

Joint Response by Forfás/ Enterprise Ireland/ IDA Ireland to the I-SEM Consultation on the Draft Decision Paper on the High Level Design for Ireland and Northern Ireland from 2016

July 2014



Three quarters of Ireland's exports of goods and services in 2012 were by enterprise agency client companies in the internationally trading sectors. Agency-assisted companies operating in Ireland provide approximately 300,000 direct jobs and a similar number of indirect jobs; 40 per cent of national Gross Value Added; and €40 billion in direct expenditure (payroll, materials and services purchases).

The enterprise agencies (Forfás, Enterprise Ireland and IDA Ireland) welcome the opportunity to input to the Integrated Single Electricity Market (I-SEM) Consultation on the Draft Decision Paper on the High Level Design for Ireland and Northern Ireland from 2016.

Energy competitiveness is of increasing importance for enterprise development. Ireland's recovery and future economic growth depends on the ability of businesses to trade successfully in increasingly competitive global markets. A reliable, sustainable and competitively priced supply of electricity is essential to maintain and grow our existing export base, to continue attracting high levels of foreign direct investment and to retain and create jobs.

The Irish energy market has undergone significant change since 2007. While there have been a number of positive changes such as the improvements in security of supply, the establishment of the all island electricity market and the opening of the energy retail business markets, there have also been some negative trends, most notably the sharp deterioration in energy cost competitiveness in recent years.

The way in which the I-SEM is designed is a very important issue for the enterprise agencies given the significant implications it will have for Ireland's future energy cost competitiveness and security of supply.

Key issues for enterprise

The availability of reliable, competitively priced electricity is critical to support job creation and economic activity across all sectors of the economy, both the internationally trading and domestic sectors of the economy. There has been a sharp deterioration in Ireland's energy cost competitiveness since 2010 which has serious implications for the enterprise base, particularly in energy intensive sectors such as food and drink, life sciences, ICT, construction materials and other manufacturing sectors.

Importance of energy cost competitiveness for enterprise

The EU is among the most expensive locations for electricity globally¹. And within the EU, Ireland is among the most expensive countries for electricity – Ireland had the 5th highest electricity price for large users and for SMEs in H2 2013. Electricity prices for large users in Ireland increased by 34 per cent between the second half of 2010 and the same period in 2013 while those for SMEs increased by 21 per cent².

Changes in relative energy prices can have far-reaching effects on investment, production and trade patterns in internationally trading sectors and directly affect the ability of enterprise to retain and grow output and employment – for example:

- The sharp increase in energy prices in recent years has put energy intensive sectors like food and drink, life sciences, ICT, construction materials and other manufacturing sectors under serious pressure to remain competitive in international markets. Many of the energy intensive companies in Ireland are large and important regional employers,

1 European Commission, Commission Staff Working Document: Energy Prices and Costs Report, January 2014.

2 Eurostat energy prices database: <http://epp.eurostat.ec.europa.eu/portal/page/portal/energy/data/database>

operating in low margin markets where prices are determined globally. As a result, the large increases in energy costs since 2010 cannot be passed on to customers and have to be absorbed by the company, thereby putting them under serious pressure to remain competitive in international markets; and

- The increasing gap between energy prices in Ireland and the US is of particular concern to the large number of US firms based in Ireland who compete with sister sites in the US for new investment and Irish companies trading in the US. In 2011, the US accounted for three quarters of inward investment into Ireland. Approximately 115,000 people are directly employed in 700 US companies and US firms export in excess of €100 billion of goods and services from Ireland.

Enterprise development and the I-SEM

As highlighted in the draft decision paper, the establishment of the Single Electricity Market (SEM) in 2007 has been a very positive development. It has brought many benefits from a competitiveness perspective. Most notably, it has led to increased efficiencies in generation and greater transparency in the electricity market as well as incentivising investment in new generation capacity and increasing competition. As a result, we have seen significant improvements in security of supply as evidenced in the large margin of spare supply (we do acknowledge that some of the improvement is due to reduced demand) and more transparent and competitive prices for enterprise. In addition, our environmental sustainability performance has improved with the rollout of significant renewable electricity generation capacity.

The enterprise agencies strongly support the SEM Committee's proposal to build on the strengths of the SEM while addressing its shortcomings. From an enterprise development perspective, the main principles that should underpin the high level design of the I-SEM are:

- ensuring a transparent wholesale market – one of the key advantages of the SEM for enterprise, particularly large, sophisticated users, is the transparency it provides on wholesale price trends, allowing them to negotiate more effectively with their suppliers and giving them a choice of electricity products, e.g. pool-price-pass-through tariff;
- ensuring the price of electricity is cost reflective and that measures to mitigate market dominance are in place and rigorously enforced;
- promoting competition in the generation and supply markets, in particular, it should continue to facilitate new entry by small players that may not be active in both generation and supply and drive for efficiencies in generation and supply;
- supporting investment in cost effective renewable capacity to meet our EU commitments;
- incentivising investment in new, efficient plant, especially flexible plant (to complement the increasingly large amounts of wind capacity on the system) while also encouraging the efficient exit of the remaining old, inefficient plant; and
- ensuring that the rules deliver efficient use of the interconnectors and do not result in unnecessarily higher costs for consumers.

Enterprise views on the draft decision proposals

This section highlights the enterprise agencies' views on the I-SEM design proposals of most relevance to enterprise.

The enterprise agencies welcome the focus in the draft decision paper on the high level design of the I-SEM to build on the strengths of the SEM while addressing its shortcomings. In particular, we support the proposals in the draft decision paper to maintain and develop transparency in the I-SEM and to facilitate efficient entry and exit to/from the market. The proposal to facilitate increased participation from the demand side is also a welcome development from an enterprise perspective.

Protecting consumer interests

We would urge the SEM Committee to ensure that protecting consumer interests (business and residential) is at the core of the new market design. We note that the previous consultation paper on the design of the I-SEM in February 2014 said, *when considering which design option to take forward for implementation, the SEM Committee will be guided by its primary objective (as confirmed in the February 2013 Next Steps Decision Paper) that: "is to protect the interests of consumers of electricity in Ireland and Northern Ireland supplied by authorised persons, where appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale or purchase of electricity through the Single Electricity market"*.

However, in its consideration of the impact of the different market design options in the draft decision paper, there is little, if any focus on what it all means for end users – the focus is primarily on the different types of market participants.

Capacity remuneration mechanism

The enterprise agencies strongly support the SEM Committee's proposed decision that a capacity remuneration mechanism (CRM) is required in the I-SEM. The capacity payment mechanism has played a key role in incentivising new investment in generation capacity, particularly in the past when Ireland had a very tight generation capacity margin, a lot of old, inefficient plant and a growing demand.

However, as highlighted in the draft decision paper, there are concerns that the location and type of the substantial investment in generation capacity over the past seven years was not optimal. We agree with the SEM Committee that it is important that new market design sends the right investment signals to ensure that future energy needs are met – that is that it delivers the right amount of capacity with the right characteristics in the right locations. It is also very important that it does this in a way that minimises the impact on costs for energy users.

Wider policy context

While outside the scope of this consultation, energy policy decisions will also have a significant bearing on how successful the I-SEM is in achieving its objectives. It is therefore critically important that the new energy policy considers the impact of related decisions/actions on the effective functioning of the I-SEM and ensures that Ireland's energy policy priorities are aligned with the I-SEM objectives:

- One of the decisions that will have greatest impact on the market are the future targets for renewable energy generation and the mechanisms put in place to achieve them:
 - Under previous gate processes to assign grid connections, offers were made on a first come, first served basis. While this ensured fairness and transparency, it was suboptimal from an efficiency perspective. We need to ensure more geographically focused renewables investment to minimise the amount of additional grid investment required and to deliver on the I-SEM objective to have the right type of generation capacity in the right location;
 - An increasing share of Ireland's generation capacity is subsidised. It is critically important for the effective functioning of the all island electricity market that renewable generation capacity is subject to market forces to the greatest extent possible. As a mature technology, price supports for new onshore wind projects should be discontinued when REFIT 2 ends in 2017³;
- The delays in delivering the North-South interconnector are adversely affecting the efficient functioning of the SEM and as a result are leading to higher costs for Irish electricity consumers. Enhancing interconnection to Great Britain and continental Europe is important to reduce our reliance on gas and wind and deliver the benefits of the single European electricity market to consumers;
- While competition has increased both in the electricity generation and supply markets, the IEA review in 2012 raised concerns about the continued high level of State involvement in the energy market. In particular, ESB retains a significant share of the price setting generation plant in the SEM. Some of ESB's non-strategic electricity generation capacity is to be sold as part of the sale of State assets but not the critical price setting plant. However as highlighted by the OECD, the IEA and others, some of ESB's price setting generation plant should be divested to reduce ESB's dominance and increase competition; and
- Demand management solutions can play a greater role in meeting Ireland's energy objectives and can also help improve Ireland's attractiveness, particularly for large energy users with a flexible demand profile.

Cost management

The costs of changes to the SEM could be substantial relative to the small size of the all island electricity market⁴. It will be important that these costs are managed carefully so as to minimise the costs that are passed on to end users.

Conclusion

Energy competitiveness is of increasing importance for enterprise development. The SEM Committee needs to ensure that the changes to the all island market design required to implement the target model deliver efficiencies and cost effective electricity to consumers.

The establishment of the SEM has been a very positive development for Irish energy customers. We urge the SEM Committee to maintain a strong focus on protecting the interests of

³ Originally to qualify for REFIT 2, projects were to be operational by the end of 2015 but in June 2013, DCENR announced that the deadline is to be extended to the end of 2017. For details see:

<http://www.dcenr.gov.ie/Energy/Sustainable+and+Renewable+Energy+Division/REFIT.htm>

⁴ The ESRI estimated the costs at €100 million (e.g. software to support the market).

consumers (business and residential) as the I-SEM is developed and implemented, ensure that the market delivers the right amount of capacity with the right characteristics in the right locations and that the costs of implementing the new market design are carefully managed. While outside the scope of this consultation, it is critically important that the new energy policy considers the impact of related decisions/actions on the effective functioning of the I-SEM and ensures that Ireland's energy policy priorities are aligned with the I-SEM objectives.