy. What are your views on that?

Ms Hepper: We always have to be careful on some of the costs and information that is put into the public domain. It is not always entirely accurate. For example, some people say that it would take £1 billion of investment in the grid over the next 10 years. Some people say that that is entirely to do with renewables, so that is what is driving costs.

When the SEF was drafted, £1 billion was the best estimate from Northern Ireland Electricity (NIE) of what investment it needed for the total upgrade, reworking and business as usual of the grid, as well as the amount that was needed for renewables. That is where you have to be careful with the £1 billion and the 113% figure, which is based on the £1 billion. Not all of that is to do with renewables.

Everybody was quite clear-sighted in signing off the SEF, but there was no doubt that bringing forward renewables and moving to decarbonising would bring initial costs. However, that had to be balanced against the cost of not doing it and the cost of leaving us as a small, isolated market that is entirely reliant on fossil fuels. There is trade-off there, and swings and roundabouts.

The incentives that are in place to bring forward renewables are kept under constant review. There are regular reviews of the ROCs at the minute, and, where technology starts to mature in the future, there will be reviews of the strike prices and the FITs. Incentives come down very quickly, and that is where you hear complaints from the renewables side about the ROCs being tinkered with. However, that is the right thing to do. It is all about balance and trying to intervene at the right time to get the right result, but without completely distorting the market.

The Chairperson: I want to pick up on something. We have to be careful, but you referred to the impact of the review of energy costs, and the likes, and the frequency. When was it most recently done?

Ms Hepper: The biggest review of energy policy was done around 2008-09, as the SEF was being prepared. That is when the overall policy was reviewed. Underneath that, we have a regular rolling period of reviews for the incentives, be they on the ROCs side of things for electricity generation or on the renewable heating side. Then, of course, the regulator is regularly reviewing through price controls and tariff reviews. Therefore, there are the overall strategic reviews at the high level and the ongoing business-as-usual reviews. If, for example, we were to say today, off the cuff, that the Minister is going to review the 40% target and that 20% might be better, it would have a very big impact on projects that are coming forward and projects that big developers have in the pipeline and are perhaps about to go into planning. There are job implications, and there are implications for our target, so it starts to become a circle. Therefore, it has to be managed in a strategic way.

The Chairperson: I appreciate that point, but I am trying to establish about the overall fundamental review. I think that that is what you were hinting at.

Ms Hepper: The overall review was in 2008-09, ahead of preparing the review.

The Chairperson: When was it prior to that?

Ms Hepper: There was a SEF 2004. It was before my time.

The Chairperson: We are talking about a frequency of four or five years.

Ms Hepper: Yes. Bear in mind the fact that, when we put the SEF in place, it was a 10-year strategy. The review would be looking at whether the direction of travel is correct, whether the fundamental underpinnings are correct and whether anything new has changed over the past three or four years. We will measure all of that together, and we will take soundings from all the stakeholders.

The Chairperson: That is grand. Thank you for that

Mr Dunne: Thank you, folks, for coming in this morning. I want to ask about network costs for large industrial and commercial users. We have had evidence from the CBI. Its representatives briefed us and said that firms here pay £5 per megawatt more for transmission and distribution than their counterparts in the Republic of Ireland. How can the Department look at and address those issues? This week, we are looking forward to new investors coming to Northern Ireland. How can large manufacturers in particular be competitive when they are faced with those costs?

Ms Hepper: The key piece of work that is in train is being carried out by the Utility Regulator. One of the key features of that will be an examination of network costs and whether they are cost-reflective in their spread across various customer groups. You mentioned the comparison with the South. One of the key issues that emerged from evidence collection in the early stages of the review was the decision of the ROI Government to skew the costs and that domestic consumers would pay for that. That will all go into the mix.

I mentioned that we have taken an entirely theoretical look at the PSO charge and what the impact would be of skewing all of that from large energy users to domestic consumers. The outcome of the Utility Regulator's work will be to line up all of those costs. That will allow us to create models to see what the impact would be if we were to skew those charges in one direction or the other. That will then feed into a potential policy position and a very significant debate at the political level about the right thing to do.

Mr Dunne: What is the Department's thinking on that?

Ms Hepper: We want to see all the information coming together from the regulator's work. However, as David and I said in our opening statements, we are very alert to the fact that, in energy policy, you are trying to balance a lot of different factors.

Some 42% of our population is in fuel poverty, and there is another band of people who are potentially on the cusp of it. You have to question whether it would drive them into fuel poverty if we were to take a stance of moving costs from large I&Cs to domestic customers. From a social and societal point of view, is that helpful? It might help companies, but it will not help consumers. An awful lot of this will come down to striking a balance on the energy see-saw.

Mr Stevenson: There is also, of course, the EU dimension. Europe is becoming increasingly concerned about some of the mechanisms that member states have put in place. In its ongoing review of energy policy, it has referred specifically to the consideration that needs to be given to impacts on competitiveness across member states if particular states start to implement measures, and the impact that that has on all classes of consumers. There is a requirement to collect a pot of money through the network charge.

Mr Dunne: I suppose there would also be an impact on small and medium-sized businesses, which we have a lot of in Northern Ireland.

Ms Hepper: There would.

Mr Dunne: Do you surcharge them to benefit the larger businesses? That is a difficult question.

Mr Sterling: Those are the interesting policy questions about where to strike the right balance.

Mr Dunne: There would be major implications if you were to do that here.

Ms Hepper: It goes back to David's frogs. As you knock one down by trying to help one group, another frog pops up, and you end up with a lot of frogs with sore heads, as well as a sore arm.

Mr Dunne: Yes. Striking that balance is difficult. Seemingly, the Government in the Republic have made that decision.

Ms Hepper: They took a decision at Cabinet level that, for the good of the economy —

Mr Sterling: To protect jobs, essentially.

Ms Hepper: Yes. They were quite content that householders bear the additional costs. I imagine that the Minister will have to make a judgement and bring it to the Executive. It would be a cross-cutting issue.

Mr Dunne: I would suggest that that should not be done in an election year. *[Laughter.]* Thanks very much.

The Chairperson: Have you given any thought to the SEM committee being given the authority to look at those charges within the SEM?

Ms Hepper: It already has the authority to do that, and it does it. It does not need to be given the authority because that is part of its role.

Mr Sterling: It should be doing that.

The Chairperson: It should be?

Mr Sterling: I am not suggesting that it is not, but that is part of its role.

The Chairperson: It that specifically on network costs?

Ms Hepper: We are interested in how network and other costs impact on Northern Ireland, to be a little selfish. Our regulator is looking at that and will bring forward a paper. An update paper is pending, which will put a series of pieces of work in train. It will report on those to the Department and the Committee. The SEM committee has a role in how the market operates: all facets of the market and all the elements, including the network costs and how they are spread.

Mr Dunne: I want to return to the first point that I made about the costs. Are you saying that the Utility Regulator is doing a piece of work on that?

Ms Hepper: Yes. You will recall that it published a piece of work in March that looked at how Northern Ireland sat alongside European countries. Having put that first piece of work out for consultation and sought views, it is shaping up for its next steps. That is all about the costs in the system, and you should see an update paper on that in the next few weeks.

Mr Dunne: OK. Thanks very much

Mr Frew: David, in your opening remarks you said that you were concerned about the level of cost for large users. I share that concern greatly —

The Chairperson: We are not quorate. We will suspend for a minute. Sorry about this.

Committee suspended.

On resuming —

The Chairperson: Sorry about that. We are badly down on our numbers today, if anybody goes out to take a phone call or something like that. Back to you, Paul.

Mr Frew: Take two, Chair. Thank you very much. We were discussing the difference between high energy users, the domestic market and small consumers. I will name a company in my constituency, and members will know rightly what I am talking about. I name that company because, when Wilton Crawford was before the Committee, he painted a stark picture. He said that, if things do not change in respect of energy costs in this country, Michelin will not be here in five or 10 years. That is a stark picture. We talked about fuel poverty. Losing 1,000 jobs directly from Michelin and losing about 500 or 1,000 jobs indirectly because of Michelin going would push 2,000 families into fuel poverty overnight. It is right and proper that you are concerned about that and that we start the debate as soon as possible about what we can do.

The PSO levy is interesting. We can control that. The potential charge increase for the domestic customer is about 2% to 3%, according to the departmental paper. Will you explain the effect that that will have on our large customers or the nearly 5,000 customers above the 70 kVA?

Ms Hepper: The information in the paper is based on the £22·1 million figure for the PSO. In 2013-14, that goes down to £14·3 million. If you were to skew that entirely to the domestic customers, it would put domestics up by about £11 a year, or about 1·5% or 2%. The impact on the large energy users would be to reduce their annual bill by about £14,500. Although there has been a lot of talk about the PSO, the answer to our collective dilemma does not lie in the PSO. It will have to lie somewhere else. We fully appreciate that £14,500 is £14,500, but when your bill is hundreds of thousands of pounds a month, that does not make a huge difference. However, it will make a huge difference to the small I&Cs and the domestics. We did that piece of work to identify clearly one element of the evidence. We will now add in the other stuff around the other network costs. The regulator will look at how those are balanced and the various options.

Mr Frew: If we were able to influence, change or tweak levies, fees and everything else that builds up the energy costs on a bill, other factors, perhaps even the generators, could take advantage of that and increase their charges. Has any work or study been done on that?

Ms Hepper: That will all be in the piece of work that the regulator is teeing up now. That is why it is very important that that work gets up and running, because the results will influence any decision-making. Again, it goes back to the point about balancing all the different elements. You do not want to fix one part of the problem only to find that you have either created a loophole somewhere or caused an inadvertent effect somewhere else, as happened with the carbon price floor. The carbon price floor, you will recall, was actually a very good and sensible way to help decarbonise, but it had unintended consequences in Northern Ireland that we had to work through. We have to guard against that.

Mr Sterling: You will recall that Bill mentioned earlier that the EU is looking at a number of member states that have skewed their charging policies and tariffs to assist large energy users in particular. We have to be careful that we do not do anything that attracts that sort of attention.

Mr Frew: But while it investigates that, the Republic of Ireland companies are being charged 20% less.

Mr Sterling: They were quite open about what they did in Dublin. Have we any indication that the EU is looking at that?

Ms Hepper: No; we have no indication of that. Indeed, we have no indication of whether they went through a process and had state aid approval for that. That would be for them to justify. Some of that will come out in the wash.

A number of companies are now very energy efficient after getting Carbon Trust loans and are doing some very good work. One company in particular, the name of which I will not mention, is now looking at combined heat and power (CHP), which could have very positive impacts, bearing in mind that the climate change levy for certain parts of CHP is not applicable. The company is looking at a number of ways to further that and to include more wind turbines. All those things come into the mix.

Mr Sterling: I just want to stress that the Minister has us and Invest NI working very hard to find ways to facilitate that company and others that are in a similar position. What I would say is that all good ideas are very welcome. We will look at anything that might make a difference.

Mr Frew: I mentioned a particular company because its representative was here to present on its behalf. For your information, Chairman, he has now moved on and is a plant manager somewhere else. Even in north Antrim, there are many large users of electricity. You mentioned companies tapping into renewable energy and creating their own energy. Again, that will help those companies, but it will skew the market.

Mr Sterling: Yes. If somebody goes off the grid, that obviously apportions the costs to other users. Again, it is another frog.

Mr Frew: You would like to think that you could incentivise companies to do that and that it would all help, but what is the Department doing to curb the effect that that would have on the grid and the burden it would place on larger companies that do not go down that route?

Mr Sterling: At the moment, we are not actively doing anything to prevent someone from doing that if they decide it is best solution.

Mr Frew: I would not say "prevent". How can we assist the other companies, the grid itself and the small users if they have to take a hit because a larger company generated its own energy? How do we help the market so that it is not skewed to the point where it places the burden on other companies?

Ms Hepper: The work that the regulator is doing will start to air some of those issues. It will not be easy to square that circle, because the bottom line is that we need a grid for the 21st century, and that grid has to be paid for. At the same time, as you rightly said, there is the point about protecting several thousand jobs. If a company or even Invest NI said, "You can protect those people by going off the grid and putting in a CHP plant", the balance, then, is between whether you protect those 5,000 jobs and all that flows from that — the knock-on consequences and the multipliers — or whether you get other people to pay a little bit more.

When all the information and evidence is gathered, this will be a complex policy issue, and I am sure that there will be much debate and polarisation on both sides about what the best step forward is.

Mr Frew: This is my last question, Chairman. We are still in the grip of a recession but, thankfully, we see signs of recovery. Companies did not have the opportunity to move away because of high energy costs; they did not have the capital or the money to do it. That might change in the coming years when they build up capital again. Is any work or investigation going on to try to ensure that those companies do not move away, even to the Republic of Ireland or GB? Is there any work that we can do to help incentivise them to stay here if they have the capacity to move away?

Mr Sterling: Invest NI generally works with the business base that it deals with — it does not talk about client companies so much now — to encourage businesses to stay here. I am not sure that any particular work is being done on energy, although we could certainly think about that. Invest NI is continually seeking to ensure that businesses are encouraged and incentivised to stay here.

Ms Hepper: When Invest NI representatives were here last week, they talked about the package that it offers, and energy costs is one element that the companies look at. There is also the package of incentives: selective financial assistance, various grants for R&D and innovation, and skills training on top of that. There are also the other wider issues for the Executive, such as industrial derating for manufacturing here and the big issue of corporation tax. All of that starts to come into the frame of the work that you are talking about.

Mr Sterling: Generally, we seek to encourage companies to move into advanced manufacturing and to get engaged in research and development. In so doing, they become much more entrenched here and are less likely to move than those that are involved in low-level, simple manufacturing, which is very mobile and can move anywhere.

The Chairperson: Thank you very much for being with us today. That concludes our session with you.