Department of
Enterprise, Trade
and Investment
www.detini.gov.uk

From: Fiona Hepper
Energy Division

Date: 25 May 2012

To: 1. Andrew Crawford
2. Arlene Foster, MLA

Copy Distribution List Below

DETI SUB 279/2012: LMU 25/12 - QUERY FROM THE ETI COMMITTEE IN RELATION TO "ENERGISING NORTHERN IRELAND" – REPORT BY LORD WHITTY

Summary

Issue:	To respond to the ETI Committee's request for the Department's view on Lord Whitty's report and to the Committee's query on social tariffs in mitigating welfare reform proposals.
Timing:	**Urgent:** This reply this is due with the ETI Committee Clerk by Friday 1 June 2012.
Need for referral To the Executive:	Not Applicable.
Presentational Issues:	None at this stage. While the report received a small amount of press coverage there has, as yet, been no specific lobbying of Government on foot of the issues raised.
Freedom of Information:	In the event of a request for disclosure of information contained in this submission under the FOI Act, the request should be considered in the context of the relevant provisions of the legislation including any relevant exemptions that may be applicable.
Programme for Government /PSA Implications:	None.
Financial Implications:	Not Applicable.
Legislation Implications:	Not Applicable.

Statutory Equality Obligations: None

Recommendation: That you consider and approve the attached draft reply to the ETI Committee.

1. At its meeting on 17 May 2012, the ETI Committee received a briefing from Lord Whitty on his recent report "Energising Northern Ireland". Following the briefing the Committee asked that the Department's views on the recommendations contained within the report be sought

2. In addition, the Committee also sought the Department's view on social tariffs in mitigating welfare reform proposals.

Background

3. Lord Larry Whitty accepted a CCNI invitation to undertake a piece of work on the three key interdependent elements which determine policy interventions on energy; Security of Supply, Affordability and Sustainability. Lord Whitty, a former Labour Energy Minister, was deemed by CCNI to have the necessary experience and expertise in this area having been involved with industry and wider sectors on energy issues in GB. You will recall that met with Lord Whitty as he finalised his report.

4. On 23 March 2012, a Consumer Council press release appeared in the local media announcing the publication of Lord Whitty's report.

5. At it's meeting on 30 March the ETI Committee gave Lord Whitty's report a provisional welcome and commented particularly on the call for a single department to formulate and oversee energy policy in Northern Ireland. Subsequent to this Lord Whitty was called to appear before the Committee on 17 May to brief members on his report.

ETI Committee Request

6. Following on from Lord Whitty's briefing, the Committee agreed to seek the Department's view on the recommendations contained with his report. My earlier submission of 6 April provided you with an overview of the main issues raised in the report and I propose that we respond to the Committee drawing on the key issues set out previously.

7. The Committee has also asked for the Department's view on social tariffs in mitigating welfare reform proposals. As Minister, you have made it clear on numerous occasions that you are not minded to introduce social tariffs and the reasons for this are set out once again in the draft response below. However, from a DETI perspective welfare reform does perhaps offer an opportunity for a more flexible approach to assisting those in fuel poverty and this is also reflected in the response drafted.

Recommendation

8. It is recommended that you approve the response to the ETI Committee, which is attached for your approval at **Annex A.**

Fiona Hepper

FIONA HEPPER
Energy Division
Ext 29215

cc: PS/Minister
David Sterling
David Thomson
Jackie Kerr
Alastair Ross, APS MLA
Paul Dolaghan
David McCune
Dennis Cunningham
Garvin Loughrin
DETI LMU
Press Office
Neth Energy

ANNEX A

REQUEST FROM THE COMMITTEE

The Committee has asked for the Department's views:

1. On the recommendations made in the report by Lord Whitty; and

2. On social tariffs in mitigating welfare reform proposals

DEPARTMENTAL RESPONSE

1. LORD WHITTY REPORT

By way of overall general comment the Minister would wish to state that Lord Whitty appears to have taken little notice of the Northern Ireland Executive's foremost energy policy document, the Strategic Energy Framework (SEF 2010). This is evidenced by the fact that, despite making clear his specific considerations are around the issues of affordability, sustainability and security of supply, he fails to recognise or acknowledge anywhere within the report that these mirror three of the four key pillars that the SEF 2010, published some eighteen months earlier, seeks to address.

While the report incorporates a number of headline comments on strategic objectives which sit well with the SEF, the Department would question many of the conclusions and recommendations for short to medium term actions. There are also several examples of the report echoing recommendations previously put forward by others (e.g. CCNI) and, as such, the report offers little, if anything, new to the Northern Ireland energy debate.

What follows is a broad overview of the issues raised in the report and the Department's initial comments against the range of key headings.

Home Heating Oil

<u>Regulation</u>

Lord Whitty has presented no new evidence to underpin his recommendations on home heating oil. His focus in the medium term is for a radical reduction on the dependency of home heating oil in NI households. But, in the short term, he is calling for the NI Authority for Utility Regulator to extend its remit to cover a licensing system for price transparency and customer service with reserve power of price control.

The Utility Regulator has previously confirmed that introducing regulation of heating oil would incur costs, both for NIAUR and the oil companies (and probably also the CCNI). These are costs which would ultimately be passed on to consumers. It therefore appears illogical to suggest increasing costs on a sector while at the same time government policy is acting to reduce its contribution to the energy mix.

High Costs

The report points to a 35% rise in the cost of home heating oil during 2011, adding significantly to the overall heating bills of NI households. The retail price of home heating oil is ultimately based on the Rotterdam Jet Kerosene market – the reference point for the wholesale price across the UK. The price of both crude and kerosene (wholesale and retail) has continued to rise in parallel with crude oil over the past few years which has increased the cost on a range of refined products. Kerosene is traded in dollars and exchange rate fluctuations with sterling have also added to the wholesale price.

Sutherland Tables, an independent energy consultant, continues to report lower kerosene retail prices in NI compared to other regions. The January 2012 statistics, the most up to date at the time Lord Whitty's report was published, show that NI consumers paid 3% less than the average GB price and at least 21% less than prices in the Republic of Ireland.

Criticisms of the Office of Fair Trading (OFT) Report

Lord Whitty repeats CCNI criticisms that the October 2011 OFT Report on off-grid energy markets did not differentiate the NI energy market effectively and calls on DETI to review pricing, consumer protection and competition in the NI market to rectify this.

In response the Department would, again, point out that the UK Government sets the overall policy framework for competition which is regulated by the OFT and Competition Commission. It is widely recognised that the OFT report fulfilled the remit set for the review. It clearly states the methodology used. The OFT also took submissions between October and November 2011 on its proposals not to refer the home heating oil sector to the Competition Commission and, on the basis of no additional evidence being received, published a decision in December not to do so.

Concerns on Short Measures

Concerns are also expressed in the Whitty report about NI customers receiving short measure in oil deliveries, even though no specific evidence has been presented. Trading Standards Service (TSS), who are responsible for enforcing the Weights and Measures (Northern Ireland) Order 1981, investigates any alleged breaches of this legislation that comes to its attention, and takes appropriate enforcement action, where necessary. Since April 2010, TSS has investigated 54 complaints alleging short measure deliveries of home-heating oil. After carrying out investigations into these complaints, TSS found absolutely no evidence of consumers being delivered short measure of oil. TSS routinely inspects tests and verifies home heating oil tankers to ensure that oil tanker meter measuring systems are accurate. The TSS position on this issue was communicated to the ETI Committee towards the end of last year and both CCNI and Lord Whitty would have been aware of this.

Natural Gas

Lord Whitty's report deals with a number of gas issues, and notes that natural gas should be available to as many households and businesses as possible. The Department would fully concur with this as it will help provide additional fuel choice, alleviate fuel poverty and also reduce carbon emissions through less dependency on oil, in particular.

In relation to the matter Lord Whitty raises regarding incentives for people to connect to gas, the respective gas price controls already allow for the companies to offer gas connection incentives, though consumers still bear the costs for a new gas boiler etc. However, incentives have to be paid for and if within price controls, then all consumers pay for these, even though they may not have benefitted from similar incentives themselves in the past. Much more generous connection incentives would have to apply to both existing gas licence areas, and perhaps any new areas, to deal with equity concerns along with potential gas company criticism of unfair support to competitors.

DETI would strongly disagree with the proposal that gas network extension to new towns/urban areas is delayed until there is greater gas penetration in existing gas licence areas. Indeed, there is a very feasible argument that they should proceed in parallel. To do otherwise leaves consumers in the West and East Down, for example, at the mercy of increasing oil prices, less security of supply and particularly impacts on business competitiveness.

The report also implies that gas extension is not being subjected to a proper consideration of costs and benefits, although there is absolutely no evidence offered to substantiate this statement. The Committee is aware that proposals to extend the gas network to the West and East Down are being explored and currently being exposed to a rigorous cost-benefit assessment. The Department completed a high level cost-benefit analysis for gas to towns in the West in 2010 and is currently in the process of completing a more detailed Outline Business Case for gas extension to both areas. This will assist DETI in making a case for possible government subvention to help off-set the costs and consider the cost and benefits in more detail. It is also accepted that even with gas network extension, most consumers in rural areas will not be connected to gas and DETI's Renewable Heat Incentive proposals could therefore provide an alternative energy source.

In relation to the assertion within the report that the cost benefit of a major gas storage facility remains to be proven, the Department would make the point that the two possible projects in East Antrim are being taken forward by private developers with no financial support from government. No private company, especially in the current economic situation, would undertake this work if they didn't see a clear commercial benefit. Given that NI has no indigenous supplies of natural gas at present, there is a clear rationale that a gas storage facility would provide enhanced security of energy supply (gas and electricity). Developers will have considered the economics of the respective projects and are currently involved in completing geological assessments in advance of committing significant funding to a project. Developers will not take forward a project unless they were convinced of the business case for storage. A storage project would also have significant benefit as we move towards much higher levels of wind energy - allowing gas fired generators to have a local gas supply available at short notice (e.g. if a large amount of wind came off the system), and perhaps at prices which might be more favourable than spot prices in the GB market.

The Department also notes that there is a recommendation that Phoenix Supply retail tariff reviews should be extended to 5 years. However, given the volatility of gas prices on world markets it is not known if this would be workable, though this is a matter for the Regulator.

The report also makes reference to the lack of competition for domestic supply in the ten towns area. However, it fails to state that against this there will be a staged introduction of competition in the *firmus energy* gas licensed area with the market being opened for large Industrial and Commercial users from October 2012, and SMEs and domestic consumers from April 2015.

Energy Tariffs

The report makes reference to a social tariff stating that there should be a mandatory requirement on supply companies in electricity and gas to provide a social tariff for those on defined means tested benefits. However, as always, the problem remains around who pays, especially given Northern Ireland’s high levels of fuel poverty and the risk that by introducing social tariffs we drive further consumers into fuel poverty. Given the accepted difficulties around targeting, the Department is of the opinion that the benefit system would appear to remain best placed to provide support for those in greatest need.

The Department would agree with Lord Whitty in relation to the point that there should not be a multiplicity of retail tariffs. This has caused customer confusion in GB and the NI Regulator is also not in favour. But this is something of a moot point, as we are not in the GB position.

It is also worth noting that as part of the implementation of the EU Third Energy Package, the Regulator has been consulting on a range of energy price modifications to enhance consumer and retail protection for both gas and electricity.

Electricity

Lord Whitty draws reference in his report to how generators costs are rewarded within the SEM. It should be noted that the SEM provides an efficient mechanism in respect of ensuring the continued availability of sufficient generation to deliver consumer demand for electricity at lowest cost through the market mechanism. The SEM has delivered new and more efficient generation, thus driving down SEM wholesale electricity prices. In relation to rewards it is the case that, if generators do not make sufficient profits, their business is not sustainable. Ultimately, the SEM encourages the most efficient and low cost generation to be dispatched in advance of others.

Reference is also made to the capacity for customer switching to be increased and the ease of switching improved. The report recognises the recent increase to 9,000 customers per month and the Committee will also be aware that a new enduring retail customer switching system for electricity is on target to become operational in May 2012 with no switching limits. Unfortunately, the report makes no reference to this work which is already in train.

Infrastructure

It is the Department's opinion that the section on infrastructure priorities offers nothing new to the energy debate. The SEF has set a 40% electricity target by 2020 and the Department is working with NIE and the Utility Regulator to deliver new grid to facilitate renewable power generation in the West of Northern Ireland in particular. As the Committee is aware the new North-South interconnector is currently at public enquiry stage.

In respect of gas networks, DETI supports the ongoing work by Phoenix and *Firmus* to deliver new network and increase gas connections in their respective licence areas. In addition, and as previously referenced, DETI has consulted on and is currently taking forward proposals, in co-operation with the Utility Regulator, to extend the gas network to towns in the West and to East Down.

Energy Efficiency

Lord Whitty has stated his strategic objective as being a coherent and sustained intervention on energy efficiency delivering substantial reductions in energy use (per unit of GDP) by 2025. Again, the Department would wish to point out that the SEF has already identified energy efficiency as a key issue going forward. However, DETI would not agree with the assertion in the report that this would obviate the need for larger infrastructure projects, as there is a requirement to progress renewables coming out of the Renewable Energy Directive, in addition to benefits for the Northern Ireland supply chain.

The report also indicates that much of the delivery of an enhanced energy efficiency strategy will need to be delivered on area based interventions. DETI is not proposing an area based intervention in its forthcoming Energy Bill consultation, although suppliers or other obligated parties would be free to adopt such an approach if they so wished.

Lord Whitty also proposes that Northern Ireland Departments should, in say two year's time, review the implementation and take up by consumers in Great Britain of the Green Deal scheme and consider whether a similar loan based scheme would work for owner occupiers and landlords in NI. This is something with which the Department could concur and indeed intends stating in the forthcoming Bill consultation paper that while the Green Deal approach is probably not appropriate for Northern Ireland at the moment, it could be considered in the future. In terms of timescale, any new measure brought in under the proposals for the new Energy Bill is unlikely to be in place before 2014/15, and as such the Department will not, given current resources, commit to any such review before then.

Single NI Department of Energy

One of the main issues picked up in the media coverage of the report was Lord Whitty's call for the creation of a single department to deal with all energy issues. As you are aware the ETI Committee had, as part of its own Renewable Energy Inquiry, recommended that the Executive should provide appropriate leadership in delivering the overall energy agenda by bringing all responsibility for energy policy and strategy under a single Government department. The Department subsequently advised the Committee that SEIDWG was already exploring the scope for consolidating and streamlining sustainable energy activities within the current departmental structure and, if this work confirmed the need for a single energy department, the necessary recommendation would be made to the Executive.

As the Committee is already aware, it was agreed at the SEIDWG meeting in July 2011 that DETI, as chair of the SEIDWG, was unlikely to be seen by other departments as fully objective on this issue and that the Sustainable Development Champions group, chaired by OFMDFM, should take this work forward and it was agreed that a cost benefit analysis was needed and DETI should take this forward and bring it back to the Champions group, via SEIDWG. The subsequent analysis indicated that the optimal balance of costs and benefits lies with a single directorate for energy within an existing department and it was agreed that this option should be referred to the Champions' group for consideration at their January 2012 meeting. DETI understands that the Champions group decided to place the issue on hold to allow both the SEIDWG and the DOE Climate Change Working Group to progress work lines for a period, and that the position should then be reviewed.

OFMDFM is now planning to put a paper to the Executive setting out the current position. DETI is keen that consolidation of energy efficiency vires would still take place and will work with DSD, DFP, and to a lesser extent with DOE with that aim, subject to senior official, Ministerial and Executive agreement. Again, Lord Whitty was made aware that government already had this in hand - but chose not to recognise this in the report.

Smart Metering

The Department would wish to point out that the references within the report to smart meters include no indication that smart meters have an associated cost and that this will have to be paid for by consumers. Similarly, there is no recognition of the smart meter actions within the Strategic Energy Framework. As the Committee is aware, DETI and the Utility Regulator are already working together on smart metering and Lord Whitty's recommendation that there should be a pilot seems to ignore the fact that there is already a smart metering pilot underway in Northern Ireland. The cost benefit analysis on smart metering has now been completed and the Department anticipates a policy announcement in the near future. The report also indicates that a smart meter programme should also provide the opportunity, prior to installation, for a complete audit of every household for energy efficiency. However, once again there is no recognition of the costs associated with such an approach.

Renewables and Decentralised Energy

This section of the report begins by quoting that present renewable generation is 9.65%. The Department would point out that this is someway off the mark with the figure at March 2012 actually sitting around 12.5%. On the issue of decentralised generation, it is also noted that there is no recognition of the significant system operation issues with decentralised systems on an island system.

NIRO

One of the report's recommendations in relation to decarbonising our system calls for the cross subsidy incentive for wind energy (mainly ROs) to be renewed beyond 2013, and for the whole subsidy/cross subsidy system for wind and other non carbon and low carbon technologies to be consistent and in place for a substantial period. As the Committee is aware, DETI is extending the NIRO to 2037 ensuring those accrediting up until its proposed closure in 2017 receive 20 years of support. This was set out in the October 2011 consultation on changes to the Northern Ireland Renewables Obligation from 2013. Furthermore, the consultation also posed a number of questions related to Electricity Market Reform and proposed a move away from the Renewables Obligation to an alternative incentive mechanism, a Feed-In Tariff with Contracts for Difference.

The Department is also considering introducing a separate small scale (up to 5MW) Feed-In Tariff and will be taking the necessary legislative powers in the forthcoming Energy Bill. The consultation has proposed that small scale onshore wind will continue at the current incentive levels (4 ROCs up to 250kW; 1 ROC up to 5MW) with a 10% reduction for large scale onshore wind (to 0.9 ROCs). In 2010, the NI Executive increased ROC levels for Anaerobic Digestion which has significantly stimulated this technology (over 70 planning applications in progress). It is also proposed to increase wave and tidal to 5 ROCs from 2013.

Offshore

While the Department has never said that renewable generation to 2020 "would largely consist of onshore and offshore wind generation" (see paragraph 5.41, page 63) the main point here is that the report does not seem to be aware of, or has chosen to ignore, the offshore work carried out to date. Similarly in relation to the comment "Decisions are needed on long outstanding proposals for new green energy based sources for electricity - including on offshore wind proposals and the biomass plants" it should be pointed out that, although the Offshore Renewable Energy Strategic Action Plan (ORESAP) has just been published (and too late for this report), the Department's draft Plan has been available as well as all the actions in 2011 leading up to the The Crown Estate leasing round announcement in December 2011 which included a 600MW offshore wind project. The Department is very much of the opinion that Lord Whitty should have recognized this in the report.

Onshore

While Lord Whitty's report does mention the SEF in paragraphs 5.47 & 5.48, his report does not adequately reflect the policies and objectives outlined in the SEF. It also fails to recognise all the work already being done by Invest NI/ DEL etc. on investment and skills in renewables within Northern Ireland. The Department would also point out that there is no mention of the Onshore Renewable Electricity Action Plan which has been in the public domain in draft form since October 2011.

Role of Consumer Council

Lord Whitty has also stated in his report that “there needs to be a strengthening of the Consumer Council’s role in the regulatory process and that discussions need to take place on how that is best achieved”.

The Department would point out that the Consumer Council’s functions already encompass consumer education, consumer support and complaints handling, as well as a multi utility statutory role to represent consumers in electricity, natural gas, transport and water. The Energy (NI) Order 2003 also gave the Consumer Council extended powers and an expanded remit with responsibility for representing the interests of energy consumers in Northern Ireland. Given that there is also a statutory requirement on DETI and the Regulator to protect the interests of electricity and gas customers, it would seem that sufficient protection powers are already in place.

2. SOCIAL TARIFFS IN MITIGATING WELFARE REFORM PROPOSALS

As the Committee will be aware, DETI does not have a role in the welfare reform proposals, although it could see how they might offer the possibility for a more flexible approach to targeting assistance to those most in need, including those deemed to be in fuel poverty. While it would not be for DETI to determine, it might be the case that reform could allow for better targeting of the funding currently made available for winter fuel payments towards those most in need of assistance with their fuel expenses. However, DETI is not in possession of all the relevant information in this regard and so the Department would have to be guided by DSD and others as to whether this would be a viable consideration.

In relation to social tariffs, DETI would state that the basic principle behind such a tariff is to set a lower domestic energy tariff for a pre-determined customer group i.e. those who are fuel poor, whereby the shortfall this creates is paid for by the remaining customer base. However, a key challenge is the identification of those households who should be targeted for help and which customer group(s) pay more as a result. Any move to introduce social or affordability tariffs in the energy sector would be extremely complex and potentially prone to negative knock on effects that could ultimately see the numbers in fuel poverty actually increase. It should also be noted that within Northern Ireland some seventy percent of households are reliant on oil for home heating. Any form of social tariff aimed at helping the Northern Ireland fuel poor would need to be capable, therefore, of being extended to help oil (and coal) customers.

Political debate and public consultation would be essential before any decision could be taken in relation to a social tariff. In addition, legislation is also likely to be needed as the Regulator’s statutory powers and general duties do not currently provide a legal basis to implement an affordability scheme that would involve large-scale cross subsidy of one group of customers at the expense of another.