



Northern Ireland
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Committee for Enterprise, Trade and
Investment

OFFICIAL REPORT (Hansard)

Electricity Prices:
Briefing from the Utility Regulator

6 June 2013

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:

Mr Patsy McGlone (Chairperson)
Mr Phil Flanagan (Deputy Chairperson)
Mr Steven Agnew
Mr Paul Frew
Mr Alban Maginness
Ms Maeve McLaughlin
Mrs Sandra Overend
Ms Sue Ramsey

Witnesses:

Mr Shane Lynch	Northern Ireland Authority for Utility Regulation
Mr Kevin Shiels	Northern Ireland Authority for Utility Regulation

The Chairperson: With us today are Mr Shane Lynch, the Utility Regulator; and Mr Kevin Shiels, director of the retail and social directorate. You are both very welcome. It is good to see you again. The usual format is that you make an opening statement. We have your papers, which we have read. Some of it is quite detailed and, I have to say, quite technical for someone like me who really is not a technical buff. Nevertheless, it is good to have you with us to shed some light on some of the issues. It is over to you, Shane. Please make your presentation.

Mr Shane Lynch (Northern Ireland Authority for Utility Regulation): Thank you, Chairman. Good morning, ladies and gentlemen. We will try, as much as possible, to be non-technical. Chairman, how much time would you like us to take to do the presentation?

The Chairperson: If at all possible, I would prefer it if you do not go much over 15 minutes, because I reckon that a lot of the issues will be drawn out and teased out by members.

Mr Shane Lynch: OK. I have set my watch.

You asked us to cover three issues today. We will talk about our recent report, which compares electricity prices across Europe with those in Northern Ireland; comment on the recent domestic tariff increase by Power NI, which has subsequently been followed by Airtricity; and talk a little bit about pending security of supply issues in Northern Ireland.

I will hand over to Kevin, who will cover the first couple of issues by way of providing some facts, and then I will talk a little bit about what we think can be done about our relative price position.

Mr Kevin Shiels (Northern Ireland Authority for Utility Regulation): As Shane said, I will talk to you about two separate issues. The first is our recently released report on electricity prices, the consultation period for which has just finished. I will bring you up to date on that, and then I will talk to you about the recent 18% increase by Power NI in regulated domestic tariffs.

In respect of our recent report on comparative electricity prices, the last time that Shane and I were here, about six or eight months ago, we said that we were going to do that work and that it would be the first time that we would have comparative information, relative to the rest of Europe, for industrial and commercial customers in Northern Ireland. At the time, you said that you would not mind if we came back and told you about it when we had the results. So, this is an opportune time.

The key things about our report are that the information is comparable with that across European countries, and that we released the report to try to kick-start a good, constructive and transparent debate about energy prices in Northern Ireland and how those compare. As this is the first time that we have information on business prices, we have a new feed into the debate. A main finding from our work is that domestic prices in Northern Ireland are around the European average, which is not a bad place to be given where we are in the energy supply chain, but we will come on to that later. Also, the prices for small-business customers, who make up about 70% of total businesses, are around the EU average. However, for the remaining 30% of business customers, who are, in technical terms, those using more than 20 megawatt hours per annum, prices were among the highest of the European countries.

The paper did not try to delve into the justification for or the reasons why those different price patterns emerged. We deliberately said that we wanted to consult on the raw findings and then do follow-up work having listened to other stakeholders' views on those raw findings. So, without trying to, if you like, jump to the answer, our paper suggests that there are three groups of drivers for why there might be jurisdictional price variances between different territories. We talked about market size and economy of scale issues; fuel mix at the wholesale and generation level, which is fundamental to prices; and the impact of energy policy, including taxation and regulation, which can affect end prices and cost drivers.

The consultation period on our paper has now ended, and we got about nine or 10 responses. As we speak, we are assessing the feedback on those issues. We will draft and publish a next-steps paper, which will set out the follow-up projects that we think are necessary coming out of the stakeholder feedback. That is all that we will say for now on the prices paper, but I am happy to come back to it again.

In respect of the recent Power NI regulated tariff announcement, we have provided you with a reasonably detailed public briefing paper, which we issued on our website at the time of the tariff increase. In a nutshell, the tariff changes were largely driven by wholesale and generation cost changes. Last autumn, tariffs fell by 14%, so this 18% rise brings them back up to where they were a year ago. We monitor Power NI's regulated costs monthly, and we will move quickly in the future to pass any cost deductions back to consumers.

Tariffs have gone up and down quite a lot in the past few years, with a couple of rises and falls. The table provided in our slides shows the tariff changes since October 2009. They are usually annual, but this one was brought forward to July. You can see two large falls and two large rises during that period, and no change one year when the tariff was frozen. The wholesale costs and corrections column shows that most of the tariff changes are driven by what happens in the wholesale and generation cost end of the market. The other bits and pieces are usually very small and do not really drive the change. Inevitably, tariffs move up and down, with underlying input costs being largely on the wholesale side. Again, I will come back to that in a bit more detail if you would like.

Mr Shane Lynch: Thank you, Kevin. At this stage, I will give you our perspective on what can be done about prices in Northern Ireland. As you can see from the slide, I have broken it up into what can be done on the regulatory front and what can be done on the energy-policy front. So, what I will take you through now is reasonably high level, and I will try to keep it in simple, non-technical language.

I want to begin by asking where responsibility lies for prices. That is the key starting point. The statutory responsibility to protect consumers in Northern Ireland rests with the Utility Regulator and the Department of Enterprise, Trade and Investment (DETI). We have different functions, which are called "functions and powers" in legislation. Essentially, we are both responsible in statute for the protection of consumers. The Executive also have responsibility, because they set policy and reflect that policy

in legislation. I would also say that all the energy providers in Northern Ireland have a responsibility to protect consumers. Add all that up, and there really is collective responsibility. It does not just sit with one particular body.

My second point is that energy policy is not just about prices. There are trade-offs to be made between sustainability, prices and security of supply. Recently, I referred to that trade-off or puzzle as being a bit like the famous Rubik's cube: if you move one dimension, you will affect the other two dimensions as well. I will give you a couple of examples of that. Recently, DETI and the Department of Finance and Personnel (DFP) were very successful in negotiating a derogation from what was called the "carbon floor price", which was a UK-wide energy policy that was designed towards the sustainability agenda. We did not implement it in Northern Ireland simply because of the impact that it would have on prices. That is one example. Another example, which I will talk to you about in a wee bit more detail later, is that we have a pending security-of-supply problem in 2016. It will cost money to fix it. If you want to improve your security of supply, it does not come without affecting the cost dimension.

Another important point that I would like to make at this stage is about perspective and the need to bear in mind our starting point. In Northern Ireland, we are challenged by our size, isolation and dependence on imported fuels. When you add all of that up, you see that we are not in a fantastic place to begin with. Therefore, in my view, you have to set your expectations or ambitions in that context. Kevin has described that, for domestic consumers and 70% of our industrial and commercial (I&C) users, we are sitting at around the European average. That is not bad. It is not a bad place to be given the context. However, we are not in a great place for large industrial and commercial users. That is certainly an issue for our international competitiveness. Against that starting point, we need to be very careful and apply a lot of scrutiny when it comes to both regulation and policy; how we regulate the industry and how we set and review energy policy going forward. We are up against it to begin with.

Another big point that I would like to make is that it is not just about protecting consumers today; it is also about protecting consumers tomorrow. I would caution against short-term or knee-jerk reactions to, perhaps, just one price increase. The real answer here is a long-term strategic answer to our circumstances. The other big point is that you will not protect consumers in the long run if you are not reasonable to investors in the long run. You always need investment in infrastructure business like that. It does not mean that we have to give investors excessive returns. However, we have to give them a fair deal and reasonable returns in the long run if, in the long run, we also want to protect tomorrow's consumers.

All that having been said, by way of context, what can we do about it? Where do we look? What big stones would you turn over? I will begin with network charges. Network charges account for maybe 20% or 25% of the final bill. First of all, the Utility Regulator sets the amount of money that NIE can charge consumers. You all know that the Utility Regulator did not accept NIE's proposals for its expenditure over the next five years. That issue is now with the Competition Commission to be resolved. We take the view that we scrutinised that long and hard. We are trying to do the best that we possibly can for consumers while, at the same time, ensuring that we have the right level of investment in the network to maintain long-term reliability and security of supply for consumers.

A key point is the distribution of network charges among different consumer groups. What is very interesting when you compare us with the Republic of Ireland —

The Chairperson: Sorry. Someone in the room has a mobile phone switched on. Will that person ensure that it is switched off, please? It is very disconcerting to other members. I apologise to you in particular, Shane. It has interrupted your presentation. It also interferes with the recording for Hansard. Please switch off all mobiles phones. Sorry, Shane. Continue, please.

Mr Shane Lynch: We can pick up this point in more detail later. Network charges in Northern Ireland are, on average, across all consumers, 22% lower than they are in the Republic of Ireland. However, what is very interesting is that when you look at what large users are paying, you see that they are paying costs that are around 20% higher. Clearly, there is something going on in the distribution of charges. It has to be significantly different in Northern Ireland compared with what it is in the Republic. We can come back to that point. It is a key finding to date.

The other point that I would make is that we have to be very careful about adding to network costs going forward, particularly because of "sunk costs", as they are called in the industry. Investment has to be paid for. Particularly in an economic recession when demand growth is pretty flat and, in fact,

some customers are leaving the grid, that means that fixed costs will have to be spread more thinly across those customers who stay. Be very careful about adding investment. For example, just before Christmas, we approved £44 million of investment on renewables. We thought that it was good bang for the buck. In our forecast, it will move us from 12% of renewables to 27%. We thought that that was a good investment, and we approved it. However, what we would say is that all investments after that become very challenging. The strategic energy framework talks about NIE's forecast of £1 billion to get us to 40%. We have to realise that that will be very expensive in network charges, particularly on large users, because the investment is at the higher end of the network — the high transmission end where they connect. You have to bear that in mind going forward.

I am conscious of time. I want to move briefly to the single electricity market, which accounts for 70% or 80% of the final bill. So, it is a big stone that you have to turn over. I will deal with it together with the retail market. The single electricity market has produced big advantages to Northern Ireland over the past five years compared with what we would have had had we not entered into that market. It is simply a case of our being able to tap into better optimisation and utilisation of the generating fleet across the entire island. That has produced lower prices on all parts of the island. So, we have benefited from being in the single electricity market. We have benefited from cancelling generating unit agreements — the old system that we had in Northern Ireland of long-term contracts. The Utility Regulator has cancelled them over the past few years. That has benefited us. So, we are in a better place than we otherwise would have been had we not taken those couple of actions.

We are still constrained, however. We need the North/South interconnector to be built. We need the Moyle interconnector to be restored to full capacity. The fact that neither of those has been done is costing us money. Ultimately, we need a regional electricity market in Europe. We are on the journey towards that. The job is not done. We can get to a better place. We have not arrived yet.

I will talk very briefly about Northern Ireland's prices being higher than they are in GB. Alongside that, a couple of reports have been published recently. In the past couple of weeks, the single electricity market committee published a report on generator profits in the single electricity market. An interim report has also been published by the Economic and Social Research Institute (ESRI) in Dublin on comparing generator profits in the single electricity market versus GB and supplier margins to profit margins. Both those reports appear to say that generating margins here are higher than in GB but that supply margins are lower. You have to take the two of them together. The single electricity market intends to look at that issue in a fair bit more detail, having just published the report. Remember my comment about today and tomorrow. There are a lot of views that prices and margins in GB are too low and that it will not attract sufficient investment to keep the lights on. So, there is a view emerging that margins are perhaps too low in GB; there is a question about whether they are too high in the single electricity market. Maybe there is a convergence that needs to happen. We need to look at that in a little bit more detail.

The bottom line is that energy policy has to be kept continually under review. Some of the key planks of energy policy are prices, industrial competitiveness and fuel poverty. The strategic energy framework states:

"it is imperative that any policy decisions made now are assessed for their impact on energy costs."

The strategic energy framework, as it stands, makes it clear that we have to assess the impact on prices of everything we do. It is for DETI to review all aspects of energy policy, including renewables, renewables subsidies, and direct and indirect subsidies. I think that the Minister said recently that the strategic energy framework is now almost five years old and that a review will be coming soon. Our view is that the best way forward is for us to dovetail the work that we have been doing with, ultimately, a review of energy policy, and that the Utility Regulator works hand in hand with DETI in looking at the issue from a price perspective in particular. Clearly, we need to involve industry and the Consumer Council.

The issue will not be resolved overnight; it is an ongoing issue. It needs a particular focus on energy prices. We recommend that we, as the expert, independent and impartial body, do that in partnership with DETI and alongside the Consumer Council, with contributions from industry.

The Chairperson: Thanks very much for that, Shane. You took us through a fair bit of stuff. I am sure that members will have questions to ask you.

The final tariffs for the network's components will not be finalised until August 2013. Is there any chance at all that we could see further indications on the horizon from September onwards?

Mr Shane Lynch: Further increases?

The Chairperson: Yes.

Mr Shane Lynch: That is not our intention. Kevin did a review recently. Normally, the whole Power NI review kicks in from 1 October each year. We brought the review forward this year because it was already in deficit. Kevin, do you want to add to that?

Mr Shiels: Normally, we do the network tariff reviews, and then they feed into the final Power NI tariff review. The Power NI tariff review had to be brought forward, so we had to make forecasts of the network charge changes because they had not yet bottomed out. We think that we have made good forecasts of those in our Power NI tariff review calculation. During July and August, the normal review of network tariffs will unfold. I do not foresee that impacting on where we are now with the regulated tariffs.

The Chairperson: As you will appreciate, it is a huge issue for small and large businesses and, indeed, for ordinary consumers in their homes. It is a 17.8% hike. In a lot of cases that we see through our constituency offices, people are living on the breadline already. If we have a bad winter, I do not know how some people will be able to manage through that. So, there is a lot riding on it.

We saw how Airtricity piggybacked on the Power NI price hike of 17.8% and bumped its prices up as well. One question has been puzzling me, and I have already had this discussion with you. Airtricity brags publicly that a lot of its supply is generated from the renewables sector. It uses that, North and South, as an advertising icon or badge. I hear the arguments about the hikes in gas prices and how those jump up and down. However, as the renewables sector grows and we hit the target of 40% of power generated from the renewables sector — Airtricity says that a huge block of what it generates comes from the renewables sector — the question that most people will be asking is this: how does the price of wind go up by 17.8%? When we reach the 40% target, as we inevitably will, with less reliance on fossil fuels and gas, will we see a reduction to consumers in the cost of electricity generated from renewables, which is heavily subsidised by government and others, or will it just be taken as another opportunity by profit-driven companies to reap the full benefits when it gets the gas and oil people out of the way? Those industries are allowed to make profits. That is granted and is why they are in business, but how can they be regulated to ensure that they are not putting the arm into an opportunity where Governments have been, by policy, driving us towards the 40%-plus from the renewables sector? It is something that not only intrigues me but is of deep concern to me if we still arrive at the same position on costs, yet there is no fluctuation in the source from which it comes, whether it is wind, water or whatever.

Mr Shane Lynch: OK. There are a couple of points. The 40% target is a sustainability objective. It is there to reduce carbon; it is not there to reduce prices. That is an important distinction. All the indications are that it will put prices up. The strategic energy framework makes that fairly clear. Let me try to explain in very simple terms why it will put prices up.

The Chairperson: Yes, please do.

Mr Shane Lynch: For example, let us say that you own a wind turbine and I own a gas turbine, and we are both competing to supply the same consumer. I have to buy gas, and your wind is free. Let us say that I have to charge the consumer 10p for my gas. We have both had to buy our turbines, but we will park that for a second. I need 10p back for my gas. What are you going to charge for your wind if we are both competing for the same consumer? I guess that you are going to charge something short of 10p. I do not think that you are going to charge them zero. That is what is called the market price. So, the first point that you have to realise is that the fact that we have wind in the mix does not necessarily reduce the price because they are commercial players, and they will charge the market price.

The second point is that we have both had to buy our turbines. At the minute, we are subsidising renewable energy. That is policy, and that is fine, but that subsidy has to be paid for by consumers. It involves what I describe as direct subsidies and indirect subsidies. The direct subsidy comes in the form of renewables obligation certificates (ROCs). The indirect subsidy relates to the fact that most of the wind that we are connecting requires significant reinforcement of the grid, whereas, for gas plants, it does not because you can connect them in the east of the Province where the grid is strong. So that

is a cost that consumers have to pay. Unfortunately, wind is intermittent; it does not come out to play every day. Therefore, we have to provide back-up thermal capacity for days without wind. That is an additional cost. It is a myth that wind results in lower prices. It does not; it results in significantly lower carbon. You must not confuse the energy policy objective that applies here.

The Chairperson: I will go back to market price. You are saying that it is a free market, and away it goes from there, but there is some form of regulation. I have met NIE to discuss investment in the significant reinforcement of the grid, and I hear what it says. However, let us not forget that the people putting up the turbines are also making a substantial investment. I have met some of those companies, and they argue that they are making an over-the-top investment in a grid that should be invested in by the likes of the power company itself. It is a cost issue. I will have to have a separate meeting with you on that because they say that they are paying for the upgrade through the costs charged to them for connection to the grid. You are saying that, in a free market, there is no input from the likes of you into the regulation of those costs to ensure that people do not incur over-the-top charges. I find that hard to understand.

Mr Shane Lynch: I will take the second question first. The single electricity market is a regulated market, and we regulate it because we have market dominance in the Electricity Supply Board (ESB). We regulate it based on the economic theory — I will spare you that — of perfect competition. What happens in a market place? I gave you an example of a wind turbine and a gas turbine and the price of gas being 10p. If there is no wind, it has to be gas because it is the only alternative. The same is true of any commodity market. You have to get your head around the fact that, on top of that, we also have subsidies, which are there for good reason. So the policy question involves weighing up whether, ultimately, the subsidies are still needed, or are they needed to this extent, going forward.

That leads me to your first question. Some wind generators say, "Hang on a minute; I have to pay £0.5 million to get connected to the grid". That seems to contradict what I said about the general consumer paying for the grid upgrade, so let me untangle that. With the bigger-scale wind turbines — the macrogeneration — that connect at the higher voltages, our connection policy is to charge the general consumer for all the required grid reinforcement, which is the £1 billion referred to in the strategic energy framework. The guy connecting it does not have to pay that much. The connection policy for microgeneration — the 250 kilowatt wind turbines connecting at the low voltage end of the network at 11 kilovolts — is different, and they have to pay for the connection themselves. We could spend five minutes explaining why that policy is different, but the fact is that it is different, which is why there is a bill of £500,000, or more in some cases. So, for many, the project does not work. It works for the bigger guys because they are being subsidised.

Mr Frew: Thank you very much for your presence today and presentation, Shane and Kevin. This is, without doubt, one of the biggest issues that governments all around the world will grapple with in the next 25 years, and Northern Ireland must grapple with it now for the sake of the future. We will hit thresholds, boundaries and barriers in the coming years, such as 2015, that will have a major impact on business. We already have a grid that is not fit for purpose and generation that will be wound down in the coming years. Our interconnector does not work to its full capacity and is stuck in a planning system that simply does not work. That paints a stark picture. Ultimately, business will suffer, and, if business suffers, the population will suffer. If we lose a large employer, which could well be a global company, we will place 1,000 families in fuel poverty overnight. Before we can really grapple with the problem, we must acknowledge that it is the biggest issue for a generation to come. I am sorry for making a statement rather than asking a question, but I wanted to set the context of how important this really is.

There are problems with the Moyle interconnector. I met the company and know that the Utility Regulator has put some pressure on it to come up with a solution. The company is, I believe, working in the right direction by laying additional cables to get it back up to 500 megawatts. It also talked about an interim solution that would help it to hit the 2015 target. How much pressure is the Utility Regulator putting on the company to lay additional cabling in order to return to full capacity as quickly as possible? Is pressure being applied for it to enact the interim solution, which is, I think, a bipole solution?

Mr Shane Lynch: I did not take you through a couple of slides on the security of supply. If you do not mind, I will take 30 seconds to do that because they feed into your question, Paul. There are three issues coming together that may give us a capacity problem in 2016: the North/South interconnector is delayed; Moyle is at half capacity; and generation capacity at Ballylumford power station, which has signalled that it will exit the market because it cannot comply with environmental requirements. Added

together, they mean that supply is very tight. We have only a couple of hundred megawatts of surplus capacity. We have been working closely with DETI on that. We are about to publish a joint paper that sets out the problem, remedies and our options. The long-term solution is getting Moyle to full capacity and getting the second North/South interconnector built. There is a surplus of capacity in the South, but we cannot access that until we get the second interconnector. Those are no-brainers — you get both done. There may be further necessary interim measures. It seems probable that there will be no long-term fix to the Moyle interconnector until 2017. However, my understanding is that there is an interim solution that can be effected by as early as 2014.

Given the nature of the company, the main area in which we can apply pressure is reputational. It is about making the issue very transparent and making it clear that the ball is in its court: the responsibility is with the company to fix the problem ASAP. We have to bear in mind that it will not be done for free. The long-term fix on the Moyle interconnector will probably cost us £60 million and impact on tariffs in the order of 2% for three years. That is the reality, but I put it to you that that is the lesser of two evils when compared with your lights going out. We know from experience that consumers place a lot of value on keeping their lights on. The short answer is that you identify the area, ask Moyle to come out and say what the short-term and long-term solutions are and what it intends to do. Make it transparent and very public that the responsibility lies with it.

Mr Frew: Large companies here pay a massive amount for energy compared with those in the rest of Europe and, indeed, the world, which puts them at a competitive disadvantage. However, we know that our householders pay slightly less than those in GB. We also know the scenario in the Republic of Ireland. How does the Republic of Ireland keep its costs down for large companies?

Mr Shane Lynch: We are in the same wholesale market, so our wholesale prices are the same. The difference is in the network charges and their allocation. As I said earlier, the fascinating point is that, overall, network charges for all consumers are 20% lower in Northern Ireland than in the Republic. We have a lower cost system here, but large users pay 20% more — the opposite of what happens in the Republic. That seems strange, and the only possible reason is that costs are allocated differently across consumer groups. Clearly, fewer costs are allocated to large users in the Republic than in Northern Ireland.

This is one of the key findings of our current work, and we are not letting this one go. We need to bottom it out — who is right? Are they both wrong, or is somebody right and somebody wrong? What is the right way to allocate costs? The guidance from Europe is that it must be done on a cost-reflective basis. I will spare you the technical and economic detail of what that means, other than to say that there is some interpretation and discretion around that. When comparing Northern Ireland with the Republic, it looks to me as though the range of discretion and how that is being applied is very significant, and that is where the answer lies, Paul. Kevin, do you want to add anything?

Mr Shiels: Countries across Europe appear to allocate their network-related costs in very different ways across consumer groups, and yet, in theory, all should allocate them in a non-discriminatory way. Shane hinted that the allocation of costs on a non-discriminatory basis is part science and part art. We want to follow up on our work looking at the allocation of network costs in Northern Ireland relative to those in other jurisdictions to get a better handle on whether there is — I am loath to say a right or wrong way because, in a sense, it is a bit of an art, but we need to at least expose what is going on with cost allocations in different jurisdictions. Our cost allocation in Northern Ireland looks very similar to that in GB but very different from the ROI cost allocation. There must be a reason for that, but none of us know that yet, so work needs to be done.

Mr Shane Lynch: I will give you one very interesting fact: Germany took this to the extreme and allocated no network cost to large users, but that practice was overturned by the European Court of Justice for being discriminatory. That is an extreme case, but it is interesting.

Mr Frew: This is my final long-winded question.

The Chairperson: Do not make it long-winded, Paul, because other members want in.

Mr Frew: People talk about wind and tidal energy being free. It is not; it is extremely expensive. I think that you have been quoted as saying that wind and tidal energy would increase costs by 113%, which would translate into a 25% rise in bills. The tidal project on the north coast has to connect to Kells, which is miles away, and thus it straddles the entire North Antrim constituency. You have differentiated between lower carbon policies and lower cost policies. However, how do we get a fit

and balance so that we do not lose business and competitiveness when trying to hit a renewables target of 40%? Should we be looking at increasing the old-style generation of electricity to see how that helps us to meet the target? If businesses decide to go it alone and generate their own electricity, what impact will that have? If a global company, which is a large employer, decides to generate electricity to get away from the problem, how does that affect the rest of the companies on the grid?

Mr Shane Lynch: In my view, all those are policy questions, Paul. We have made policy decisions, and we can change them. You have to be aware of the interdependence of policy objectives. The 40% renewables target is a very laudable objective and does a lot for carbon reduction, but it does not come free. Another key objective in the strategic energy framework is industrial and international competitiveness, as you said, and the 40% renewables target will adversely impact on international competitiveness because of the price. So there are trade-offs and balances. The big advantage of the regulator working hand in hand with the policymaker, DETI, is that we have the experience of implementing policy. We can provide the feedback loop, as I describe it. The key thing is to carefully examine every policy decision and its future impact. The answer lies in more of the same: lots of scrutiny.

Mr Frew: What about the companies generating their own electricity?

Mr Lynch: That is not a good outcome because they leave —

Mr Frew: Are you fearful of that?

The Chairperson: Paul, I need to move things on a wee bit. There are a couple of points that I need you to clarify, Shane. I am sorry, Paul, but I must bring in other members.

Mr Frew: That is OK.

The Chairperson: You mentioned a joint paper on the security of supply. When will that be available? I am sure that the gentlemen at the back of the room were listening very closely to you, Kevin, when you spoke about the further work required on costing. I do not know whether you meant that further work would be done or simply that further work was required. Is there an action column? Briefly, just for the record, please tell us when the report is likely to be published and whether you have committed to working further on the costing issue.

Mr Shane Lynch: Do you mean cost allocations?

The Chairperson: Yes, cost allocations, in light of what has just been said about business.

Mr Shane Lynch: Of networks?

The Chairperson: Will we hear more on that?

Mr Shane Lynch: Yes. That is one of the areas that we have identified and need to delve into.

The Chairperson: So you will deal with it. OK.

Mr Shane Lynch: The answer to your first question is that the report will come out in mid-June.

Mr Shiels: May I speak for just 30 seconds? The purpose of consulting on the original paper was to generate debate, which happened, and ideas about areas that require further follow-up. Three or four areas were identified and will be followed up, though we have not yet decided on the order of priority. Network cost allocations is definitely one area that will be followed up.

The Chairperson: Can you give me an insight into what the other two or three areas are?

Mr Shiels: Yes.

The Chairperson: I do not need elaborate detail. Just give us bullet points to inform the rest of the meeting.

Mr Shiels: One of the other areas is as follows: when you look at the dispersion of prices, it seems that renewables and taxation policy can affect the final price across different customer groups, so we want to look at that. Sorry, Chair, I cannot remember the other one.

The Chairperson: Just send us an e-mail or something.

Mr Shiels: We will write a paper on the next steps, which I hope to take to Shane and the board by the end of June. That will clarify what we received in feedback and what the next steps will be.

The Chairperson: A number of members have indicated that they have questions. I am allowing a fair bit of latitude today, but please get to the point and ask your question, members.

Mr Flanagan: Thanks for the presentation. We started talking about prices for large-scale energy users, but then world events led to Power NI putting its prices up, so we had to move slightly.

I will assume that you have a gas turbine solution because, on the basis of some of your comments today, I do not think that you are leaving the regulator's office to go into the renewables industry. Patsy, you have a wind turbine. Shane, you pay 10p for your gas, and Patsy pays nothing for his wind. You said that, in a free market, the price would be set somewhere just under 10p. However, we are not in a free market, so how much does Patsy pay for his wind in that instance?

Mr Shane Lynch: Zero.

Mr Flanagan: If he bids in the single electricity market to generate wind when you are burning gas at 10p, how much does he get for his wind?

Mr Shane Lynch: If I am the price-setter, 10p.

Mr Flanagan: In a free market, is the price-setter the person with the highest cost or the lowest cost?

Mr Shane Lynch: Highest.

Mr Flanagan: In a free market? If you are selling a bag of spuds for £3 and Patsy is selling a bag of the same spuds at £2, who do you buy the spuds from?

Mr Shane Lynch: If both bags are needed to feed families —

Mr Flanagan: We are on about, say, a hotel, not a family.

Mr Shane Lynch: If you need only one bag, the cost is £2. If you need both bags, it is £3.

Mr Flanagan: Your bag costs £3 and his costs £2, so do you get £3 and he gets £2, or do you both get £3?

Mr Shane Lynch: If both bags are needed, we both get £3.

Mr Flanagan: Patsy, if your bag of spuds was £2, would you get £2 or £3?

The Chairperson: I think that I will stick to electricity.

Mr Flanagan: No, go back to spuds. They are simpler.

The Chairperson: It is a good analogy and takes us back, Shane, to the point that we raised earlier about the form of regulation of the overall costs associated with the generation of electricity. We have heard how cost fluctuations occurred as a direct consequence of the gas market. To my simple mind, the point that Phil is pressing again is that, if the cost of a source of energy, whether it is photovoltaic, wind, or water, is lower, what is the form of regulation that can be determined, subject to subsidy, ROCs and even taxation policy? Basically, what I hear from you is that there is no control over the

amount of profit that can be made on foot of this as long as somebody else is charging that wee bit more.

Mr Shane Lynch: There are two markets: wholesale and retail. In the wholesale market, every generator — wind generators, gas generators, coal generators — bid their price half-hourly. They are obliged to bid what it actually costs them — their variable cost. So you have to bid zero for your wind turbine, and I have to bid 10p for my gas turbine. All bids are stacked up one on top of the other, from the lowest, at zero, to the highest, at, let us say, 10p. We put demand alongside the bids. Let us say that, in supply, all the generation adds up to 100 units, and demand is 90 units. We need only 90 units of supply, so we do not use 10. However, the price set is what economists call the system marginal price. The last and most expensive generator sets the system marginal price, and everybody gets that price, including the guy whose bid is zero.

Mr Flanagan: Why?

Mr Shane Lynch: I will ask Kevin to think about that for a second because he is the economist.

Mr Flanagan: Are you going to bluff here for a lock of minutes to give him time to answer? *[Laughter.]*

Mr Shiels: That was a hospital pass.

Mr Shane Lynch: In any market, you pay what is called the marginal cost, whatever that is. Put it like this: if demand was 90 units and supply was only 80 — so 10 customers are not supplied — what would they pay to get supply? What would they pay for their bag of spuds? If the £2 spuds were already taken, would they pay £3? If they wanted them and needed to eat, I think that they would

Mr Flanagan: So the last 10 would pay £3, but the first 80 would pay only £2. However, in the single electricity market, everybody pays £3.

Mr Shane Lynch: In the market, what happens is that once the guy whose bid is £2 realises that somebody down the road is prepared to pay £3, he will put his price up.

The Chairperson: Or lose his customers. That is the difficulty.

Mr Shane Lynch: Yes, but if he can —

The Chairperson: The guy whose price is higher loses customers.

Mr Shane Lynch: Yes, but the fact that people are prepared to pay £3 sets the market price for everybody.

Mr Flanagan: We will go back to the difference between the wholesale and retail markets. Airtricity generates an awful lot of its electricity from renewable sources. It is paid the same price as the most expensive generators in any half-hour period. I cannot see any justification for Airtricity increasing its retail prices to the same extent as Power NI, given that its generation costs may not have gone up but its wholesale take-in has. I know that it is not regulated, but will you explain the justification for Airtricity's 17.8% price increase?

Mr Shane Lynch: Airtricity is what is called a supply company. It bought all its power from the wholesale market. Its generation company, which owns the wind farms, has sold power into the wholesale market. As I explained in my wee example, the wholesale market sets a price every half hour, which is called the system marginal price. Most of the time, that price is set by gas plants, and the price of gas has gone up on the wholesale markets. So the system marginal price has gone up. Therefore, the wholesale price has gone up to all suppliers, including Airtricity, which, as a retailer, has simply passed on that wholesale price increase.

Mr Flanagan: So is the electricity sold by Airtricity generated by Scottish and Southern Energy (SSE)? Does SSE sell to a different subsidiary company that then sells to Airtricity, another subsidiary company, which then charges customers through the nose for it?

Mr Shane Lynch: By the way, not all Airtricity's power comes from renewables. I do not have the percentages here. However, the price that the Airtricity supply company pays for generation is the price that comes out of the wholesale market. Everything is settled in the wholesale market at the one price.

Mr Flanagan: Is it fair to say that Airtricity is making disproportionately more than some other providers for the generation and supply of electricity?

Mr Shane Lynch: It is fair to say that a renewable generator makes a lot more money when the price of gas goes up.

Mr Flanagan: So why would it need to increase its retail price?

Mr Lynch: That is because —

Mr Flanagan: The quote from Airtricity is that it:

"regrets the need to increase energy prices."

So Airtricity is saying that there is a "need" to do it.

Mr Shane Lynch: That is because it is buying from the wholesale market and not from its generating company. The generating company, SSE, has made a lot more money because it owns the wind farms. It makes a lot more when gas prices are high.

Mr Flanagan: So is it all about balancing the books within one parent company?

Mr Shane Lynch: Yes. The key point here is that, in a market, everybody has the market price. However, renewable companies make a lot of money when fossil fuel prices are high because they get the market price, and they still get their subsidies. They are still getting their direct and indirect subsidies.

Mr Flanagan: When are you going to sort that out?

Mr Shane Lynch: Subsidies are an issue for —

Mr Flanagan: Not the subsidies, but the fact that everybody is paid the same.

Mr Shane Lynch: That is common in most markets.

Mr Flanagan: It is not common when you are selling bags of spuds, and the price of spuds is going up.

The Chairperson: There is a very important point, which is starting to distil through the line of questioning, and it is this: would you support increased regulation to make sure that the costs are not going up disproportionately. Businesses have to get a profit. That is the way that they are, but if they are disproportionately increasing prices owing to fluctuations that are way beyond their control but are working very much to their advantage, is there a case to be made for increased regulation of price controls?

Mr Shane Lynch: Regulation happens in two places. The Utility Regulator regulates Power NI at the retail end. At the wholesale end, the Single Electricity Market (SEM) Committee, which is the joint regulatory body between us and the Commission for Energy Regulation (CER) in Dublin, regulates the wholesale market. That committee recently published a report on generator profits, and you will see that generator profits go up, particularly for renewables, when gas prices go up. A couple of things are happening. The design of that market has to change quite significantly anyway to comply with a western European market design by 2016. That project is happening at the minute, and we are working towards that.

In the light of the report that we published recently, the Single Electricity Market Committee is also reviewing whether there is anything else that we should be doing in the short term. I would put your

proposal in that category. The SEM Committee intends to look at those issues anyway, but I will add a word of caution, which is to repeat what I said earlier. A lot of judgement and balance is needed here. We have to protect the consumers of tomorrow. Any intervention that we do in the form of increased regulation in the marketplace has to be very carefully thought out and consulted on, because we do not want to create instability for the investment climate. It is about striking a balance between making sure that investors get a reasonable rate of return, but not an excessive rate, and consumers get a fair deal.

Mr Flanagan: In your opinion, are renewable generators getting a fair rate of return at the minute?

Mr Shane Lynch: From looking at that report, I would say that renewable generators are doing well.

Mr Flanagan: Is it a fair rate of return, or are they getting far too much?

Mr Shane Lynch: The question is this: will they need the subsidies?

Mr Flanagan: Are the subsidies the problem, or is the rate of direct payment that they are getting from the single electricity market the problem?

Mr Shane Lynch: In any market, if you have a product that is of a low cost compared with the alternative, you will do well.

Mr Flanagan: Why not, through the single electricity market, set a fixed cost for the generation of electricity from wind, instead of letting those generators be paid the same price as the more carbon-intensive ones?

Mr Shane Lynch: Where wind farms can make good money, there is a huge incentive for them to keep building. Think about our 40% carbon target. If you can create the market signal for more and more wind farms to be built, there is a good chance that you will achieve your carbon objective. The question is this: how strong does that signal have to be? I think that the signal already in the market is strong because the price has been set by the price of gas, and I question whether we also need the level of direct and indirect subsidies that we have.

Mr Flanagan: I missed you saying this, but Paul mentioned the 113% that you referred to. Was that a price increase?

Mr Shane Lynch: Yes.

Mr Flanagan: And a direct increase of 25%. The Irish Wind Energy Association (IWEA) commissioned a report from Redpoint. The report outlines that there is an 11.5% reduction in wholesale electricity prices by reaching 45% wind in the overall generation mix in the single electricity market. A report by EirGrid and the Systems Operator for Northern Ireland (SONI) identified an annual benefit of €295 million in lower total energy costs across the single electricity market. How do those two reports correlate with what you are saying?

Mr Shane Lynch: I have not studied those reports in any detail. Let me just check some of your figures. Did you say that it will reduce the system marginal price (SMP) by 11%?

Mr Flanagan: The report stated that there that will be a 11.5% reduction in wholesale electric prices by reaching 45% wind generation.

Mr Shane Lynch: It would have some impact on reducing the SMP if it were not there, but it would not take it down to zero. It would drop it a bit at the margins. From what you have read out, the report does not appear to have told you the cost of subsidies, including direct subsidies through renewables obligation certificates (ROCs) and indirect subsidies through backup generation when the wind does not blow, and network reinforcement. The figure of 113% comes from the £1 billion. The strategic energy framework talks about the Northern Ireland Electricity (NIE) forecast of £1 billion of investment on the network to get to 40%, and we approved an investment of £44 million just before Christmas that will take us to 27%. That was a very good investment in our view, but it increased network tariffs for large users by 5%. Pro rata, £44 million puts network tariffs up by 5%, and £1 billion would put them up by 113%. It is a very simple calculation.

Mr Flanagan: Kevin said that the price increase by Power NI is based on some forecasts. Do those forecasts take into account what you think will come out of the Competition Commission (CC) determination on RP5? Does it take into consideration the price increase that will have to be brought in to cover increased distribution costs for gas as a result of the extension of the gas network?

Mr Shiels: Not the latter, for sure.

Mr Shane Lynch: No impact.

Mr Flanagan: Is that too far away?

Mr Shane Lynch: Gas to the west?

Mr Flanagan: Yes.

Mr Shane Lynch: It will have no impact on electricity network tariffs.

Mr Flanagan: It will have an impact on electricity generation.

Mr Shane Lynch: If people switch from using electricity to gas?

Mr Flanagan: No. Companies that generate electricity from gas will have to pay higher transmission and distribution (T&D) costs to subsidise the expansion of the gas network.

Mr Shane Lynch: Companies that currently use electricity in their production facilities?

Mr Flanagan: No, Kilroot and Ballylumford will be faced with a 7% increase in T&D costs to cover the extension of the gas network.

Mr Shane Lynch: Why do you think that?

Mr Flanagan: Because transmission and distribution charges are postalised.

Mr Shane Lynch: For gas?

Mr Flanagan: Yes.

Mr Shane Lynch: Their transmission gas costs will have gone up. It is marginal, but that will not kick in this year.

Mr Flanagan: Has it been factored in?

Mr Shane Lynch: Not for this year.

Mr Flanagan: What about RP4?

Mr Shiels: The outcome of the CC reference is unknown. There is a technical part of a licence, called annex 2, that assesses how NIE's required revenue is determined, and we have retained the RP4 arrangements in the calculation. It is impossible to do anything else, because we do not know what the outcome of the CC reference will be.

Mr Agnew: Thank you for the information so far. This has been a very informative meeting. I will not use Phil's spuds analogy, but I will come to the issue of the price setter. Gas is essentially the price setter at the minute because it is the most expensive generator. I am not quoting you directly, as I would need the Hansard report for that, but you said earlier, "Be careful of short-term price-related knee-jerk reactions." If we were on 100% renewables, what would be the price setter? It would not be gas.

Mr Shane Lynch: Correct.

Mr Agnew: With renewables, the cost of the fuel, which is the wind —

Mr Shane Lynch: Would be zero.

Mr Agnew: You would probably think about that in the long term.

Mr Shane Lynch: There is a big "if" there.

Mr Agnew: Absolutely, but it had to be said. The problem has almost been presented in your projection as renewables putting up prices, but what you have highlighted is that the reason that we have such high prices is the price of wholesale gas.

Mr Shane Lynch: The only caveat I would add is that, technically, you could not run a system on 100% wind. You would always need gas or some form of fossil fuel.

Mr Agnew: Not 100% wind, but I would not say that to use 100% renewables is impossible.

Mr Shane Lynch: The cost of some of the other renewables is not zero. Biomass, for example, is quite expensive.

Mr Agnew: I accept that. On the £1 billion investment in the grid that you mentioned, I think that I have spoken to you before and you mentioned that that is the price of the strategic energy framework. Do you agree with that?

Mr Shane Lynch: It probably looks a bit on the high side.

Mr Agnew: Yes.

Mr Agnew: I think that £800 million was the figure that you gave me the last time that I spoke to you, but I could be wrong.

Mr Shane Lynch: We have not had an updated figure from NIE. I think if you were to ask it for an updated figure, it would probably be less than £1 billion.

Mr Agnew: Say that we scrapped the 40% target, my understanding is that there is significant investment needed in the grid regardless. What type of figure would we be talking about? What I am trying to get at is this: is the £1 billion or £800 million just because of renewables, or would we need to spend a percentage of that on our grid infrastructure anyway because of maintenance, upgrade and whatever else? Tied into that, one thing that we have not talked about is the amount of energy lost in our grid owing to the efficiency of our grid. If we are upgrading our grid, do we improve the efficiency, and is that taken into consideration when you talk about passing on costs to consumers? If we are losing energy in the grid system, surely we have to take into account improving efficiency.

There are two questions there. Is the £1 billion or £800 million, or whatever it might be, solely because of renewables? If we scrapped our renewables targets, could we just scrap that altogether, or would we have to spend a significant amount of money anyway? Secondly, are we improving the efficiency of our grid with that investment?

Mr Shane Lynch: The £1 billion is exclusive from the other investment that we need in the grid to maintain its reliability and safety. That is over and above. For the next price control period, from 2012-17 — RP5 — we proposed capital expenditure of £390 million just to keep the network safe and reliable and to deal with a little bit of demand growth. That is up from the £360 million in the current period. Are we trying to make the grid more efficient overall in how it transports energy from A to B? The answer is yes. NIE has an obligation to run the grid efficiently, as does SONI. The biggest way of reducing losses is to bring demand and supply as close together as possible so that the electrons do not have as far to travel.

Mr Agnew: Which the renewable upgrades will achieve. At the moment, we have a system whereby we feed everything from east to west.

Mr Shane Lynch: That is true.

Mr Agnew: By having more renewable energy closer to the point of use, you are increasing efficiency.

Mr Shane Lynch: You are reducing losses from the network. That is definitely true and is an advantage.

Mr Agnew: Is that being considered in the figures that you are quoting?

Mr Shane Lynch: It would be considered. The way in which we have tried to deal with this, Steven, and we think that it is a sensible way of dealing with it, is by approving investment by investment. We took the £44 million before Christmas, did a full cost-benefit analysis and consulted. For all of the investments that make up the £1 billion, or whatever the number is, we propose to do something similar — take them investment by investment and figure in all the benefits, including the reduction in losses that you highlighted.

Mr Agnew: The Committee will hear from Manufacturing NI next. In the future, we will hear, perhaps informally, from the Northern Ireland Independent Retail Trade Association (NIIRTA) and Pubs of Ulster about energy costs for small businesses. As you mentioned before, everything has a knock-on effect. If we seek to bring down costs for high energy users, does that mean putting up costs for domestic consumers and small and medium-sized businesses? Paul highlighted some of the costs if we were to lose a large business. If we lose lots of small businesses or drive lots of domestic consumers into fuel poverty, there is a cost there. You are not here to set policy, but is there another policy option for reducing costs for high energy users that does not involve simply passing costs on to lower energy users, whether domestic or commercial, or is it just about how we distribute those costs among those three groups of consumers?

Mr Shane Lynch: Unfortunately, there are no free lunches. There is a bill that has to be paid. The number one objective should be to try to get the bill as low as is reasonably possible, bearing in mind our other objectives, such as security of supply and sustainability. We have tried our best to get the bill as low as is reasonably possible. Energy has to be distributed, so somebody has to pay it. If you decide that large users will pay less, domestics and small users will have to pay more. As Kevin said earlier, it is not an exact science. It is one of the projects that we are going to look at to see whether you can change the policy around that distribution. We are somewhat bounded by European policy and legislation on the issue. I mentioned the German example.

Mr Agnew: How are we bounded? You also mentioned the Irish example. It seems that it distributes its network costs significantly differently from how we distribute ours.

Mr Shane Lynch: That is the discussion that we have to have. We have to do a further piece of work to determine how much discretion there is and the extent to which you should exercise it.

Mr Shiels: The key point is that it is a zero-sum game. If some groups pay less, others will pay more. That is a fact.

Mr Agnew: We cannot talk too much about what the Republic of Ireland is doing, but if we were to copy what it is doing, would you say that that would be compatible with EU policy?

Mr Shane Lynch: It is too early to say. We need to look at the issue a fair bit more carefully.

The Chairperson: I am sure that you have had dialogue with your counterpart in Dublin on these matters.

Mr Shane Lynch: Not to any great extent. We clearly recognise that there is a very big difference in how the costs are allocated.

The Chairperson: Is that down to your bit of work now?

Mr Shane Lynch: Yes.

Mrs Overend: Thanks very much. It has been a very good discussion this morning. I am glad that I am not new to the Committee, because it takes a while to get your head around all the issues.

This is very concerning. Security of supply is a huge issue, as Paul talked about, as is where we go now so that the lights do not go out in 2016. The fixes will all cost money. I presume that the North/South interconnector will cost more money if it goes underground rather than overground. The Moyle interconnector will cost money. Responsibility for the other part of the fix lies with the Department of Enterprise, Trade and Investment (DETI). Whether it lobbies for a derogation from the EU emissions directive or considers helping Ballylumford to comply with the regulations in the short term, that will cost money.

We are here to talk about costs for the large suppliers as well. We want the economy in Northern Ireland to be efficient. The costs of energy are so high, so we are not competitive. Everything is pointing to increased costs. From the discussion around renewables and DETI's policy in that regard, it looks as though there will be increased costs. What can be done to reduce costs? What policies can be implemented to try to reduce costs? Do we need to look at other sources of energy, such as something that has not been thought of in Northern Ireland? Do we need to look at the electricity network in Northern Ireland? Do we need to talk about how efficient it is or about what investments need to be made in it and how that impacts on costs? Do the Government need to look at taking ownership of that?

I am just throwing out random questions here. *[Laughter.]* It is one of those days.

Mr Shane Lynch: There are quite a few points there, Sandra. Capital costs are associated with the North/South and Moyle interconnectors. Those have to be paid for. The benefits will outstrip the costs by a long shot. Therefore, as I said earlier, to get both of them done is a no-brainer. In particular, it is imperative that we get the North/South interconnector done. I am told that undergrounding will increase the capital cost by at least a factor of three. Clearly, the Planning Appeals Commission (PAC) will have to look at that from a planning perspective, or whatever. However, from our perspective as an economic regulator, we have to highlight that undergrounding will impact on costs for consumers. That is just a fact.

Your big question concerns what can be done. As I said, let us begin by being realistic. Northern Ireland is challenged because of its size, isolation and dependence on imported fuels. Set your ambitions accordingly as to where you want to be in five or 10 years' time relative to prices in the rest of Europe. I think that being at European-average levels is not a bad place to be, given our starting point. The real message here is to pay attention to all the cost drivers that are coming down the line well in advance, before they bite. Scrutinise them in a lot of detail. Realise that you do not have a blank chequebook. Ambitions can cost money. That is really it.

To summarise, our view is that policymakers and regulators do and must work very closely together on the issue. The future imperative for that is even stronger, given where we are at today.

Mr Shiels: I think that the coming review of the strategic energy framework is an opportunity to take an evidence-based look at energy policy and the options for going forward. That is something that we can work on with DETI. Given the fundamentals that we have, that high-level strategic view is needed on which way to go forward from here.

Mr A Maginness: I think that all the questions have been asked. Do we definitely need both the North/South and Moyle interconnectors? Is what you are saying is that there is no other option, so we have to have them? I take that as a yes. The cost of the Moyle interconnector shocked me. We are talking around £60 million. I think that the original investment was around £30 million. No? Perhaps I am incorrect.

Mr Shane Lynch: I do not have the exact figure.

Mr A Maginness: It is a shocking cost. It will have a major impact, I would have thought, on prices ultimately.

Mr Shane Lynch: We estimate around 2% for three years.

Mr A Maginness: That is very significant —

Mr Shane Lynch: It is.

Mr A Maginness: — if you add that to other pressures on prices. The North/South interconnector is still stuck in the planning process. Have you any indication of when that might be resolved?

Mr Shane Lynch: NIE has resubmitted its application. It is incentivised under its price control to get that done as soon as possible. However, that is not 100% within its control.

Mr A Maginness: RP5 is with the Competition Commission. Will that ruling be final and binding on all parties?

Mr Shane Lynch: Yes.

Mr A Maginness: There is no appeal from that or anything?

Mr Shane Lynch: No. Technically, the ruling can always be appealed by either party in the courts through a judicial review.

Mr A Maginness: Yes, leaving aside some sort of judicial review or something like that.

Finally, by way of observation, the domestic electricity charges in Europe — we were talking about wind and renewable energy, and so forth — the two countries with the highest charges are Denmark, which has massive use of renewable energy for generation purposes, and Germany, which again has a significant sector for renewable energy. Those two countries have the highest domestic charges. Therefore, what you are saying is that renewable energy will not necessarily reduce prices but that it may be effective for carbon reduction rather than price reduction.

Mr Shane Lynch: That is correct. I have not studied Germany and Denmark in detail. Kevin probably knows —

Mr A Maginness: Well, according to the graph here and the figures that you supplied —

Mr Shane Lynch: I think that in at least one of those countries taxation is quite high as well.

Mr A Maginness: It says VAT, but VAT is included in all those prices. I would have thought that it was fairly uniform throughout Europe.

Mr Shiels: It is fairly uniform. Denmark and Germany are known to be countries with high energy taxes. That is probably driving them to the left-hand side of the graph. I will pass on whether it is renewable energy that is driving them to the left-hand side of that graph. I cannot comment on that.

Mr A Maginness: Finally, I wish you well, Mr Lynch. I know that you are leaving your position. Thank you very much.

The Chairperson: You just stole my thunder. *[Laughter.]* It does no harm to repeat it. I have always found you to be very approachable and helpful in informing the Committee and me personally. As we have heard today, energy is a very complex issue. It is always helpful to have someone who is fit to explain it to us in understandable terms. I wish you well in whatever path you chose from October onwards.

Mr Flanagan: I am sure that he will be back before October. *[Laughter.]*

The Chairperson: We just never know.

Ms Maeve McLaughlin: As Alban said, many issues have been raised. The key message is the difference in distribution charges and the examination of that, both North and South, in the piece of work that will be done.

You both mentioned the need to review and scrutinise policy, which is fine, and put a particular focus on current energy costs and on getting the balance between consumer and investor. In your opinion, to whom is current policy more biased towards? Where is it more weighted?

Mr Shane Lynch: That is a perennial question. Where are we currently at? You look at profitability of the generating companies. At present, it is pretty healthy and has been for a number of years. Their margins have come down quite a bit compared with 2007-08. Wholesale costs are 70% to 80% of the bill, so that is the biggest place to look. There is a big opportunity, as we redesign the market into this western European market, to look at any imbalance.

Going back to Sandra's question, that is the big opportunity. We are a small place, a small island, and we need to interconnect physically. We also need to integrate economically with western European markets. Ultimately, competition should reduce margins. Competition is a better remedy than regulation in the long run. Regulation is a surrogate for competition.

At the minute, however, we have to rely on regulation because we are too small. The big opportunity to readdress margins overall will come with regional integration. Another key point is distribution of charges, and we have touched on that extensively.

Ms Maeve McLaughlin: The European consumer directive has been processed, and it seems to be more of a principle about rights, responsibilities and empowering consumers in a lot of these issues. The same goes for some of the legislation going through Westminster. Is there an examination of how that would assist or protect? Are you looking for opportunities that may exist there to focus on energy prices as well as empower consumers in relation to the challenges?

Mr Shane Lynch: Another big answer to this is to use less electricity or gas; consume less, and it will cost you less. That is empowerment and education. Again, that is an objective that is always there. Ultimately, we will get to smart meters, which are a few years away, when people can buy their power on a half-hourly basis, and the price varies on a half-hourly basis. That is for the long term and is a bit away yet.

Kevin, do you want to add anything about what is being done in the short term?

Mr Shiels: A lot of work is being done in Europe about customer engagement in markets and customer protection. Key bits of that are already implemented in Northern Ireland, and we will make sure that they continue to be implemented.

Some studies show that consumer demand can be reduced by 10% with better engagement and knowledge of energy usage. That is quite a lot when we are talking about percentage points off bills. A lot more needs to be done on consumer empowerment and engagement. Those are not focused on because we tend to focus on the economics and prices. However, there is another part to what we do in our office, which is about consumer protection and encouragement around that, making sure that the companies and consumers have the interface right in terms of the information that consumers need from companies to change their behaviour and minimise their costs.

The Chairperson: That is a valid point, all that customer empowerment engagement and stuff — very valid and very useful, how we educate people to lower their costs and stuff. But when people are really down to the wire, and the 17.8% hike means the difference between feeding their families more or less, and people cannot afford to insulate their homes, that is when you see it exposed for what it is worth. That is why we are trying to deal with these issues and make sure there is some control over the likes of renewables bumping up and increasing their profits on the back of the market hikes in gas or whatever other fossil fuel that might be out there. How that is done is probably a chat for another day.

I hear what you are saying about ROCs and subsidies at one level, but that may just lead them to reduce their investment at another level. We have to make sure that there is control over exorbitant pricing or just bumping up the price for the value of keeping it behind the highest guy in the market. I think that a lot more work is required on that. I am glad to hear that somebody somewhere is thinking about it, and hopefully a few actions will start to emerge.

On that note, I would like to thank Shane and Kevin for being here with us today and everybody for engaging with them. Inevitably, you and your office will be back again to discuss this and other

issues. Thanks very much indeed for being with us here today. I am sure that the people at the back were listening very intently to what you said.

Mr Shane Lynch: Thank you.