Regulatory Reform in Ireland

Regulatory Reform in Electricity, Gas, Pharmacies, and Legal Services

OECD

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LA RÉFORME DE LA RÉGLEMENTATION DANS LES SECTEURS DE L'ÉLECTRICITÉ, DU GAZ, DE LA PHARMACIE ET DES SERVICES JURIDIQUES

FOREWORD

Regulatory reform has emerged as an important policy area in OECD and non-OECD countries. For regulatory reforms to be beneficial, the regulatory regimes need to be transparent, coherent, and comprehensive, spanning from establishing the appropriate institutional framework to liberalising network industries, advocating and enforcing competition policy and law and opening external and internal markets to trade and investment.

This report on *Regulatory Reform in Electricity, Gas, Pharmacies, and Legal Services* analyses the institutional set-up and use of policy instruments in Ireland. It also includes the country-specific policy recommendations developed by the OECD during the review process.

The report was prepared for *The OECD Review of Regulatory Reform in Ireland* published in 2001. The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers.

Since then, the OECD has assessed regulatory policies in 16 member countries as part of its Regulatory Reform programme. The Programme aims at assisting governments to improve regulatory quality — that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. It assesses country's progresses relative to the principles endorsed by member countries in the 1997 *OECD Report on Regulatory Reform.*

The country reviews follow a multi-disciplinary approach and focus on the government's capacity to manage regulatory reform, on competition policy and enforcement, on market openness, specific sectors such as electricity and telecommunications, and on the domestic macroeconomic context.

This report was principally prepared by Sally Van Siclen, Principal Administrator, of the OECD's Division for Competition Law and Policy. It benefited from extensive comments provided by colleagues throughout the OECD Secretariat, as well as close consultations with a wide range of government officials, parliamentarians, business and trade union representatives, consumer groups, and academic experts in Ireland. The report was peer-reviewed by the 30 member countries of the OECD. It is published under the authority of the OECD Secretary-General.

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Sectoral reforms in Ireland have been an important part of the move toward market-based growth but as yet progress has varied among the sectors. Work by the OECD and by other organisations indicates that a range of key regulatory and competition issues remain in many sectors. In this report, we examine selected issues in electricity, gas and professional services, using legal services and pharmacies as case studies.

ELECTRICITY AND GAS

1. INTRODUCTION

The Irish electricity and gas sectors are dominated by two vertically integrated state-owned entities, the Electricity Supply Board (ESB) and *Bord Gáis*, respectively. Electricity and gas demand are growing rapidly, reflecting GDP growth. The shift toward gas as the electricity generating fuel of choice mean that incremental electricity generation requires incremental natural gas supply. By 2010, or earlier, 70% of electricity is likely to be generated by gas and in 2000 shortages of gas were projected in winter 2002

Reducing the cost of non-traded, as well as traded, goods and services improves the competitiveness of Ireland. Effective competition in the non-traded sectors reduces costs. In other European Union Member states, the EU directives in electricity and gas have been used as springboards to re-examine thoroughly the structure and regulation of those sectors and, in many cases, to reform and introduce competition that lowers costs. There is in Ireland, while the economy is growing robustly, and before any actual ownership has been transferred from the state, an opportunity for reform that truly promotes the interests of consumers and the competitiveness of the whole economy.

Such reform involves changes in structure, regulation and institutions. Structural change means separation into distinct companies, with distinct commercial objectives and ultimately distinct owners, of electricity generation from supply, and both from the grid business of transmission-distribution, as well as investments in transmission to make significant trade with Northern Ireland and Scotland feasible. It may be advisable to create separate, competing generation companies, or it may be sufficient to develop an all-island market and promote competitive entry into electricity generation. (A fundamental issue in Ireland is the size of electricity demand as compared with the size of existing generating units, the minimum efficient scale of new generating units, and whether the legal framework supports two or more independent owners of capacity at a single generating plant.) In gas, structural change means a similar separation of transmission from supply, or alternatively to retain vertical integration while selling rights to transmission capacity and introducing competition in transmission. Changes in regulation mean proceeding with the transformation of the entities into limited liability companies, and also imposing on their boards commercial objectives and incentives. It means too introducing economic regulation that provides incentives for efficiency and competition, such as a price cap regime. But without private investors pushing for better returns, incentive-compatible regulation like price caps has but an attenuated effect on companies' efficiency. Access to the electricity and gas transmission networks needs to be non-discriminatory, at prices that induce their efficient use, and subject to independent regulation, as is already the case for electricity. Reforming institutions means putting into place an independent regulator with effective regulatory powers exercised within the policy framework with accountability to Government and Parliament, and ensuring that the Competition Authority applies the competition laws and advocates for competition principles in the sectors.

A main obstacle to private investment in the sectors is regulatory uncertainty. Laws and institutions are not yet fully in place in Ireland, and policies not clearly set out. While progress was made in the course of 2000 – the independent regulatory institution was staffed and operating, and had been granted regulatory authority over final electricity tariffs, and access to gas (necessary for new electricity generation) was allocated — as of early 2001 the independent transmission operator was neither incorporated nor staffed and the principles for gas transmission tariffs were under review. Delay favours the incumbent state-owned firms, who due to the implicit state guarantees are relatively unaffected by policy uncertainty. As long as new generating capacity and new gas transmission capacity are put off, the incumbents' dominance if not monopoly are prolonged. Thus, within a framework of market-oriented proposals and widespread consultation, the Government should undertake to reduce the delays and uncertainty in the future legal framework for these sectors.

2. POLICY OBJECTIVES

The Department of Public Enterprise has three main policy objectives. These are: to promote the evolution of competitive energy (and other) sectors to contribute to Irish competitiveness, to manage any change in ownership to "best cater for the development of the sectors and the long term interests of the companies and their employees," and to provide an effective regulatory framework that balances independence and accountability (DPE 1998) More specifically for the energy sector, the objectives are:

- To ensure environmentally sustainable energy production and consumption;
- To develop a competitive energy supply industry;
- To ensure security and reliability of energy supply;
- To maximise energy efficiency; and
- To ensure that energy infrastructure is operated safely (DPE 1998).

The difficulty of reconciling these objectives is acknowledged, and indeed implementation to date reflects tradeoffs. Thus, the objective of competitive energy sectors is to be striven for not by changing the structure of the incumbents, but rather by new entry into the potentially competitive activities of the sectors. But entry is foreseen to be limited: Under a Tripartite Agreement (between the managers and unions of ESB, and government), the incumbent electricity monopoly will seek to retain about 60% share of the electricity market. Security of supply was given priority over competition development in the July 2000 statutory instrument on allocating gas capacity for electricity generation, and, in the event, one-third of the capacity was allocated to the incumbent electricity generator.

However, the DPE has noted that these objectives can be congruent. The DPE has written that, in the long term, the best assured future for the companies for which it exercises ownership and their employees is achieved by planning for inevitable liberalisation and moving ahead of minimum requirements.

3. DESCRIPTION OF THE SECTOR

The Electricity Supply Board (ESB) and *Bord Gáis Éireann* (Irish Gas Board) dominate all activities in the eponymous sectors. ESB consumes about half of all gas consumed in Ireland. Both the ESB and *Bord Gáis* are fully state-owned "State-sponsored bodies".[1] (A diverse group of entities has the

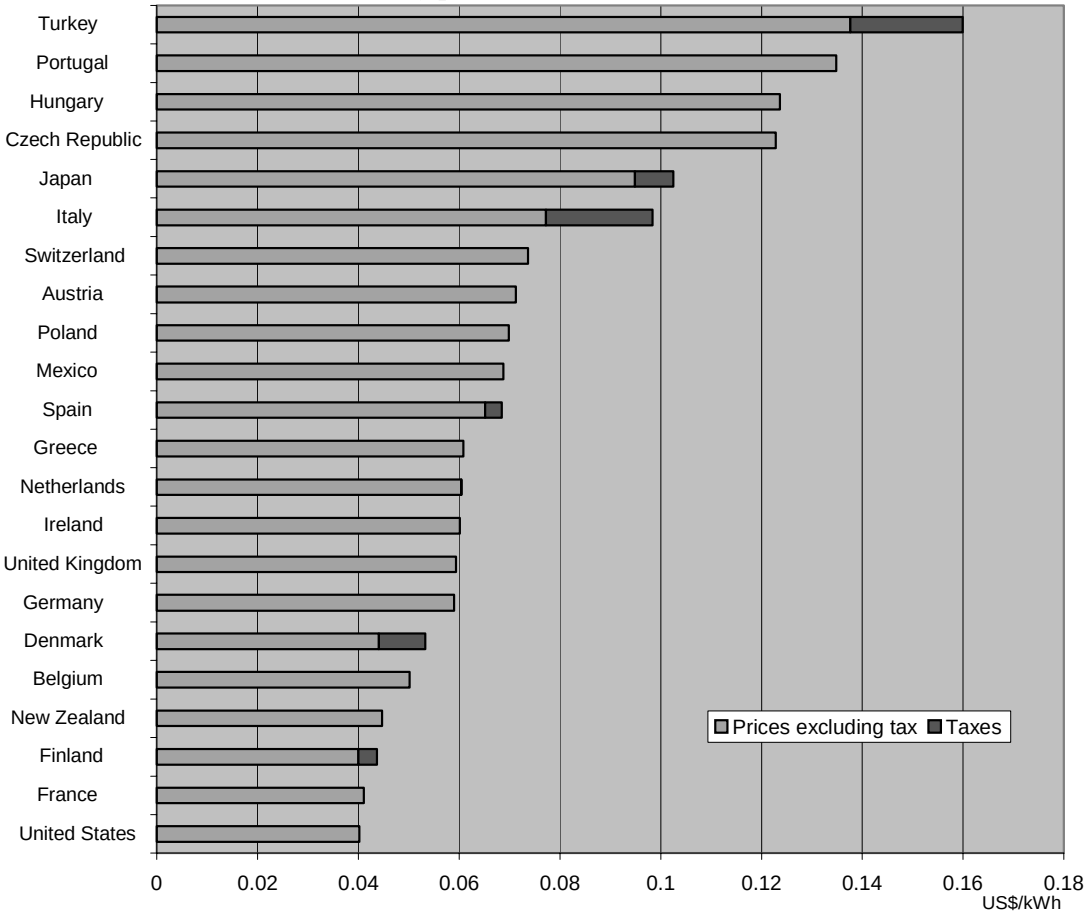
status of “State-sponsored bodies” in Ireland.) Access to the grids is regulated, by the Commission for Electricity Regulation (CER) for electricity and through Government directives for gas. CER is expected to begin, in 2001, to regulate final electricity tariffs for captive consumers in addition to its current regulation of the of generators and suppliers of electricity. The Government, as owner, controls other aspects of the sectors. Prices of electricity for both industrial and domestic customers are low by European standards, and about median among International Energy Agency members. Two plants, Moneypoint (coal) and Poolbeg (gas) generate more than 20% and about 22%, respectively, of total electricity in the Republic.

Since February 2000, about 30% of electricity demand (nearly 400 large users, using more than 4 million kWh annually) may choose electricity supplier. This is the first step in a phased liberalisation of all electricity consumers by 2005 (ESB 2000). Since 1995, gas consumers with annual usage above 25mcm/year, and since August 2000, all power generators irrespective of size, have been able to choose their gas supplier and transport the gas through *Bord Gáis*’ network. (This amounts to 6 to 8 large users and about 60 small-scale power generators accounting for about 75% of demand.) This degree of consumer liberalisation meets or exceeds that specified in the directives agreed by European Union Member states. The EU electricity directive allowed Ireland an additional year to implement the first phase of liberalisation.

New electricity generators are poised to enter the Irish market, according to market participants. Some already supply power to liberalised Irish consumers, and will have built generating plants in a few years. However, in the short term, gas transmission capacity restricts the number of new gas-fired power plants to two or three.

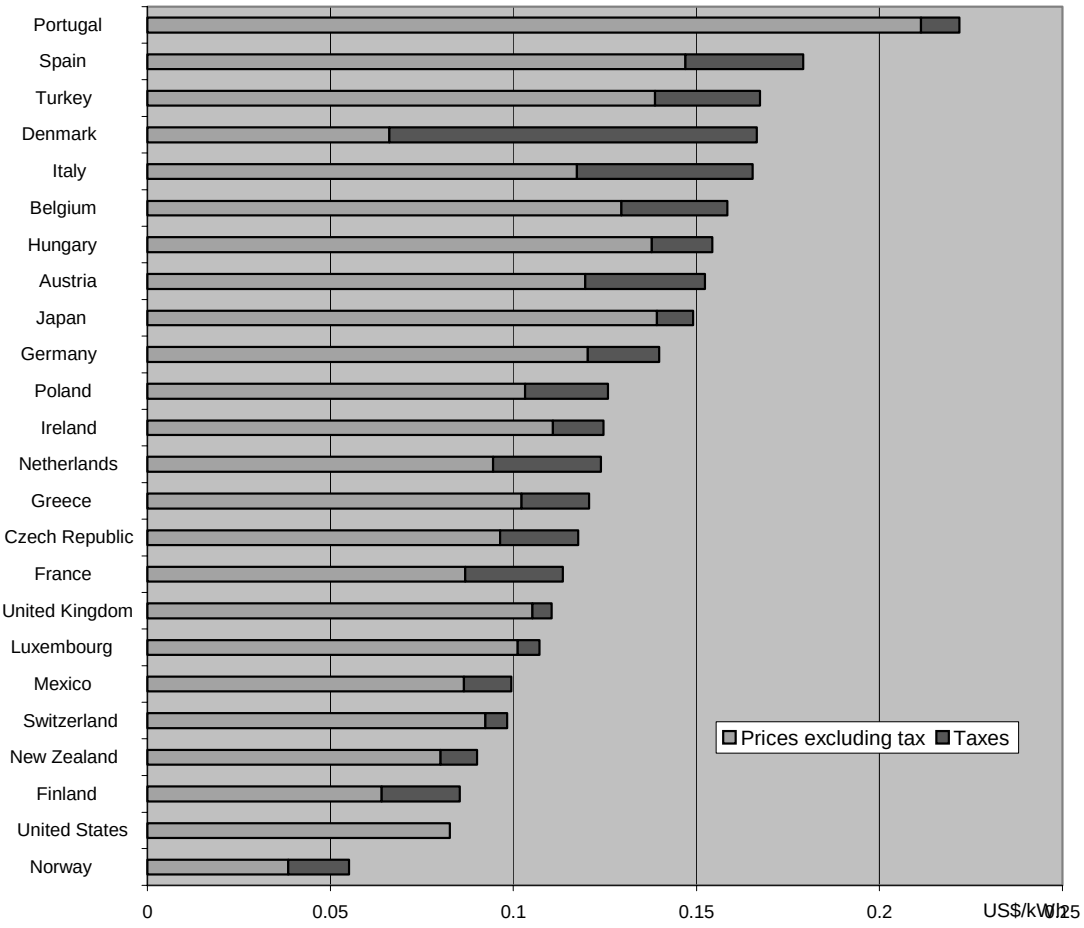
Ireland’s energy sectors are moulded by its location and geology. Perched on the edge of Eurasia, Ireland can, with current connections of 280MW, trade a limited quantity of electricity, and that only with Northern Ireland. While this connection will be upgraded, and a connection between Northern Ireland and Scotland built, their capacity could supply only a small part of total Irish demand. About two-thirds of natural gas (63% in 1999) arrives via one pipeline from Scotland. Electricity is also generated from imported coal and oil and indigenous peat, which is a soft organic material formed by partial decomposition in water of plants for a few thousand years.

Figure 1. **International price comparisons**
Industrial electricity prices in selected OECD countries, 1998



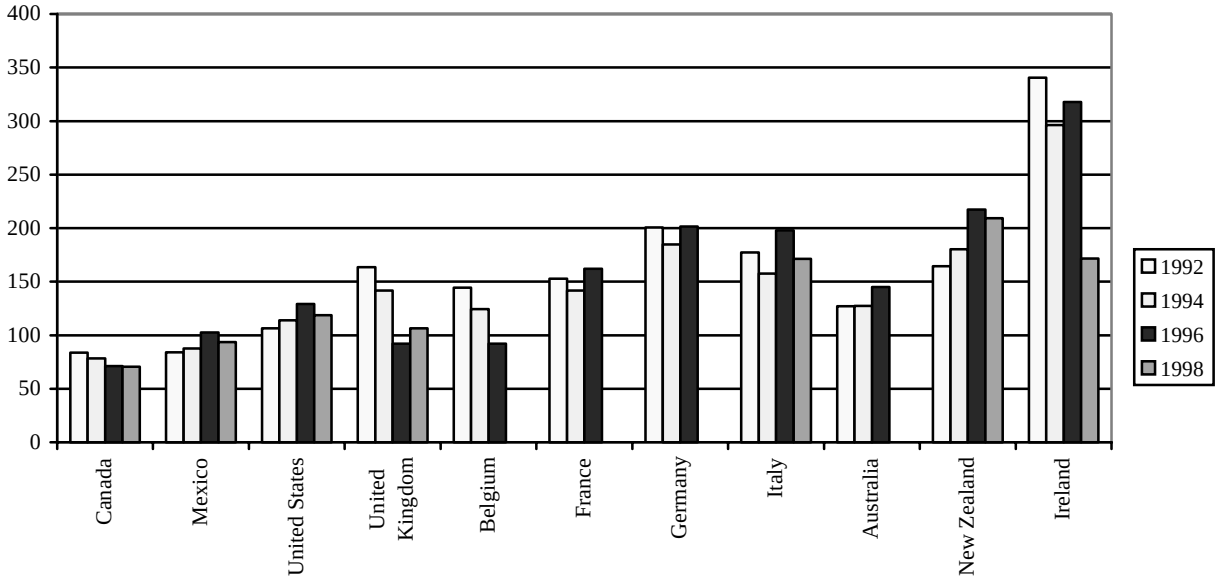
Note: Data not available for Australia, Canada, Korea, Luxembourg, Norway, and Sweden.
Source: IEA/OECD (2000), *Energy Prices and Taxes*, 3rd quarter, Paris.

Figure 2. **International price comparisons**
Households electricity prices in selected OECD countries, 1998



Note: Ex-tax price for the United States. Data are not available for Australia, Canada, Korea and Sweden.
Source: IEA/OECD (2000), *Energy Prices and Taxes*, 3rd quarter, Paris.

Figure 3. **Gas prices in selected OECD countries**



Average price per 10b kcal on a gross calorific basis. All prices in US Dollars
Source: IEA, Natural Gas Information (1999), Table 17

Box 1. **Irish electricity and gas sectors at a glance**

Electricity

Installed capacity (end 1999): 4 360 MW (of which ESB owns 4 158 MW, excluding Poolbeg steam turbine, 160 MW, commissioned in 2000; remaining 202 MW is small scale generation).

Annual Generation (1999): 20.89 TWh (ESB 20.17 TWh and SSG 0.72 TWh).

Fuel mix (generation in 1999): 32% gas, 26% coal, 28% oil, 7% hydro, 7% peat

Expected growth is 4.4% per annum, 1998-2006 (It was 6.6% from 1998 to 1999) (CER and ESB, ESB 2000).

Interconnections: 280MW to Northern Ireland, of which 200MW is under long-term contract

Gas

Imports: 88 099 Terra Joules.

Domestic production: 51 329 GCV.

Total final consumption: 139 428 GCV.

Electricity generation: 69 581.

Distribution losses: 2 597.

Industrial consumption: 18 848.

Commercial consumption: 11 416.

Residential consumption: 17 957.

Non-energy use: 19 029.

Box 2. **Description of the electricity sector**

The electricity sector has four main stages of production, which vary in terms of their scope for competition and the regulation that can be applied. These stages are:

- Generation – the production of electric power using a variety of fuels and technologies
- Transmission – the high-voltage "transport" of electric power over distances from generators to distribution networks and large industrial customers
- Distribution – the low-voltage "transport" of electric power to smaller customers
- Retailing or supply — a set of services including metering, billing and sale of electric power to final consumers.

A fifth component is system operation. The electricity system must remain in balance, with demand and supply equal at each moment in time. Demand varies unpredictably. Hence to remain in balance, supply must respond immediately to changes in demand. System operation is the control of the generating units and other equipment attached to the transmission grid to ensure this demand-supply balancing, as well as to maintain other quality attributes of electricity.

Transmission and distribution are, for the foreseeable future, natural monopolies at any given geographic location. Further, even where a transmission grid has different owners in different geographic regions, the physical properties of electric power imply not that the sections of the grid could compete but rather that they would each "transport" a share of the power. Consequently, competition in transmission and distribution is infeasible.

By contrast, both generation and retailing are potentially competitive activities and indeed are competitive in many countries for at least some final consumers. It should be noted that generators may be located on either the same or the opposite side of an international border from the users of the electric power.

Behaviour by one user of an electricity system can change the costs of other users. These externalities imply that, at least up to relatively large geographic areas, system operation over a larger area is more effective than over a smaller area. This implies that system operation at any given geographic location is a natural monopoly activity and competition is infeasible.

Access to the limited capacity of the gas interconnector from Scotland is key to the expansion of electricity generation in the short term. The existing indigenous gas field is nearly depleted but another, Corrib, was discovered in the 1990s. The press reports that Corrib will be developed. However, if the Corrib field is not developed in time, then a second gas pipeline from Britain will have to be built in the next half-decade. It could be provided without government or other external assistance (IEA, 1999) and a variety of private and public sector proposals have been made – paralleling the current pipeline to Scotland, to Wales, and to Northern Ireland.

There is excess demand for the gas interconnector capacity. By October 1999, *Bord Gáis* had received applications for gas capacity which corresponds to a total of 4 000 MW additional gas-fired generating capacity (DPE, 1999). In July 2000, a statutory instrument was signed (S.I. No. 237 of 2000, Gas (Amendment) Act, 2000, (Section 2) Regulations, 2000, 26 July 2000) that instructed CER to allocate a fixed amount of gas transmission capacity to new power generation. The statutory instrument gave priority to supply shortage considerations over competition considerations. In the event, gas transmission capacity was allocated to three generators — an ESB-Statoil joint venture, and two new entrants — totalling about 800 MW capacity. In that connection, the Competition Commissioner of the European Union indicated that a substantial change in the structure of the electricity market "can only be achieved by means of new market entries," and that ESB's joint venture with Statoil cannot be considered to be an independent operator (Monti, 2000).[2]

Discussion about how to allocate the limited capacity had centred on the desire to introduce earlier competition in electricity generation.[3] Granting priority to avoidance of supply shortage was seen as further delaying the development of a competitive structure in the generation market by enabling the incumbent to gain access to gas capacity that would otherwise have gone to an independent competitor. (Sunday Business Post, 23 July 2000). The issue had been identified some time ago. The International Energy Agency had noted that investment in new generation would be rationed by the availability of gas supplies and was urging since mid-1999 that the first power stations allocated gas supplies be owned by a company other than ESB. In October 1998, the ESB, in consultation with the DPE, said that in excess of 200 MW additional generating capacity would be required in late 2001/early 2002, and a further 800 MW by 2005.

Box 3. **The natural gas sector**

Like many other industries, the natural gas industry comprises a number of distinct "stages of production", differing in the nature of their regulation and the scope for competition. It is possible to distinguish five broad stages of production, from the point of extraction (the "well-head") to the point of consumption (the "burner-tip").

(a) Production – which can be further broken down into the exploration, drilling, extraction and processing of gas. For the purposes of this paper, re-gassification facilities for gas in its liquid form (known as LNG) can be included within this stage of production.

(b) Transmission – the high-pressure transportation of gas to high-volume customers such as distribution companies, large industrial customers and power stations.

(c) Distribution – the low-pressure distribution of gas to small and medium-volume gas customers.

(d) Storage – the smoothing of the flow of gas through the transportation network by pumping gas into holding facilities at off-peak times, and withdrawing the gas at peak times.

(e) Retailing or Marketing – the provision of services of contracting with production, transmission and distribution companies on behalf of gas customers and associated billing and metering services.

In most cases, competition between gas producers is feasible. Competition may not be effective in practice, as one or a few producers may own all the viable independent sources of gas. This is especially of concern when the independent sources of gas are under the jurisdiction of a foreign country.

While gas transmission pipelines exhibit sizeable economies of scale, competition between pipelines may nevertheless be feasible in some countries, according to the magnitude and the geography of demand for gas flows. As a rule, however, it seems likely that for the foreseeable future effective inter-pipeline competition even in fully liberalised markets will be limited to a few geographic locations.

While some gas customers, particularly very large ones, are supplied directly off the high-pressure transmission network, most smaller customers are supplied through local gas distribution companies, known as "LDCs". Like many other network industries, local gas distribution exhibits economies of density – once the costs have been sunk of installing a gas main down a street, the marginal cost of connecting another house or building to the gas main is very small. Because of these economies of density, local gas distribution is, generally speaking, a natural monopoly. Competition would not normally be expected to be feasible in gas distribution.

Demand for gas is highly seasonal. Demand at peak times can be several times higher than at off-peak times. Gas storage facilities smooth the flow of gas through the network, which are filled at off-peak times and drawn down at peak times. Gas is stored in a number of different types of facilities, such as depleted gas reservoirs or disused mines. Although access to certain key facilities (such as depleted gas reservoirs) can be limited, the economies of scale in gas storage are small. As a result, there remains scope for effective competition in gas storage services, with the possible exception of regions with low population density.

Electricity transmission. The electricity transmission and distribution system in Ireland needs to be upgraded. *Forfas*, the national economic and technology policy board, recommended in *Enterprise 2010* that 220Kv supply to all regions be guaranteed (*Enterprise 2010*, January 2000). Some observers note that potential investors do not consider locating in parts of western Ireland due to electricity supply problems (Business & Finance, 23 March 2000, p. 17).

Connections beyond the Republic will be upgraded in the next few years. The ones between the Republic and Northern Ireland are being upgraded from 280MW to 400MW in 2001. CER auctioned off the use of some of the capacity for a year, although there remains some hesitancy, for security reasons, in relying upon the connection. The Moyle Interconnector between Northern Ireland and Scotland will have 500 MW capacity when completed in 2001, although 125 MW has been reserved under long term contract. While these connections will facilitate the reliability of the Irish systems, the nameplate capacities amount to only about one-seventh of installed generating capacity in the Republic, and effective capacities are invariably lower.

Renewable energy generation. Ireland has set an ambitious target for increasing the amount of electricity generated by renewable sources of energy. In its Green Paper on Sustainable Energy, this target was increased by 500MW (about one-eighth of total). Ireland has relied on auctions to build generation using specified technologies (the *Alternative Energy Requirement* competitions). It is expected that these projects and the 2005 target will deliver a total capacity in excess of 600MWe in 2005, the vast majority of which (over 80%) will be wind powered (ESB, 1998). Since February 2000, this mechanism has been augmented by allowing any electricity supplier supplying from renewable energy sources (green electricity) to supply any final consumer. The ERA, 1999 requires the CER to have regard to the need, "to promote the use of renewable, sustainable or alternative forms of energy." CER recently amended the trading regulation to allow green operators to mix with non-green sources, thus facilitating their activities. However, the expansion of wind powered generation is hampered by the lack of verified published data on site-specific and overall grid capacity acceptance limits from wind powered sources. Until resolved, this will hinder growth in the liberalised green market.

Peat, the traditional fuel in Ireland, is supplied by *Bord na Móna*, a State-sponsored body, to ESB under long term agreement.[4] The International Energy Agency estimates that, in 1999, the cost of generating electricity from peat was 50% higher than doing so from alternative fuel (coal). The IEA notes, however, that the producer subsidy for peat was far lower than the producer subsidy equivalent for coal in, say, Germany or Spain (IEA, 1999). Peat emits more CO_2 per unit electricity generated, 1 467g/kWh as compared with 851g/kWh for coal or 492g/kWh for gas (IEA calculation). However, since the exploitation of peat for electricity generation takes place in an area of higher than average unemployment, it was originally considered to form part of the social safety net. Current plans call for the six old peat-fuelled plants to be replaced by two new peat plants, bringing the total to three. The Minister for Public Enterprise may direct the CER to impose on ESB the requirement, as a public service obligation, that up to 15% peat, as a primary fuel source, is used in the fuel mix of electricity generation in any year (ERA, Sect. 39). This requirement is intended to ensure that Ireland is reasonably self-sufficient in electricity generation. Gas from the Irish seabed and from other European Union Members also ensures this self-sufficiency.

Anticipating competition, ESB has already improved its efficiency. A Cost and Competitiveness Review programme yielded net annual cost savings of I£60m. Staff reductions contributed substantially; about 2 000 employees have voluntarily departed since 1996. According to a commitment made under the Cost and Competitiveness Review, 5% of shares will be transferred to ESB staff after ESB is transformed into a limited liability company (ESB, 2000). ESB has set a target of an additional I£100m annual cost savings over the five years from 2000. Meeting this target would mean further staff reductions, greater efficiencies, competitive sourcing of business and purchasing services, and replacement and refurbishment of generating plant (ESB, 2000). These efficiency improvements are being driven by the threat of competition, as they could have been carried out under the existing regulatory regime.

4. REGULATORY INSTITUTIONS AND REGULATION

Three institutions – the Department of Public Enterprise, the Commission for Electricity Regulation (*An Coimisiún um Rialáil Leictreachais* or CER), and the Competition Authority – are involved in regulating the sectors. The Minister for Public Enterprise has overall responsibility for the gas and electricity sectors. She makes policy and, together with the Minister for Finance, exercises the ownership role in ESB on behalf of the state. ESB is a statutory corporation established under the Electricity (Supply) Act 1927 and *Bord Gáis* is a statutory body, established under the Gas Act 1976. (The Department of Marine and Natural Resources is responsible for *inter alia* licensing gas exploration and development.) The formulation of government policy in these sectors could be greatly influenced by the nature of the partnership framework, which includes business and trade union representatives. The Minister, as shareholder, decides on major investments, such as new power plants or gas pipeline extensions. She appoints eight members of the Board of ESB (the four other members are elected by ESB staff) and ESB's independent auditor. She appoints all nine members of the Board of *Bord Gáis*. For both entities, the respective Boards appoint the chief executive and other managers. At present, the Minister gives general directives to *Bord Gáis* on transmission access pricing and resolves access disputes. In March 2001, the Government proposed the transfer to the Commission for Electricity Regulation of responsibility for regulating gas transmission access, granting consents for gas pipeline construction, and licensing pipeline operation and storage and supply of natural gas (DPE, 2001). However, the policy framework relies on competition from other fuels to limit expressions of monopoly power by *Bord Gáis*.

The CER regulates network access and entry into electricity generation, and supply to liberalised consumers. Statutory Instrument No. 445 of 2000 provides for CER to regulate final electricity tariffs paid by captive consumers, *i.e.*, those who are not "eligible," after the S.I. came into effect on 20 December 2000.The CER makes the rules for trading in electricity (ERA, Sect. 9) in accordance with the Policy Direction issued by the Minister in July 1999. To secure compliance, CER may apply to the High Court for an order requiring the holder of a license or of an authorisation to comply with its direction (Sect. 26).

The CER has structural independence. Its one to three members are appointed by the Minister for Public Enterprise, after a selection process by an independent body, for three to seven year terms, renewable once. The Minister may remove a member of the CER in event of incapacity or stated misbehaviour, and must state the reason. The CER is independent in the performance of its functions and has financial independence since it may impose a levy on electricity undertakings. The CER must submit to the Minister an annual report on its activities and proposed future work programme. The Minister must provide these reports to each House of the *Oireachtas*. The CER must report to a Joint Committee of the *Oireachtas*, from time to time and as requested, and have regard to its recommendations (Schedule ERA). However, CER's independence from the Minister is mitigated by the fact that its authority to regulate final tariffs to captive consumers and the agreement between the transmission system operator and owner is granted under Statutory Instrument rather than statute, so that the delegation of authority is reversible by the minister. The Government intends to grant the regulatory power to the CER under primary legislation to be prepared later in 2001.

The CER has varying degrees of discretion. Under the gas capacity allocation rules (Gas Amendment Act, 2000), the CER had almost no freedom of decision-making, being limited almost to estimating projects' completion dates. By contrast, the CER is independent in regulating transmission and distribution grid access. It can direct the ESB on the basis for calculating charges for the use of and connection to the grids, on the content of connection and use agreements, and the terms of connection offers. CER may also resolve connection disputes. CER, solely, determines the "appropriate proportion" of costs and the "reasonable rate of return" on capital that enter the calculation of charges for the connection or use of the electricity grids (Sect. 35).

The Competition Authority is the only institution that may enforce the general competition law. There is also the right of private action. While there are no exemptions from that law, where other legislation authorises non-competitive practices and conditions the competition law cannot correct them. (Of course, a damaged person could sue under European Union competition law, provided the transaction in question has a community dimension. In those cases, the EU law takes precedence over the national legislation.) The Authority had two competition matters in the electricity and gas sectors in recent years. Responding to a complaint received May 1997, the Authority expressed its views that, under the Competition Acts, *Bord Gáis* could not charge different prices to firms buying similar quantities of gas where those firms were in competition with one another, nor could it offer more favourable terms to a firm in which it had an interest where doing so placed a rival firm at a disadvantage. In addition the Authority indicated that *Bord Gáis* could not set charges to competitors for use of the interconnector and the gas pipeline which were less favourable than those applying to itself. The Authority had ongoing discussions with *Bord Gáis* regarding the setting of access charges for use of the transmission network.

In August 1998, the Authority received a complaint regarding an 'Optisave Contract' that ESB was offering to a number of its larger customers. The Authority objected to a clause which provided that, after market liberalisation in February 2000, a customer who was offered cheaper electricity by a competing supplier would have been required to give details of the offer to the ESB (while not naming the other supplier) and to allow it an opportunity to lower its prices. The customer would only have been allowed to switch to another supplier if ESB failed to match or offer a lower price, and then only after giving ESB six months notice of termination. Further, customers could not submit alternative offers to ESB before the date of liberalisation. ESB subsequently agreed to delete the clause to which the Authority had objected and to amend the agreements to provide that either party may terminate on giving three months notice.

4.1. Regulation

The regulation of ESB is less formal and complete than that in many other OECD countries. ESB must "break-even."[5] Within that framework condition, the regulation of ESB's tariffs is changing in 2001. Under the earlier system, ESB may apply to the Minister for Public Enterprise for increases in the tariffs charged customers, and the Minister may grant or deny the application. There have been significant delays in consideration of the application: In January 1995, an application for a price increase had been with the Department for seven years (Dail Reports, 21 February 1995, Col. 870 reported in Massey and O'Hare, p. 73). The basis for the decision appeared to include the overall profitability of ESB. (Response to question in Parliament, Minister for Public Enterprise Mary O'Rourke, 29 June 1999, ref. No. 16298/99). However, CER is to acquire the power to set and change tariffs under S.I. 445 of 2000. In addition, the Minister exercising ownership must give ESB prior approval for large capital expenditures, such as to build power plants. Extensions of power lines and new power plants also require planning permission from local government.

Public service obligations. Public service obligations are imposed by order of the Minister for Public Enterprise. These obligations may relate to security of supply, regularity, quality and price of supplies, environmental protection, and use of indigenous energy sources. She may direct CER to require that up to 15% peat as a primary fuel source, is used in the fuel mix for electricity "available to" ESB in any year. Orders under this section shall provide for the recovery, by a levy on final consumers, of the additional costs incurred including a reasonable return on capital (Sect. 39 of ERA). If complete cost recovery were guaranteed, companies fulfilling public service obligations would not be provided incentives to fulfil them efficiently. In addition, where public service obligations receive excessive compensation, market competition is needlessly distorted. In particular, if the amount of the transfer makes it profitable for ESB to exceed the 15% share, or indeed for it to displace competitors' generation, then the transfer increases total cost of the system beyond the limit implicit in the 15% share policy decision.

Transmission pricing. Two issues arise as regards transmission access in Ireland, pricing and access in light of the congested network. Charges for the use of or connection to the grids shall enable the ESB to recover the appropriate proportion of direct and indirect costs incurred, and a reasonable rate of return (Sect. 35). Originally, the ESB had proposed that generators connecting to the transmission grid would be charged on the basis of "deep" connection charging principles. That is, the cost of transmission reinforcement at a distance from the generator would be charged to the generator. Subsequently, the CER issued a Direction to ESB in accordance with Section 34 of the Act to adopt a shallow approach to transmission connection charges. This reduces the connection charge to generators and shifts some costs to "use of system" charges (which are calculated to provide locational signals for generators) paid by all users. The Transmission System Operator, *Eirgrid*, will be responsible for transmission pricing, subject to CER approval. Some concern has been expressed that *Eirgrid* may not be given the commercial objectives or incentives to price transmission to induce lowest total system cost behaviour. The congestion of the Irish transmission network means that there are only a few points where a new generating plant could be physically connected. It is estimated that only two generating plants can be added in the Dublin area, for example. Thus, the granting by ESB of a grid connection to its joint venture with Statoil before other potential entrants could enter a grid connection agreement has been seen by the potential competitors as having serious repercussions on the future development of competition in the Irish electricity market. The EU Competition Commissioner has indicated that the allocation procedure needs clarification (Monti, 200)).

Transitional costs. The Minister for Public Enterprise can, after consultation with the CER and the European Commission, provide for the recovery of stranded costs from final consumers (Sect. 40 ERA). However, Ireland has confirmed to the European Commission that it does not intend to notify a stranded cost recovery regime.

Accounting separation. Integrated electricity undertakings are to keep separate accounts for their generation, transmission, distribution and supply activities. These accounts must be kept in accordance with the Companies Acts, 1963 to 1999, as if they were carried out by separate companies, "and with a view to avoiding discrimination, cross-subsidisation and distortion of competition (Art. 31, S.I. No. 445 of 2000). ESB must accounting separate, in this manner, also its supply to liberalised consumers from supply to captive consumers. The Eligible Supply Business, a business unit of ESB, is to purchase electricity from its own generators on the same basis as independent suppliers (ESB, 2000).

A generating license condition prohibits generators considered by the CER to be dominant in the electricity generation market from discriminating in favour of affiliates or related undertakings, and prohibits cross-subsidy with other businesses, affiliates or related undertakings of the licensee. For the purpose of this condition, the CER determines what constitutes the market, and whether the licensee is dominant (Electricity Generation License at http://www.cer.ie/new.htm on 12 June 2000).

Gas

Bord Gáis is not subject to economic regulation, except for access to its pipelines. *Bord Gáis* has split into four business units. The business unit for transmission has a separate management and operates independently of the remainder of the company and, under *Bord Gáis*' code of practice, is to offer the same services at the same prices to the remainder of *Bord Gáis* as it offers to third parties and must not share business sensitive information obtained in the course of carrying out its transmission business with other units. Under the corporate governance *Bord Gáis* has imposed upon itself, each business unit is to operate in a commercial, arm's length and transparent manner, and not cross subsidise. Each business unit keeps separate accounts and presents financial statements as though they were separate incorporated entities. *Bord Gáis* has had the practice of extensive outsourcing, a practice that allows costs to be more finely allocated and that may have resulted in higher efficiency and lower overall costs (ESRI 1995, p. 18).

There is continuing discussion about how the transmission tariff should be calculated. The interconnector is a significant cost item, so the question of whether all gas sold should contribute towards its costs, or only gas that passes through the interconnector, has been an important point of contention. It is generally agreed in Ireland to not reflect geographic differences in the cost of on-island gas transmission, even though not doing so signals gas users to locate in higher-cost-to-serve places.

Box 4. **EU gas directive key features**

Third-Party Access Requirement: Member states must allow certain gas customers to buy gas from the supplier of their choice and to have it transported through the existing pipeline network at regulated rates. This right must only be available initially to very large gas customers. For the first five years, only gas customers taking at least 25 million cubic metres (mcm) of gas per year and electricity generators must be eligible; for the next five years the threshold reduces to 15 mcm per annum; in the final 3 years, this threshold reduces to 5 mcm per annum. It is thought that there are 8 gas customers in Ireland who qualify for the first group. Member states may liberalise smaller customers, sooner. Member states can choose between "negotiated access" and "regulated access". Under negotiated access individual customers enter into commercial negotiations to determine the precise terms and conditions. Gas companies are required to publish their "main commercial conditions" for the use of the system. Under regulated access, gas customers have a right of access on the basis of published regulated tariffs.

Independent Regulatory Institutions: Member states are required to designate competent authorities, independent of the parties, with access to the internal accounts of the natural gas undertakings to settle access disputes expeditiously.

Unbundling: Natural gas undertakings are required to keep separate accounts in their internal accounting at least for their gas transmission, distribution, storage and consolidated non-gas activities "as they would be required to do if the activities were carried out by separate undertakings".

New Investment: Member states must allow a general freedom to build and operate natural gas facilities via objective, non-discriminatory and transparent authorisations.

Public Service Obligations: Member states are allowed to impose on gas utilities, in the general economic interest, public service obligations which may relate to security of supply, regularity, quality and price of supplies and to environmental protection.

Capacity Rationing: Natural gas undertakings may refuse access to their system on the basis of lack of capacity, or where the access to the system would prevent them carrying out the public service obligations that are assigned to them.

Derogations: A natural gas undertaking may apply to a Member state for a derogation from the obligation to provide access if it considers that it would encounter serious economic and financial difficulties because of its take-or-pay commitments. The Commission oversees the granting of the derogation. The directive allows a derogation of the market opening requirements for those markets (Finland and Greece) which are dependent on one main external supplier and are not interconnected with the system of another Member State.

Source: OECD (2000*a*).

The future

Additional reform has been announced. The government has announced that electricity users totalling 40% of demand will be free to choose supplier in 2002, and 100% by 2005. Three auctions for a total of 600MW of "virtual independent power producers" (VIPPs) generation capacity were held in October 2000. ESB and two independent companies won. An auction for 40GWh of "green" energy was also held and won by ESB and an independent company. The VIPP contracts are expected to have a one-year duration, beginning 1 November 2000. In the gas sector, discussion on transmission access pricing

continues but no decision has been announced as of January 2001. With respect to gas supply, in March 2001 the Government proposed to accelerate liberalisation by allowing customers with annual consumption below 2 million cubic meters to have regulated access to the gas network (this amounts to about 100 customers) and to aim for liberalisation of all consumers by 2005 (DPE, 2001).

5. EVALUATION OF THE REFORM

Ireland has embarked upon a major reform of its gas and electricity sectors. While much has been accomplished, Ireland is closer to the beginning than the end of establishing an energy sector where private investment, innovation and lower prices are driven by competition.

The discussion of electricity reform has gone on for some time.

- The May 1993 Ministerial announcement of the "unbundling" of ESB into business units said that the objective of the change was "to introduce greater cost transparency and competition into the electricity sector" (Press Release, 21 May 1993, Republic of Ireland, Government Information Services, on behalf of the Department of Transport, Energy and Communication, cited in Cross, p. 71). At the same time, it was announced that, "The new arrangements will be subject to independent public regulation" (Communication of the Department of Transport, Energy and Communications to the ESB Board of Directors, 21 May 1993, cited in Cross, p. 71).

- A 1995 paper by economists at the ESRI (The Economic and Social Research Institute) argued that "[T]he crucial objective should be to introduce competition into the [electricity and gas] industr[ies] in Ireland *wherever it is realistically possible*. However, it may still be desirable to keep the bulk of the existing physical assets in state ownership while opening up the market to new entrants wherever feasible." They also warned against privatisation of a monopoly and recommended comprehensive regulation by an independent authority (Fitz Gerald and Johnson, 1995).

- The May 1997 consultation document, *Proposals for the Electricity Supply Industry in Ireland*, proposed, among other things, the establishment of ESB as the "single buyer" for captive customers.

- The 1998 *Legislative Proposal for Implementation of Electricity Directive 96/92/EC* would have established an independent regulator (who would have been responsible to control tariffs, as well as network access and entry), put transmission operation (but not assets) into a separate state-owned company, liberalised some consumers and allow ESB to be the sole licensed supplier to captive consumers.

- The 1999 Electricity Act granted the regulator fewer powers than did the Proposal. Specifically, it retained government control over tariffs to captive consumers.

- The 1999 Electricity Act is itself an interim legislation; further legislation is intended.

- The Statutory Instrument No. 445 of 2000 granted to CER regulatory control over tariffs to captive consumers and dispute resolution powers, provided for the establishment of the transmission system operator and specified its objectives, specified that ESB would be the unique transmission system owner and distribution system operator, and provided a framework for the "infrastructure agreement" between the transmission system operator and owner.

The reform proposals were criticised. The Competition Authority pointed out, in 1997, that international experience indicated that breaking up a monopoly firm is likely to be more effective than controlling a dominant firm. It noted too the need for a mechanism for efficiency savings in generation to be passed onto consumers as lower prices. Vertical separation and limits on ESB's market share should be considered, according to the Authority. The Authority said that, "[G]reater emphasis should be placed on promoting competition and some of the structural proposals contained in the paper should be re-examined" (Competition Authority, 1997). The Authority called the 1998 proposal, "a significant improvement compared with what had previously been proposed." It said that, "[C]onsideration should be given to permitting greater competition in the gas and electricity sectors. This would involve vertical separation in gas as in electricity, progressive further liberalisation in gas supply and measures to reduce the ESB's dominant position in generation." It noted too, the need for independent regulation (Competition Authority, 1999). While the Irish Business and Employers Confederation (IBEC) "broadly welcomed" the direction of legislation in a May 1998 consultation paper on electricity, IBEC, noted that lower prices must be and had not been set as an objective In April 2000, IBEC "called for Government to give the development of a competitive electricity market the priority it deserves" (IBEC, 2000).

Some important proposals have been delayed or only partially implemented. For example, the Minister announced on 6 June 1995 that, from 1 January 1998, very large electricity users could buy from generators other than ESB (Massey and O'Hare, p. 84). The change in the law to allow this took effect only in February 2000. The scope of the authority of the independent regulator has been diminished as discussion has proceeded. In 1993 it was announced that the electricity sector would be subject to independent public regulation. In 1998, the Legislative Proposal (paragraph 44(4)(b)) stated that there would be, "periodic review by the [Electricity Regulatory] Authority of, charges or tariffs." In 1999, the Minister for Public Enterprise, responding to a question in Parliament said that "Future price increases, including tariff re-balancing, will be a matter for the new Commission for Electricity Regulation" (29 June 1999, ref. No. 16298/99). But under the Electricity Regulation Act, 1999, the CER (which came into being, rather than the Authority) may only review transmission tariffs; the Government retains the power to regulate captive consumers' tariffs, although the Minister has delegated to CER that power in Statutory Instrument No. 445 of 2000.

As well, there are instances of the reforms being strengthened over time. For example, the single buyer of electricity, as a long-term entity, has been rejected in favour of liberalising all consumers and regulating access to the networks. The announcement of the intention to transfer regulatory authority in the natural gas sector to the CER and to accelerate liberalisation of consumers, points in the direction of strengthening reform.

Delay in finalising and implementing reforms has hindered the development of competition. In spite of earlier warnings, a law that addressed the allocation of gas capacity was passed only after supply shortage concerns had become imminent. This delay benefited the incumbent because competition objectives were subordinated to short-term issues of supply security. Delays and uncertainties about gas regulation benefit state-owned over private, competitive interconnector projects, since their state financing is less sensitive than private financing to uncertainty. Had the uncertainties been resolved earlier, one of the proposed competing privately-funded interconnector might have been built. In the event, in February 2001 it was announced that the incumbent, *Bord Gais*, will build the second interconnector.

5.1. Structural reform to promote competition

The small scale of the Republic of Ireland's electricity system raises the question of whether a competitive generation market is feasible. Existing plants are large relative to the size of demand, so ESB's plants could, at most, be split among two or three independent companies. Experience in the United

Kingdom, Spain and New Zealand indicates that further increasing the number of independent generating companies would induce yet lower prices and higher productivity. Such an increase in numbers of competitors could be effected by having distinct owners of distinct generator sets within a given plant, for example. Similarly, experience in New Zealand showed that imposing a capacity cap and relying on new entrants to provide competition did not develop effective competition. Under a capacity cap, ESB would retain market power even after some years of high demand growth. This is because, during periods of high demand, when small competitors are generating at capacity, ESB will set market prices. Facilitating competition from generation in Northern Ireland, such as through transmission infrastructure investments and compatible regulatory regimes, would introduce two sizeable independent competitors to the market in the Republic of Ireland. "Virtual independent power producers" (VIPPs), or firms re-selling power generated by ESB, could have some mitigating effect on ESB's market power, but cannot be relied upon to provide competition to ESB. All of these factors indicate that Ireland will have to rely on a basket of structural and regulatory changes in order to introduce effective competition. No single change, alone, will be sufficient.

Box 5. **Effects of competition in electricity**

Significant time series on efficiency and prices after the introduction of competition are only available for the United Kingdom. Since 1990, productivity has skyrocketed (as output rose by 8% from 1988 to 1995, employment was reduced by 50%), and prices have plummeted. In real terms, over the 1990-1997 period, household ("domestic") prices decreased by 20%, and prices to other consumers fell 19 to 27% (Littlechild, 1998, cited in IEA, 2000). In 1998, in real terms, the standard domestic tariff in England and Wales was 26% lower, and for industrial customers the price was 23 to 32% lower than in 1990. (Office of Electricity Generation 1998, p. 58) Only shorter time series are available for other reforming countries. For example, 1997 prices in the Australian state of Victoria fell to less than half their 1995 level, reflecting the introduction of competition, privatisation and excess capacity. However, prices in Norway and New Zealand, where the sector remains state owned and there is a high reliance on hydropower – thus subjecting the system to cost variations due to hydrological variations – did not fall with the introduction of competition (IEA, 2000).

It has been argued that Ireland's is such a small electricity system that the cost of setting up and running an electricity pool system may outweigh the benefits, and that if some other way of introducing competition can be found, then it would be best to retain a co-ordinated planning model (Fitz Gerald and Johnston, p. 15). The Moneypoint plant accounts for about one-fifth and the Poolbeg plant for almost a quarter of all electricity generated in the Republic. Other authors have observed that, at best, ESB's existing generating capacity could be split into two or three competing companies (Massey and O'Hare, p. 117).

Some other countries and states achieved rapidly a more competitive structure by splitting the incumbent monopolist's generation. The United Kingdom (England and Wales), New Zealand, Australia (three largest states), some states of the United States, and Argentina have split generation. It is planned in Italy and South Korea. But these were jurisdictions where the market was much larger than Ireland's. For example, the capacity of the smallest of the three generating companies expected to be spun off by ENEL in Italy is more than half the entire generating capacity in Ireland. The total capacity of the four smallest of the five generating plants spun off in Victoria, Australia is a bit more than half the Irish total.

Some countries combined capacity caps on the dominant generator with divestiture. Italy, for example, capped ENEL's electricity generation plus imports at 50% and ordered divestiture to attain that cap. This share has been called too large both by the competition authority and the energy regulator. New Zealand initially combined a cap with divestiture, but subsequently ordered further divestiture by the dominant generator because of insufficient competition. If ESB retains, as it aspires to, at least a 60% share of the market then effective competition is unlikely. The comparisons with the markets in the United Kingdom and Spain — which are less concentrated than envisaged in Ireland, and where prices were above

competitive levels — are instructive. Under European Union competition law, a company with a market share above 40% would usually be considered dominant and its actions subject to special scrutiny to ensure its dominance is not abused. Even the 40-60-share split would not be attained for a decade, if generation grows at 5% annually, as predicted. If gas supplies constrain capacity expansion, then even this timetable is optimistic. A 40% market share would not allow many independent generators of significant size. Discussions about the allocation of gas pipeline capacity centre around plants of 400 MW, which places them a bit smaller than Poolbeg. While wind-powered generating plants are substantially smaller, their technical characteristics mean they cannot behave strategically in the market.

Box 6. **United Kingdom and Spain**

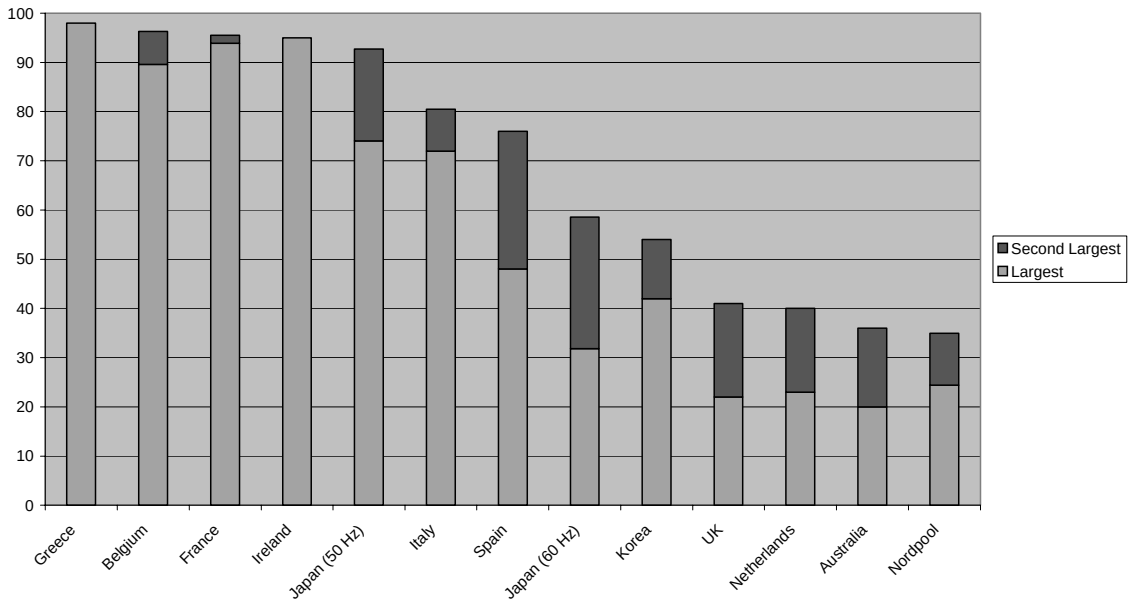
Both the United Kingdom and Spain had electricity sectors with structures more conducive to competition than Ireland will have under present proposals, and in both countries there was evidence that market prices were well above competitive prices. The United Kingdom had three and Spain had two large electricity generators. In the United Kingdom, for some time the main generators were not vertically integrated, but in Spain they were integrated into distribution-supply, and partly owned the transmission grid.

In the United Kingdom, the Office of Electricity Regulation found that the two dominant non-nuclear firms had significantly increased prices and reduced output during the 1997/8 winter. Other competitors expanded output within the limits of their capacity. During that period, the two firms set the system marginal price 70% of the time. The Director-General concluded that the most effective way to increase competition in the short term was to transfer more of the two dominant firms' capacity to competitors (Office of Electricity Regulation, 1998, pp. 8-9).

In the Spanish market, the two largest firms owned 76% of production and, in 1998, provided the marginal capacity 59% and 24% of the time, respectively. Several analyses have been performed for or by the CNSE, the former independent energy advisory body. One, which took into account competition from imports, suggested that either company, acting on its own, could raise prices.[6] Another[7] suggested that such behaviour could lead to an average price 39% above marginal costs. A more recent study of actual Spanish market operation identified market power problems. A study[8] of the Spanish market in 1998 reached similar conclusions. Two reports released by the CNSE in July 1999 identify specific instances in 1998 where the two companies offered very high prices to the spot market for generators located in areas of high consumption and low generation.[9]

Three factors largely determine whether the cost of generation would be lower if ESB's generation were split among several companies. Economies of scale imply that the resulting operating units should not be too small; competition implies that the resulting companies should not be too few, and transition costs mean that some splits that would be efficient in the long run may be too costly to implement. Effective competition in generation requires *inter alia* a number of independent sellers along the merit order of generation, that is, from base load (generation that is always operating) through mid-merit to peak load (generation that operates only when demand for electricity is high). Each of these sellers must be of some size for competition to be effective; otherwise, the dominant firm can raise price unilaterally when its small rivals are operating at capacity.

Figure 4. **One and two firm concentration levels for selected countries or regions, 1998**[1]



1. Data refers to 1999 for Greece and Ireland.

Source: OECD, IEA, Electrabel annual report (Electrabel + SPE), EdF and Charbonnage de France annual reports, Edison April 1999 presentation to shareholders, Spanish and Korean Ministry of Industry and Energy, Ofgem (NatPower and PowerGen in England and Wales 97/98, NEMMCO, Macquarie and Delta annual reports (SE market only), Nordpool annual report and Vattenfall, Statkraft.

"Virtual" independent power producers

In Ireland, contracts for "virtual independent power producers" have been auctioned. These are financial instruments; neither ownership nor operational control of any generation assets will change hands. The idea is that owners of these VIPP contracts will compete in the supply market to re-sell electricity to liberalised consumers. VIPP contracts for 600MW, plus 40GWh of "green" electricity, or about one-seventh of installed capacity, were offered for auction in October 2000. The auction was won by ESB and two independent companies, Viridian (the Northern Ireland transmission owner), and ePower. (No one could win more than 240MW.) The contracts will be for one year, beginning 1 November 2000, though ESB's dominance is expected to persist for much longer. Further auctions may be held. The capacity and energy charges in the VIPP contracts are the same for all contracts, and energy charges vary by time of day and ESB's fuel costs. These charges were negotiated between the regulator and ESB. VIPPs pay a penalty for taking more energy than contracted, and are prohibited from supplying the same customer by both VIPP and other means.

VIPP contracts have major weaknesses as a tool to promote competition. They have been labelled "not an effective mitigation measure" when offered to the United States' Federal Energy Regulatory Commission,[10] although they were accepted in Alberta, Canada where ESB is the Independent Transmission Administrator. The concern in the United States was that the contracts did not remove the output of the plant from the control of the plant's owner. By retaining operational control, the owner could manipulate downtime to withhold capacity. Further, these contracts do not provide incentives to increase operating efficiency. Over the longer term, the contracts may not last as long as the market power they were intended to mitigate, and it is more difficult to reach agreement on investment decisions – for modernisation, environmental compliance, and so on – for the plant. It may be difficult to oversee these complicated financial instruments. Finally, it is unclear how the incumbent buying VIPP contracts from itself has any effect on competition. However, VIPPs may be able to "package" electricity in ways that better match consumer needs.

By contrast, joint ventures have successfully built and operated generating plants where one parent company is the designated operator. Each owner makes independent decisions about the amount of power to "take." Joint ventures, however, lend themselves to more complex agreements over much longer time spans than do the VIPP contracts envisaged.

Development of an all-island market

The development of an all-island electricity market is necessary to develop competition in generation for consumers in the Republic, as well as in Northern Ireland. In 1999, economists at the ESRI said that an all-island market, "could give rise to substantial savings in the very long run for consumers in both jurisdictions" (ESRI 1999, p. 252). An all-island electricity market is developing. However, before it can proceed, the transmission grid needs substantial reinforcement. Besides enhancing competition, this will also increase security of supply and fuel diversification and reduce the need for, and thus the cost of, operational reserve of generation (http://www.nie.co.uk/ on 12 June 2000). Continuing the co-ordination between the regulators on the island will also aid the increases in efficiency from cross-border trade and investment.

There is already limited cross-border trade between the Republic of Ireland and Northern Ireland and by 2002 Northern Ireland and Scotland will be electrically connected. The Northern Ireland system is smaller than the Republic's, with maximum demand of 1 665 MW and annual sales of 7 291 GWh. Three privately owned generators operate in Northern Ireland, but two plants account for 90% of output in Northern Ireland, and two vertically integrated power companies operate in Scotland. Investment has also crossed the border, with ESB owning 40% of a small power station and planning to develop a combined cycle gas turbine (CCGT). Viridian Group, the owner of the transmission-distribution company in Northern Ireland, has contracts to sell to liberalised consumers and is progressing toward building a gas-fired plant in the Republic.

Generators in Northern Ireland would find it economic to supply Irish consumers. A superficial examination of relative prices in the Republic and Northern Ireland might suggest that generators in Northern Ireland would have little interest in selling in the Republic. According to UNIPEDE figures, industrial prices in the Republic are 34% lower than in Northern Ireland and household prices 22% lower (ESB, 2000). The price of electricity sold to households in Northern Ireland is much higher than in Britain (Ofreg, Tackling the High Cost of Generation: Executive Summary). However, these prices are vestiges of vesting contracts in Northern Ireland, so do not reflect marginal costs.[11]

There is greater scope for developing a competitive all-island market than of developing two separate competitive markets. Each of the Republic and Northern Ireland are supplied mainly by two power plants. Four is surely more competitive than two, and by joining the markets entry in one place has a pro-competitive effect across the island. In April 2000, the regulator said of generation and supply in Northern Ireland, "these markets are becoming competitive but competition is still at an early stage and is far from fully developed" (Ofreg 2000*a*, p. 8). Thus, both the Republic and Northern Ireland would benefit substantially from a single market. The Authorities in the Republic and Northern Ireland are aware of the potential offered by an all-island energy market and the two administrations have jointly commissioned consultants to examine the operation of the markets in each jurisdiction with a view to creating an all-island energy market in a European context. This report is expected in mid-2001.

Vertical integration

Despite accounting separation, both ESB and *Bord Gáis* continue to be vertically integrated into both competitive activities – generation (for ESB) and supply – and monopolistic activities – transmission and distribution. In the electricity sector, even though ESB and *Eirgrid* have separate management, they have common owners in the Ministers of Finance and Public Enterprise. The vertical integration means the companies retain incentives to discriminate against non-integrated rivals, and to exercise market power. Three possible concerns are discriminatory operation of transmission, insufficient investment in transmission, and misattribution of costs to the regulated activity. Discrimination discourages entry and increases total system cost, and insufficient investment in transmission – notably electricity from Northern Ireland and gas from Scotland or beyond – reduces competition to supply Irish consumers. Misattribution of costs provides an "unlevel playing field" for non-integrated rival generators or gas suppliers.

Other countries have experienced problems in ensuring non-discriminatory transmission access. Accounting separation is the least effective means of preventing discrimination against non-integrated companies. As noted by the Irish Competition Authority, in the United Kingdom, "both the MMC and Ofgas concluded that accounting separation was insufficient to eliminate the potential for anti-competitive behaviour on the part of British Gas" (Competition Authority, 1998). The CER has noted that regulatory accounts of the separate businesses would provide more appropriate financial and economic information than accounts as prepared under the various Companies Acts (CER, 2000). Divestiture, that is, separation of ownership of generation from transmission, is the only form of separation that eliminates incentives to discriminate. Lesser forms of separation can reduce the ability to discriminate, provided appropriate regulation is in place and the regulator is vigilant.

The shift of operational control of electric transmission to *Eirgrid* diminishes the scope for discrimination in dispatch and other operations. However, scope for discrimination remains, particularly as the timing and means of maintenance — which ESB is responsible for carrying out — can affect the competitiveness of generators. In addition, it may be very difficult for *Eirgrid* to induce ESB to make timely grid investments that reduce the profitability of its generating plants. Indeed, ESB has deferred investments in transmission even when there was no competitive advantage to doing so. Statutory Instrument No. 445 grants to *Eirgrid* responsibility for planning transmission development, ESB an obligation to implement the development plan and CER the power to approve the development plan and regulate both entities. *Eirgrid* can "step in" and arrange work to be done if ESB delays or defaults in carrying out the development plan. CER should ensure that investments in transmission are timely, particularly those that would facilitate competition from Northern Ireland. In addition, ESB, being responsible for maintenance of the transmission grid, may get access to commercially sensitive information in the normal course of events. Further, ESB would retain incentives to try to allocate as many costs as allowed to regulated activities. In the longer term, if the cost or failure rate of regulation of transmission turn out to be too high then the complete ownership separation of electricity transmission from generation would be necessary.

5.2. Institutions

Independent regulation provides a safeguard to competition especially in sectors where there is an essential facility to which all firms need access. In Ireland, the Minister for Public Enterprise is the primary regulator of gas. The Minister for Public Enterprise has substantial regulatory power as regards electricity, although the Minister has delegated by statutory instrument much of her power to the CER, and the CER has the power to regulate entry into generation, transmission, and electricity trading. More specifically, the Minister has delegated to CER power to regulate final tariffs to captive consumers and the agreement between *Eirgrid* and ESB. The current intention is that a future law will increase the scope of regulation by the CER.

Ireland is discussing the various regulatory institutions and their characteristics. The focus of the consultation document, *Governance and Accountability in the Regulatory Process: Policy Proposals* (DPE, 2000), is the relationship between accountability and independence. Both of these features, as well as others, are necessary for effective regulation.

A market environment requires regulatory institutions that make decisions that are neutral, transparent and not subject to day-to-day political pressures. In order to make fair and reasonably predictable decisions, the regulator must have analytical expertise and not rely on the expertise of the regulated utilities. Unpredictable regulation discourages private investment, and changing regulation renders sunk investment less efficient. Thus, a greater reliance on independent regulation can reduce regulatory barriers, promote entry and investment, and accelerate the development of competition. The regulator must also be functionally separate from policy-making in order to maintain a neutral regulatory regime. To be seen to be fair, the regulator should have well-defined obligations for transparency, notably with respect to its decision-making processes and information on which the decisions are made. Further, the objectives of the regulator must be clearly stated, more specifically than, for example, "the public interest" and progress towards these objectives should be monitored. Finally, the powers of the regulator should be clearly stated. The combination of transparencies of objectives, powers, processes, decisions and information give the public clear performance criteria to evaluate the extent to which the regulator is fulfilling its role.

Particularly in a country with a state-owned incumbent, there are many potential conflicts of interest. While Government looks after the broad public interest, Government as regulator looks after the interests of consumers and producers of a good or service, and Government as owner ensures the profitability of its firms. When all of these roles are played by a single entity, the inevitable tradeoffs are not subject to public scrutiny and debate. By contrast, an independent regulator can be made publicly accountable to fulfil one or a very few objectives.

Other OECD countries have independent regulators of electricity and gas, including Australia, Finland, Italy, the United Kingdom and the United States. In Germany and New Zealand, the threat of action under the competition law is used, along with information disclosure in New Zealand. While specific arrangements differ in each country the main features of independent regulation are: complete independence from the regulated companies, a legal mandate that provides for separation the regulatory body from political control, a degree of organisational autonomy, and well defined obligations for transparency (*e.g.*, publishing decisions) and accountability (*e.g.*, appealable decisions, public scrutiny of expenditures). Key to independent regulation is independent expertise and sources of information. CER has these attributes; its scope of responsibilities to go along with them should be enshrined in an act. Consultation with the Competition Authority in questions regarding markets, would be one source of independent expertise.

5.3. Regulation

ESB has little persistent external pressure to reduce costs. The mandate that ESB "break even" meant that it was assured of covering its costs with its revenues. For example, during a long period where it was not permitted to raise its tariffs, ESB complied with the break-even mandate by reducing investments, which resulted in lower than desired standards of service in rural areas. But on the other hand, ESB's accounting practice of "double depreciation" allows it to accumulate reserves to finance investment. With rate-of-return regulation, ESB can be expected to under-invest (when the allowed rate is lower than the market rate) or over-invest (when the allowed rate is higher than the market rate) in capital.

Some other countries use a price cap methodology to regulate utilities, or those parts that are natural monopolies, because this method, applied to profit-seeking companies, provides them incentives to reduce costs. In Ireland, one proposal would subject *Bord Gáis*'s transmission to price cap regulation. So long as prices remain under their respective caps, and the companies meet other specified criteria such as safety, environmental, universality of service offerings and reliability standards, the companies are free to take actions to increase their profits, often actions that reduce their costs. Where a company is not profit-seeking, these efficiency incentives do not operate. Neither ESB nor *Bord Gáis*, owned by the state and governed by boards appointed by the state and employees, is profit-seeking (even if they might report substantial profits). Even in these circumstances, price caps can protect consumers from monopoly exploitation.

Where price cap regulation is not used, the regulator needs cost information. Overcoming the information asymmetry between regulator and regulated company is challenging. Two general strategies are to get information from other companies, either overseas or private entrants, and to require accounting that generates information from the regulated firm. For example, the creation of distinct distribution companies may help identify cost-reducing practices in one part of the country that can be applied more widely.

5.3.1. Tariffs

According to ESB, households pay about 10% less than the cost of supply, and industrial customers pay about 10% more than the cost attributed to them. (Without formal regulation, these figures have not been independently assessed.) If effective competition to supply large customers does indeed develop, then ESB will be provided a strong incentive to reduce the cost of supply to them. When all households are offered the choice of supplier, then any system for a "supplier of last resort" will need to ensure that any subsidy required is funded equitably and that the choice of "supplier of last resort" is made competitively. In particular, higher cost-to-supply customers can be expected to use the "supplier of last resort" and the level of subsidy should reflect that propensity. Competitive bidding for minimum subsidy can ensure that the amount of subsidy is not unnecessarily high and that the lowest cost supplier is the provider.

A package of measures to address inflation included a commitment by the Government that it would not approve any new price increases by public bodies during the remainder of 2000. In such an environment, an application by ESB to raise prices would not be considered. While a suitable macroeconomic environment is important, it may be more important to ensure long-term efficiency and investments in regulated sectors.

Transmission tariffs, as well as charges for connections, influence the choice of generators about where to locate and the feasibility of competition by generation located in Northern Ireland. The location of generators affects the overall system cost. Hence, economic efficiency is served by transmission charges that induce entry at low-system cost locations. Some other countries and regions have locational pricing of electricity in order to reflect transmission costs so as to induce efficient use of generation and transmission. This is particularly important in congested systems.

5.3.2. Regulation of Eirgrid and the Energy Procurer for efficiency

It will be difficult to provide *Eirgrid*, the transmission system operator (TSO) with incentives for efficiency. Since *Eirgrid* should seek innovative ways to reduce system cost, command and control regulation is unsuitable. Performance-related pay of managers might induce the desired behaviour. But a main weakness of *Eirgrid* is its relative lack of information as compared with ESB, who will continue to

own the transmission and distribution assets and be primarily responsible for their maintenance and expansion. (Although *Eirgrid* is "to operate and ensure the maintenance of and, if necessary, develop" the transmission system, generally ESB maintains and constructs the system.) Since this asymmetry is inherently unmeasurable, performance-related pay would have to use more or less imperfect proxies.

The 1998 Legislative Proposal described a Public Electricity Supply Business. From February 2005, the Public Electricity Supplier will have an economic purchase obligation, *i.e.*, it will not be supplied in the first instance by ESB Generation. Such entities are difficult to regulate. While it would seem "fair" to pass onto consumers the costs of the energy procured for them, this would mean the Public Electricity Supply Business would not have incentives to bargain for better prices or to seek alternative lower cost suppliers. Indeed, since its parent company, ESB, owns almost all the generation available, bargaining between units of ESB is probably unlikely. Since captive consumers (generally households) will in general not have time-of-use metering or tariffs, the Public Electricity Supply Business will purchase on behalf of demand that is insensitive to short term price variations. The combination of the Public Electricity Supply Business passing through its cost of energy and buying for price insensitive demand means that it will be profitable for suppliers to charge higher prices.

5.3.3. Competitive neutrality

For competition to reward the most efficient firm(s), the "playing field" must be level as regards regulation and other state interventions. In the energy sector, capital constitutes a large part of total cost. As a result, differences in the cost of capital between state-owned and private companies can have a significant effect on total cost. Differences can arise through the implicit or explicit guarantee against bankruptcy enjoyed by state-owned enterprise (enabling a SOE to borrow at lower interest in a more uncertain climate) and though the owner not requiring market-like rates of return on equity.

Other OECD countries, notably Australia, have tried to diminish the differences in cost of capital. In Australia, "government business enterprises" must either borrow at commercial rates or pay the estimated difference due to the state debt guarantee. In addition, GBEs are required to achieve a commercial rate of return at least sufficient to justify the long-tern retention of assets in the business, and to pay commercial dividends to the budget from those returns. The level of estimated dividends (and forecast payout ratio) is agreed annually between directors and shareholder Ministers. In the United States, differences in tax, legal, and regulatory treatment between state-owned and privately owned electric utilities result in significant cost differences, though the extent to which the entire 16-20% difference in costs is accounted for by different treatment is disputed (Regulatory Reform in the United States, p. 293).

Equal treatment as regards land, *e.g.*, the price at which public land is made available, treatment under the land use laws, is also important because the location of a generating plant can greatly influence the cost of integrating the plant into the transmission grid and transmitting the plant's output.

6. CONCLUSIONS

The plans of the current government are encouraging, but reforms of the Irish electricity and gas sectors have only begun. The liberalisation of large consumers is an important first step. It is therefore important that the liberalisation of all consumers proceed as planned and further acceleration might be considered.

The reforms to date are not sufficient for the development of effective competition. The Competition Commissioner of the European Union wrote in December 2000 that, "The current structure of the Irish electricity market is not favourable to competition" (Monti, 2000). The objectives of the reform

have not been clearly set out to promote consumer interests. Further structural change, including the diminution of ESB's dominant position in generation, is an integral part of a reform package. Whether that diminution takes the form of a capacity cap or divestiture, is a decision that needs to rest on the experience of market entry, competition from Northern Ireland generation, and assessments of market prices and performance. Investments in transmission to facilitate supply from Northern Ireland, or even Scotland, can have a positive effect on competition and reliability in both the Republic and Northern Ireland.

Accounting separation has proved, in other countries, to be the least effective way to reduce discrimination against competitors. Where there are significant economies of scope between stages of production, then vertical integration may be superior. But that does not appear to be the case in electricity and gas. Discriminatory access is difficult to police, but if it is detected then that should be a signal to separate the potentially competitive activities – generation and supply – from the networks.

The second integral part of an effective reform package is putting in place appropriate regulatory institutions, in particular an independent regulator. The CER had few resources and little time to prepare for market liberalisation at the outset. Compared to corresponding institutions in other countries, the CER has few resources and limited scope for applying its powers. Independent, well-resourced and well-respected regulatory institutions attract investment since investors can feel they will be treated fairly and consistently. The CER's powers should be expanded, in statute, to cover all aspects of economic regulation of the electricity and gas undertakings. And it should have the resources to do the important tasks assigned it. To the extent that the market is integrated across national borders, such institutions are needed in each jurisdiction, and increasing co-ordination will be needed between these institutions.

No single reform will enable the Irish electricity and gas sectors to become competitive. The economy, and therefore demand for energy, is relatively small on a global scale and the location is not conducive to the importation of much competition. However, by combining structural change in generation, enhanced transmission to allow access by generation in Northern Ireland, and interim gas allocation rules that promote competition, in combination with the institutional and regulatory changes, then the Irish electricity market can become competitive.

Energy might seem an unimportant input into Irish competitiveness – after all, there are world or large regional prices for fossil fuels themselves. But the non-traded aspects of the sectors can result in large cost differences, as noted above. And in Ireland, energy could become a bottleneck that impedes the development of some regions. Hence, the reforms embarked upon should be continued in an integrated way so as to deliver a more efficient, competitive sector.

7. POLICY OPTIONS

1. Increase competition in the market for electricity by:

- Prohibiting, in the short and medium term, further additions to ESB's generating plant. In the longer term, if effective competition develops, then remove this limit on ESB so that all generators can compete across the entire market.

- Require divestiture of some generation plant by ESB. If market prices to liberalised customers are above competitive levels after the generation fuelled by the existing gas capacity comes on line, and if the amount of entry then expected and import capacity are together insufficient for effective competition, require further divestiture.

- Ensuring by establishment of appropriate access tariffs and terms, that conditions of access to the transmission and distribution grid, including for example ancillary services, are cost-reflective and non-discriminatory.

- Requiring divestiture of transmission from generation if transmission constraints are not relieved or if there is discrimination in access.

- Proceeding with plans to increase the capacity of transmission of electricity between the Republic and Northern Ireland.

- Ensuring that any long-term contracts do not block further liberalisation of consumers.

- Liberalising choice for all electricity and gas consumers by 2005, or sooner if there is evidence of liberalised customers being subsidised by captive customers.

2. *Ensure well-resourced and independent regulation of the electricity and gas sectors by:*

- Maintaining, for electricity, regulatory responsibility for tariffs, specific license conditions and transmission access and, for gas, shifting regulatory responsibility for transmission access, to the Commission for Electricity Regulation.

- Retaining enforcement of the competition law in the sectors, however, with the Competition Authority.

3. *Modify the tariff structure to improve efficiency in the sector by:*

- Making regulated tariffs cost-reflective. Consider eliminating the requirement that tariffs be geographically uniform in light of the non-uniformity of cost of supply.

4. *Reduce barriers to entry for gas importers and sellers.*

- The corporate separation of transmission should be a first step toward ownership separation of transmission from the potentially competitive activities.

5. *Increase efficiency of regional employment support by:*

- Putting into place more efficient support for employment and eliminate the subsidies to peat.

NOTES

1. In addition to its Irish investments, ESB has significant investments in power generation in UK, Northern Ireland and Spain, and is the Independent Transmission Administrator of Alberta, Canada (ESB 2000).

2. The SI instructs the CER to allocate up to 3.3 mcm/day of capacity to two or more new power generators. (Capacity of the interconnector is planned to be 14mcm/day in October 2000 and 17mcm/day in October 2001) (IEA, 1999). CER evaluated and ranked the applications. Plants that are expected, by the CER, to be commissioned earlier rank higher, and among plants with the same expected commissioning date, larger rank higher. As a general rule, CER is to allocate capacity according to the rank order until the capacity is exhausted. However, if the CER believes that the allocation implied by the rank order "would ultimately result in demand for the supply of electricity in the State not being met," or "would … result in the promotion of competition in the market for the generation and supply of electricity being adversely affected," then the CER shall alter the rankings.

3. "The main reason why this option [first commissioning date wins] was favoured was that it enables the introduction of competition to the electricity market at the earliest possible time." Also, "In reaching this decision the Minister has had regard in particular to the necessity of establishing new power production capacity at the earliest possible date and the desirability of ensuring the early development of competition in the electricity supply market." [*Policy Statement and response to the submissions received on: The allocation of capacity in the natural gas network for the generation of electricity* 14 December 1999 at http://www.irlgov.ie/tec/energy/Allocat.htm on 2 June 2000). The DPE's strategy statement 1998, published in April 1998 [DPE Annual Report and Financial Statements, 1998, p. 27 at http://www.irlgov.ie/tec/publications/YrReview.pdf on 12 July 2000], says that the DPE would promote competition in electricity generation by encouraging new entrants.

4. To compare size of operation, the turnover of Bord na Móna in the year ended March 1999 was IR£153m, of which some was not from the energy market, whereas the turnover of *Bord Gais* in 1998 was IR£313m (http://www.bge.ie/htm/faces/fac_fs6c.htm on 12 June 2000).

5. Section 21(2) of the Electricity (Supply) Act 1927 requires ESB to fix charges for the sale of electricity and for goods and services rendered by it so that the revenues derived in any year from such sales and services will be sufficient and only sufficient to pay all salaries, working expenses, and other outgoings properly chargeable to income in that year and such sums as the Board may think proper to set aside in that year for reserve fund, extensions, renewals, depreciation, loans and other like purposes (ESB 2000*b*).

6. Frankena, Mark (1997), *Market Power in the Spanish Electric Power Industry*, Report prepared for the Comisión del Sistema Eléctrico Nacional, Madrid, March.

7 Ocaña, Carlos, and Romero, Arturo (1998), *A simulation of the Spanish electricity pool*, CNSE, Madrid, June.

8. London Economics (1999), *El sector eléctrico español, Análisis del poder de mercado*, Madrid, Februrary.

9. CNSE (1999), Análisis de la participación de Endesa en ciertos episodios anómalos en los mercados de energía eléctrica gestionados por el operador del sistema and Análisis de la participación de Iberdrola en ciertos episodios anómalos en los mercados de energía eléctrica gestionados por el operador del sistema, Madrid, 28 July.

10. Allegheny Energy Inc. and DQE Inc. Docket Nos. EC97-46-000, ER97-4050-000 and ER97-4051-000, Federal United States Energy Regulatory Commission, Order issued 16 September 1998.

11. "The main obstacles to price reduction through competition are the long-term availability contracts for Ballylumford and Kilroot. These contracts - which account for some 90% of Northern Ireland's electricity output - cannot be cancelled before 2010" (Ofreg, Tackling the High Cost of Generation).

Table 1. **Summary of market structure in selected OECD countries**

	Netherlands	**Belgium**	**Italy**	**Germany**	**France**
Transmission	A single transmission company (Gasunie) supplies 46% of the gas market directly.	Like the Netherlands, Belgium has a single transmission company (Distrigaz) supplying about half (54%) of the total gas market directly. Distrigaz was privatised in 1994.	In Italy, SNAM, controlled by ENI, is the dominant transmission company (with around 97% of total transmission capacity) and is the only company to have a nation wide natural gas transmission network. EDISON GAS, the second Italian transmission company, has a transmission capacity of around 3%.	Ruhrgas is the dominant transmission company, carrying 70% of the total gas supplies, but there are 17 other transmission companies. Collectively these transmission companies directly supply 32% of the total gas market.	In France there is one dominant transmission company (Gaz de France, "GdF") along with two other smaller subsidiaries (Gaz de Sud-Ouest and Compagnie Française de Méthane). About 30% of the market is supplied directly off the transmission network.
Distribution	35 LDCs, all of which are owned by regional and local authorities.	There are 23 distribution companies, the majority of which (19) have private shareholdings (although even in the cases where private shareholders are in a majority, the public shareholders keep the majority of votes on the company boards).	A very large number of LDCs (more than 800) are active in the distribution of gas. Around 50% of these are directly managed by municipal local authorities. ITALGAS Spa, the largest company, with a 30% share of distribution nationwide, is controlled by ENI. SNAM supplies directly around 92% of the demand of natural gas for electricity production.	There are also a large number (673) of distribution companies. "there is no clear distinction between different types of gas supply companies in the gas chain. Many companies mainly active in distribution are also involved in transmission and vice versa".[12] Of these distribution companies, the majority are state-owned. Less than 25% of the companies have some degree of private ownership.	Although GdF is by far the largest company in the gas distribution sector, supplying the bulk of the gas demand of residential/commercial and small industrial customers, there are also 15 state-owned and private distribution companies which supply 2.8% of the market.
Vertical Integration	There are almost no ownership links between Gasunie and the LDCs, or between the LDCs and gas producers. The only exception is the minority shares (10%) held by Gasunie in two LDCs (Intergas and Obragas).	There are no ownership links between Distrigaz and the LDCs.	ENI is vertically integrated in production, transmission, and distribution activities. ENI, through SNAM, has a 91% share in the Italian market for natural gas. ENI owns gas import facilities, transmission networks and the largest distribution company ITALGAS. EDISON GAS is also vertically integrated in production, transmission and distribution activities through ownership links.	Most of the transmission companies have ownership interests in LDCs. Some of the gas producers have ownership interests both in transmission and distribution companies.	GdF is highly vertically integrated. The other two transmission companies are owner by Elf, Total and GdF.
Horizontal Integration	Only 11 of the LDCs are pure gas companies, the majority also distribute electricity and heat.	Of the LDCs only 6 are pure gas companies, the others usually also supply electricity and cable TV signal distn.	The majority of the LDCs also distribute other services, particularly water and less often electricity.	Only around 20% of the LDCs are pure gas distribution companies. The majority distribute both gas and water or gas, water and electricity.	GdF is a specialised gas company, but the 15 independent LDCs are usually involved in activities other than gas distribution, such as water distribution.

Table 1. **Summary of market structure in selected OECD countries** (*cont.*)

	United Kingdom	**Australia**	**New Zealand**	**USA**	**Argentina**
Transmission	BG Transco (formerly the pipeline operating part of British Gas) provides an integrated transmission and distribution network. There are no other companies providing these services. British Gas was privatised in 1986.	Arrangements differ in the different states. Most transmission pipelines are state-owned, except in Victoria and New South Wales.	One major transmission pipeline network in the North Island owned and operated by NGC (Natural Gas Corporation).	About 45 privately-owned interstate pipeline companies provide transmission services. These are privately owned and regulated entities.	Two new pipeline companies where formed in 1992, in the north (TGN) and the south (TGS). These companies are privately owned.
Distribution	BG Transco also operates the distribution network.	Several distribution companies, many of which are private.	Two main distribution companies - NGC and Orion - distributing primarily in the northern half of the North Island. 4 smaller companies. A mixture of private and local government-owned.	Distribution is carried out by local distribution companies which are usually privately owned and regulated.	8 distribution and supply companies were created in 1992. These are privately owned.
Vertical Integration	The gas distribution system in Great Britain has historically been the most highly integrated in Europe. In addition to being a considerable gas producer, British Gas was completely integrated from the beach to the burner tip until the early 1990's when competition was introduced. However, in 1997 British Gas separated into a production and marketing company (Centrica) and a transmission/distribution company (BG Transco). BG is also heavily involved in production, with ownership of a significant proportion of the North Sea gas fields.	Vertical separation between transmission and distribution in Victoria, whereas transmission is integrated into distribution in New South Wales. There is no integration between production and transmission.	NGC is vertically integrated between transmission and distribution. It also has a significant gas marketing business. All but two of NZ's gas distributors also have a gas retail business.	There is little integration between transmission and gas production and between transmission and distribution.	The Gas Act 1992 prohibits producers and storage companies from owning a controlling interest in a transportation or distribution company.
Horizontal Integration	Neither Transco nor Centrica are involved in other industries although many of the new competitors in the gas marketing sector also provide electricity or water services.		NGC and some other distribution companies are integrated with electricity companies.	Some distribution companies are integrated with electricity companies.	

12. IEA (1998*b*), p. 35.

PROFESSIONAL SERVICES: PHARMACIES AND LEGAL PROFESSIONS

Box 7. **Professional services**

The principal reasons to regulate professional services are to correct or prevent market failures that result in inadequate quality or safety. One possible market failure arises when consumers cannot evaluate the quality of the service. In this case, it is difficult for high-quality but high-cost practitioners to sustain themselves in the market and quality can decline unacceptably. Related to this is deceptive over-treatment, when consumers cannot evaluate what services are necessary for the desired outcome, and as a result providers take advantage of their ignorance to supply "too much" service. The two problems may appear in the same market, as consumers can differ in their experience and knowledge. Another possible market failure is for markets to be "missing." For example, potential investors rely upon information provided by auditors hired by the company whose accounts are examined. Even if potential investors desired more information than that desired by management, they cannot hire the auditors to provide the additional service.

The regulatory response to ensure quality or safety against these problems often takes the form of licensing rules that require practitioners to be qualified. Standards for services may establish criteria for maintaining and evaluating quality and for identifying abuses of "over-prescription." Disciplinary rules may expel providers whose quality is inadequate.

But regulatory responses also tend to reduce competition. They may limit entry, control prices, mandate service levels, prevent truthful advertising, and prohibit commercial relationships. In practice, restrictions on competitive practices such as price competition, truthful advertising, use of non-deceptive trade names, and relationships with other kinds of businesses have correlated with higher prices and less innovation, yet without necessarily improving quality. To the extent that quality was actually increased or protected, the costs of ensuring quality have, historically, included higher prices, reduced output, and reduced product differentiation.

A significant part of the Irish economy depends upon, or consists of, professional services. As the economy has boomed, demand for these services has experienced a corresponding expansion. More providers are needed to meet this increased demand, and this has come from several sources: expanding places for professional education at Irish universities and other programmes, Irish citizens going abroad – notably to the United Kingdom – for professional education, return of Irish expatriate professionals, and immigration of already qualified professionals. This report examines the ways in which two professional services are regulated, and seeks ways to reform the regulation so that professional services can be provided more efficiently at an appropriate quality. The report concentrates on the legal professions – barristers and solicitors – and pharmacies.

The discussion of these professions illustrates issues that appear in other professions that are not examined here. The main problems that can affect professions are unnecessarily restrictive conditions for entry and rules about advertising and location, and explicit or implicit collective fee-setting. The high scores on the Leaving Certificate (from high school) now required to enter professional training programmes, and the widespread resort to professional training in the United Kingdom, suggest that demand to enter some professions is highly constrained. The number of training places is often determined by the corresponding professional body, creating a risk of self-interested constraint that would justify a second look, to determine whether the number of places is sufficiently to serve the public interest, would be in order. Self-governing professional bodies may impose further restrictions on practitioners that reduce

competition but that may not improve the quality of the service to the public. The problems described in this report are only indicative of a range of practices in professional and other services that may need to be reviewed in order to increase efficiency and eliminate bottlenecks in the Irish economy.

Previous studies have called for reforms in Ireland's professions. During the 1980s and 1990s, the Fair Trade Commission and later Competition Authority undertook several enquiries, in response to a Minister's request to undertake a wide-ranging study. Reports were published on concerted fixing of fees, and advertising restrictions in the accountancy and engineering professions, restrictions on conveyancing and advertising by solicitors, and restrictive practices in the legal profession. In 1993, the Competition Authority issued a Certificate to the Association of Optometrists under the Competition Act, following amendments by the Association to its Code of Ethics to meet the Authority's concerns in relation to the siting of premises, advertising, fees and charges. The Authority also issued reports about practices of architects, surveyors, auctioneers, estate agents and trademark and patent agents. As a result of the Competition Authority's actions, advertising restrictions have been considerably liberalised and fee scales are only allowed only if used as guidelines, and not as minima (OECD, 1997, p. 129). A recent consultant's report on business services in Ireland found that self-regulation was predominant. It recommended independent collection of information, scrutiny by the Competition Authority of codes of conduct of self-regulating bodies with statutory power, separation of the control of education and entry from the profession's self-governing body, and elimination of anything that has the effect of a quantitative restriction on entry. The consultant made a number of other specific recommendations about solicitors, barristers, the court system, auditors, surveyors, and advertising (Bacon, pp. 42-43).

8. PHARMACIES

Pharmacies are highly regulated in Ireland, as they are in many other countries. However, the evidence suggests that reform of some of the economic – as distinguished from safety – regulations could bring about lower prices and more efficient provision. The retail margin on medicines in Ireland is higher than in any other EU country (Bacon, pp. 10-11). Community pharmacists can receive salaries high enough to impair the supply of pharmacists to hospital pharmacies and industry [Forum]. Pharmacies are changing hands at high prices, in one famous example in Limerick for IR£ 2.7m in 2000. Competition is limited by preventing new pharmacies from locating near existing pharmacies. Reducing barriers to competition among pharmacists is expected to increase competition, which in turn would induce pharmacists to identify more efficient ways of performing their professional tasks and thus reduce the cost to consumers. A concern is to ensure adequate provision of pharmacy services to people living in rural areas. While 21 new pharmacies have opened in rural or semi-rural areas between 1996 and 2000, reforming economic regulations can improve services at lower cost.

Community pharmacies constitute the bulk of the pharmacy sector, accounting for about 80% of total employment of pharmacists in Ireland (about 1 400 out of just under 1 800 employed pharmacists in 1998). They, rather than hospital pharmacies or industry, are the focus here. In 1993, there were 1.1 pharmacists per pharmacy in Ireland (Bacon, p. 9, citing MacArthur).

8.1. Regulation

Pharmacies and pharmacists in Ireland are subject to two main types of control: (a) control of medicines and (b) control of the practice of pharmacy. The Pharmaceutical Society of Ireland (PSI), the Irish Medicines Board, the local health boards and the Department of Health enforce the law on retail sale and supply of medicines. In practice, the PSI concerns itself with the activities of pharmacists and pharmacies. As regards the practice of pharmacy, there is, as well as primary legislation in the Pharmacy

Acts, additional statutory regulation of the Council of the PSI under the Pharmacy Act 1962. There is control of entry by way of the European Communities (Recognition of Qualifications in Pharmacy) Regulations, 1987 and the Health (Community Pharmacy Contractor Agreement) Regulations of 1996.

The legislation sets out the controls on medicines. In effect, "scheduled" prescription medicines for human use can only be supplied under prescription, some of these may only be dispensed in a hospital, and most medicines exempt from prescription-only may only be dispensed in a pharmacy by or under the supervision of a pharmacist (IPU Yearbook, p. 272). Some substances are specifically exempted from the pharmacist-supervised sale requirement, and thus these may be sold in non-pharmacies. They are, notably, aspirin, paracetamol, nicotinic acid, certain vitamins and toothpaste components (IPU Yearbook, p. 273). The supply of medicines by mail order is prohibited (IPU Yearbook, p. 272). Legislation also controls advertising. It prohibits advertising to the general public of controlled drugs and prescription-only medicines, as well as of certain, specified illnesses and the medicines to prevent, diagnose or treat them. Advertising to health professionals should comply with the summary of characteristics incorporated in the product authorisation and present information objectively (IPU Yearbook, p. 275).

The Pharmaceutical Society of Ireland is a public body with statutory responsibility for regulating the qualification of pharmacists in Ireland, as well as for enforcing the law on retail sale and supply of medicines. The PSI has established a Code of Ethics and professional standards guidelines, and may reprimand pharmacists who do not comply. All pharmacists employed in Ireland must be registered with the PSI (Pharmaceutical Society website, Forum).

The General Medical Services (GMS) Scheme provides full medical and surgical services to persons or their dependants who cannot, without undue hardship, provide for these services themselves. Community pharmacists may contract with the Health Boards to supply drugs, medicines, and appliances under the GMS. The provisions of the GMS contract have a pervasive effect on community pharmacists for two reasons. First, at the end of 1999, about 31% of the population is covered by the GMS, and 78% of all prescriptions that are reimbursed are reimbursed under the GMS. Second, and following from the first fact, all but a very small handful of community pharmacists are "contractor pharmacists."

In addition to these three sources of rules, is the Irish Pharmaceutical Union (IPU), representing qualified pharmacists. The IPU's purposes include to promote the economic and professional welfare of members, to negotiate and settle differences and disputes and to regulate the relations between members of the Union and their employers, to represent its members, and to encourage ethical practice of pharmacy. "[M]isconduct includes any act or default likely to bring discredit upon the Union or its members or any part of its members." [63*a*]

8.2. Entry restrictions

Pharmacists must earn a Bachelor of Science (Pharmacy) degree and complete one-year of practical training under the supervision of a tutor pharmacist, or meet requirements for their foreign education to be recognised. At present, only Trinity College Dublin offers a pharmacy degree in Ireland. The capacity of the course was 50 until the 1997 intake, when it expanded to 70. Nevertheless, the Leaving Certificate score required was one of the highest of any profession. The fact that people with high scores were unable to win a place at the pharmacy school indicates substantial excess demand for places. In August 2000, the Minister for Education and Science announced his decision to increase the annual intake of pharmacy students to 120 and invited the relevant institutions to make proposals to meet the increase.

Despite limited domestic supply of pharmacists, or perhaps in reaction to it, the largest part of recent additions to the PSI Register (about half during 1988-1997 and more than two-thirds in 1998-1999) came from UK universities. Many are Irish citizens. This heavy dependence on training outside Ireland has given rise to complaints that, "It is not appropriate that the State depend on UK universities to continue to provide a very large proportion of the supply needs of the pharmacy profession in Ireland" (Forum).

This substantial labour flow from the UK, or provision of pharmacist education in the UK to Irish students, is made possible by European Union directives. These directives say that persons holding a (specified) comparable certification from a Member State may practice pharmacy in other Member States, subject to some restrictions. In Ireland, the main constraint, in practice, has been that such a person cannot, throughout his career, ever manage or supervise a pharmacy that has been in existence for less than three years. This has been characterised as "an artificial counterbalance to the licensing system perpetuated in some Member States" in a High Court decision (Ailish Young v The Pharmaceutical Society of Ireland, the Minister for Health, Ireland, and the Attorney General, 1992, No. 2098p). This constraint was put into place to ensure that lifting the entry restraints on EU-trained pharmacists would not result in massive opening of new pharmacies in Ireland, openings that were restricted in many other EU Member States. The rules on "contractor pharmacies" perform essentially the same function.

There is also provision for mutual recognition of pharmacy qualifications obtained in Australia and New Zealand. The main requirements are that an applicant have practised as a registered pharmacist for at least one year in the state of registration, and pass an oral examination in the laws governing the practice of pharmacy and the sale of medical preparations and poisons in Ireland (Pharmaceutical Society website). While it is possible to register as a pharmacist in Ireland based on original qualification in pharmacy that was not granted in a European Union Member State or Australia or New Zealand, the process can take two and a half years to complete and requires residency in Ireland to have been already established (Pharmaceutical Society website).

Despite the restrictions on entry, there is not now a mechanism by which pharmacists who have become impaired can be forced to quit practising. The Pharmaceutical Society would like to see "fitness to practise" included in new legislation.

Limits on the location of pharmacies effectively limit the number of pharmacies. Pharmacies that wish – as all but five at present do – to be contractors under the GMS must comply with the location restrictions. New contracts are made with pharmacies on the basis of "definite public health need," which is defined as:

a) The ratio of pharmacies to population at least 1:4 000 in urban areas and towns (over 3 000 population) and at least 1:2 500 in rural areas, and

b) No other pharmacy within 250m in urban areas and towns or within 5km in rural areas, and

c) No adverse effect on the viability of existing community pharmacies in the area, to the extent that it will affect the quality of pharmacy services being provided by them.

On receipt of an application for a new contractor pharmacy, the CEO of the (regional) health board must publish a notice, announcing the receipt of the application and asking for comments, and announcing that additional applications may be made in that catchment area.

Despite the heavy process, since 1996, 27 new contracts have been granted, of which 21 were in rural or semi-rural locations that did not previously have a community pharmacy.

The reasons put forward by the Department of Health for these restrictions were (1) to erect similar controls to those already in place in many EU Member Countries (2) to promote the development of a quality-driven service, and (3) to prevent further clustering of pharmacies in areas already well-served while promoting the provision of services in rural areas.

Before 1996, Ireland did not restrict entry of pharmacies. This resulted in Ireland having one of the highest ratios of pharmacies to population in Europe (Thesing, p. 11). Other countries, including Italy, Spain, Hungary, Norway, France, Australia and, since 1987, the United Kingdom, restrict the number or location of pharmacies. In New Zealand and Spain, only registered pharmacists may own a pharmacy and none may own more than one. Sweden reserves pharmacies to the state. By contrast, the United States, South Korea and Mexico do not have significant entry restrictions on pharmacies. Prescription drugs are delivered by mail in the United States, and future reform may bring mail delivered drugs to the United Kingdom.

8.3. Pricing, mark-ups and dispensing fees

Pharmacies, as implied above, sell both under the GMS and to private patients. Both types of transactions are heavily regulated, at least for medicines dispensed under prescription. In particular, for a sale of a prescription medicine under the GMS, the pharmacist cannot charge a mark-up; he is compensated his cost of the medicine plus a flat dispensing fee. The flat fee (can vary if a powder or ointment must be prepared or if the medicine is dispensed at night. For a sale to a private patient, *i.e.*, one not under the GMS, the pharmacist charges a 50% mark-up, under established custom and trade. The wholesale cost of prescription medicine is set by multi-year agreement between the Department of Health and Children and the Irish Pharmaceutical Healthcare Association, representing drug makers.

Other products that pharmacists sell include “over the counter” medicines, *i.e.*, those exempt from prescription-only, as well as cosmetics, toiletries, camera film, and so on.

Many other OECD Members also control retail prices of prescription medicines, and negotiate the wholesale prices with the pharmaceutical companies. Some also restrict prices for “over the counter” medicines.

8.4. Advertising restrictions

Advertising by pharmacies is tightly constrained by the ethical rules of the profession. Listings in the telephone directory and notices in the newspaper cannot advertise more than its existence and hours or change of hours. Special events, such as testing, can be advertised only by a notice in the window of the pharmacy. The cumulative effect of the restrictions means that a pharmacy cannot increase its foot traffic by advertising.

8.5. Conclusions and Policy Options

The pharmacy sector has a vital role to promote the health of Irish citizens. One reason given for the restrictions is that they will ensure that each pharmacy has sufficient scale to make the investments to strengthen its delivery of more sophisticated health care services such as testing and advising. Another reason given is to improve the delivery of health care services in rural areas. Thus, it is fair to compare the actual effects of the restrictions with these objectives, and to ask whether a different approach might be less costly to society.

The restriction on pharmacists educated in other EU countries, holding certificates that Ireland has agreed certify education comparable to that someone would have received in Ireland, does not promote health care delivery. It simply restricts entry, and thus has anti-competitive effect. In particular, it restricts entry of new pharmacies – those that would have opened if foreign-trained pharmacists were unrestricted – and employment possibilities for a subset of pharmacists. As the proportion of pharmacists with this handicap increase, the restriction may also raise the price of pharmacies operating for more than three years above the price of comparable pharmacies operating for less than three years.

Therefore, the restriction on economic freedom of pharmacists educated in other EU Member countries should be eliminated.

An additional benefit of eliminating this restriction will be to provide a back-up if the number of training places in Ireland does not expand enough. If the expansion were delayed, or if the estimate that 120 will be sufficient turns out to be too low, then the effects will be muted by the flexibility offered by international trade – whether one thinks of the trade as being in pharmacists or pharmacy education.

The logic provided for restricting the location and number of pharmacies is flawed. Incumbents in other sectors in other economies make similar arguments, that if they are protected from competition then they will perform a variety of good works. In fact, competition – keeping up with the competitors – is what induces quality-improving investments. Telephony in many OECD countries provides a good example.

Where there is a genuine public service obligation, such as loss-making provision of a service to rural areas, the solution is not creation of a protected monopoly to cross-subsidise the unprofitable activity. Rather, the solution is to split the task into two parts, of providing the service and of paying for the part that must be subsidised. The provider is chosen by auction for minimum subsidy, where the auction terms specify the services to be provided. The funds are provided either by the state budget, or by a small fee like a tax on some set of persons. By funding and providing the public service obligation in this way, the subsidy from taxpayers is minimised – the lowest cost provider should win a fair auction.

Pharmacies in Ireland probably do not need such a heavy regulatory structure. Free entry works just like an auction – the most efficient provider enters. Such quality-ensuring characteristics as minimum opening hours, inventory, and continuing education can still be required by regulation. And, since there can be continuous competition among pharmacies, pharmacies will have incentives to provide those quality attributes that are difficult to specify in regulation but which consumers value. If there are rural areas that would not have a pharmacy under such conditions, but that need one according to public policy criteria, those may have to be subsidised directly. For example, the United Kingdom subsidises some pharmacies to be open on Sundays and bank holidays. They already are being subsided indirectly, by consumers and potential pharmacists who endure inconvenience and higher costs. The proposed change would make the subsidy transparent.

Therefore, eliminate the location restrictions on pharmacies. Assess the exit and entry in the sector, and provide transparent subsidies to pharmacies that are desirable on the basis of public policy objectives, but are not forthcoming under free entry.

9. LEGAL SERVICES

The legal profession in Ireland is divided into solicitors and barristers.[1] Solicitors, who deal directly with clients, provide legal advice, prepare the paperwork for legal proceedings, retain barristers, and have overall management of a legal case. Solicitors also advocate in District Court. They also engage in other work not directly related to court, such as property conveyancing, testacy, and commercial contract work. Barristers provide legal advice and advocate in court as well as in tribunals. While the division of which profession advocates in which courts has not been enshrined in law or regulation since 1971, it persists in practice. Other practices which constrain practitioners' commercial freedom include the apparent prohibition of employed barristers appearing in court and the requirement, under their professional rules, for barristers to take work only from solicitors or from members of specified professional bodies.[2] But a client may direct his solicitor to retain a particular barrister. Further, the business form in which barristers and solicitors may practice is restricted: barristers may enter neither partnerships nor companies, whereas solicitors may enter partnerships with other solicitors — but not other types of professionals.

Solicitors and barristers are self-governing through the Law Society and the Bar Council, respectively. Both self-governing bodies are responsible for the certification and discipline of their members. Some aspects of the way in which these tasks are fulfilled can have the incidental effect of restricting entry and some aspects of competition. However, the restrictions differ in their extent and effects in the two professions. Partly, this difference in effect results from the practice of clients not having direct access to barristers, so that the information asymmetry between clients and professionals is limited to the market for solicitors' services.

Both professions restrict entry to the extent that the number of places in their respective professional schools is limited. Under current demand conditions, these entry limits do not seem to be binding on barristers – there is substantial exit – but they seem to limit the number of solicitors below the free-entry level. Before the Competition Act 1991, there was a history of recommended scale fees for solicitors. There is evidence that the since discontinued recommended scale fees for conveyancing still provided a "focal point" from which solicitors discounted their fees some years later. Advertising restrictions can restrict competition. In Ireland, solicitors have substantial freedom to advertise, including fees and areas of specialisation. However, in 2000-2001 legislation to restrict solicitors' advertising of personal injury claims is being considered. By contrast, barristers are prohibited from advertising. The effect of this prohibition is small, though, because barristers make themselves known to solicitors by other means.

Any evaluation of restrictions, regulations and customs must take into account their differing effects on the different types of clients. Clients who are frequent, large buyers of legal services, such as insurance companies and banks, have enough experience to assess the quality of services received. Further, some have sufficient market power to ensure that they receive good value for money. Clients who are involved in the legal system infrequently may be unable to assess quality and have little bargaining power in negotiating fees. This report focuses on the effect of the regulations and practices on small, infrequent clients.

Ireland has already implemented substantial reform in the legal professions. Earlier reforms, which allowed solicitors to advertise and which removed the compulsion of scale fees published by the self-governing bodies, lifted the main hindrances. Further reform of the regulation of the legal professions should focus on removing remaining impediments to competition among solicitors, and providing incentives on solicitors to ensure that even inexperienced clients receive barristers' services at competitive fees. Opening up the service of conveyancing to, for example, banks and financial institutions, would provide additional options to purchases of conveyancing services. Continued freedom of advertising for

solicitors will encourage consumers to shop around for cost-efficient legal services, which in turn encourages competition among solicitors. Making solicitors responsible to pay barristers their fee would increase solicitors' incentives to ensure cost-effective barristers services. And enabling clients to instruct barristers directly would increase efficiency. Allowing solicitors and barristers to practice in other business forms could increase efficiency, and other common law systems give legal professional greater scope in this dimension than does Ireland's. Any publication of, *e.g.*, a survey of costs, that could help to form solicitors' or barristers' expectations about a standard price should be suppressed. The control of education and entry of legal professionals should be moved from the self-governing bodies, but close ties as regards quality of entrants and content of education should be maintained.

9.1. Regulatory bodies

Solicitors have a self-governing regulatory body, the Law Society. The Law Society exercises statutory functions under the Solicitors Acts 1954-1994 for the education, admission, enrolment, discipline and regulation of the solicitors' profession.

The Society is authorised by law to consider complaints about inadequate professional services and overcharging. (Solicitors (Amendment) Act 1994, sections 8 and 9) Conflicts about negligence and breach of contract are resolved in court. Within the Law Society, the Registrar's Committee is responsible for resolving complaints under the Law Society's self-regulation. Some lay members (persons who are not solicitors) sit on the Registrar's Committee. If satisfied that a bill is excessive, the Society can direct the solicitor to refund immediately some or all of what has been paid, and to waive the right to recover those costs. After the Registrar's Committee of the Law Society has dealt with a complaint, if the person complaining is a member of the public and remains dissatisfied, (s)he may apply to the Independent Adjudicator, who is appointed by the Law Society. The Adjudicator may direct the Society to either re-examine the complaint or to apply to the Disciplinary Tribunal of the High Court. If a complaint has not been resolved or dealt with by the Registrar's Committee, the Society may refer a complaint to the Disciplinary Tribunal. (Complaints may also be made directly by members of the public.) The Disciplinary Tribunal, independent of the Law Society, is appointed by the President of the High Court and includes lay members. The Disciplinary Tribunal decides whether to bring the complaint before the President of the High Court, and if so, recommends the penalty to be imposed on the solicitor. The President of the High Court makes a decision on the basis of the Disciplinary Tribunal's findings or after further evidence in the High Court (Law Society website).

Another way a client can complain about high fees, without going to the Law Society, is to request that the bill be taxed, that is, reviewed by a court official, the Taxing Master. Also, the losing party in a court case against whom the winners' legal fees have been awarded can appeal the amount to the Taxing Master. Statistics on Taxing Masters' decisions show that, from the year 1996-97 to 2000, fees are reduced by 20 to 30%, depending on the year and Taxing Master, in those cases where a complaint was made (Question No. 244.).

The self-governing regulatory body for barristers is the Bar Council. It also represents the interests of practising barristers. The governing body of the Bar Council contains only barristers. The Bar Council promulgates a Code of Conduct and administers the Law Library, of which all practising barristers are members. The Bar Council's Professional Practices Committee considers complaints of misconduct by a barrister made by another barrister; the Professional Conduct Tribunal considers such complaints made by anyone else. The Professional Conduct Tribunal consists of five practising barristers and two non-barristers, one nominated by the Irish Business and Employers' Confederation (IBEC) and one by the Irish Congress of Trade Unions (ICTU). The Tribunal may impose penalties if it finds that a barrister has violated the Code of Conduct or breached proper professional standards (Law Library website).

The Bar Council is a non-statutory body. While both barristers and solicitors are considered officers of the court, judges are traditionally drawn from the ranks of barristers, although District Court judges are frequently solicitors. Control over the education of barristers is not entirely in the hands of barristers, as the Honorable Society of Kings Inns, the educational establishment for barristers is composed of members of both the Judiciary and the Bar.

9.2. Entry

Solicitors and barristers impose exacting entry requirements, including courses, examinations, and work under supervision. Barristers in Ireland are educated at the Honourable Society of King's Inns ("the King's Inns"). To become a barrister in Ireland, one must have a law degree approved by the King's Inns (or pass its Diploma in Legal Studies examination), pass a two-year course at the King's Inns, and work with an established barrister, "devilling," for one year. For solicitors, the entry requirement for solicitors, also, is graduating from university (or being a law clerk with five years experience and meeting other requirements), passing the course at the (unique) Law School and a number of examinations, and serving a two-year apprenticeship with a practising solicitor. Since 1991, any solicitor in good standing in Northern Ireland, England or Wales could apply to the Law Society and be automatically registered. Only about forty persons enter in this way each year. A person who is qualified to practice, in a non-European Union country, a profession that corresponds substantially to the profession of solicitor, may allowed to practice in Ireland. The Law Society may impose obligations of education, training, examinations, and practice in the first three years of Irish practice. (Sect. 52, Solicitors Act 1994) Over the past four years, about 14 to 17% of solicitors admitted were from outside the Republic of Ireland.

Various European Union Directives affect entry. Directive 77/249/EEC, allows lawyers who have obtained their qualification in another Member State of the European Union to provide legal services, with some limited exceptions. Under Directive 89/48/EEC, which deals with the recognition of professional qualifications requiring a period of training of at least three years duration, EU qualified lawyers are, in general, subject to an aptitude test if they wish to become barristers or solicitors in Ireland. Directive 98/5/EC – in the process of being implemented in Ireland – provides a right to EU lawyers to pursue, on a permanent basis under the home State title, in a Member State other than the State in which they obtained their qualification, the professional activities of lawyers in the host State. This right is subject to a registration requirement. A lawyer, who has practiced for at least three years in the host State's law, can apply to enter the relevant host State profession without having to pass the aptitude test provided for in Directive 89/48/EEC.

The economic effects of the entry restrictions appear to differ between barristers and solicitors, at least at the present time. For solicitors, the entry barriers seem to be binding. An author in the Law Society Gazette notes, "After the crisis of three years ago when there were so many calls within the profession to limit entry to the Roll of Solicitors, those cries have died down to a whimper. Where once the Law Society maintained a register of solicitors seeking employment, they now maintain a register of employers seeking solicitors (Gilhooly, 1999). This may be a short-term phenomenon, because from October 2000 the capacity of the Law School doubled to 400 places. For comparison, about 7 000 solicitors are on the rolls and about 5 300 to 5 400 practice. In Japan, where entry into the legal profession is highly restricted, only about 500 new lawyers were permitted annually and about 15 000 were already active.

Restrictions on entry into the profession of barrister appear, at present, to have little effect on competition. Each year relatively large fractions of practising barristers enter or leave the profession. Many barristers, especially new ones, cannot support themselves in their chosen profession (Because standards for admission to King's Inns are high, they presumably have enough skills to support themselves in some other profession.) One survey reported that 800 of the 1 300 practising barristers had gross incomes of IR£20 000 or less in 1995 (Bacon). High turnover and low incomes of many practitioners both suggest that entry controls are not restricting competition among barristers.

For more than a decade, reports have recommended that the responsibility for educating and certifying legal professionals be borne by the state rather than the self-governing bodies. "The great danger arising from such control over entry, in the opinion of the Commission, is that that the number admitted might be restricted to a level which was believed to match the perceived requirements of the profession, and not of the public" (FTC, p. 313). "[T]he Government should accept in principle a move away from control of education and entry to a sector by the sector's self-regulating body" (Bacon, p. 42). The argument is that the interests of the public and of the incumbent professionals differ, where the public wants a larger choice of professionals charging lower fees.

Conveyancing is one area of legal practice that is now reserved to solicitors in Ireland. Other common law jurisdictions have opened conveyancing to other professions. All Australian states but Queensland have done so. One study of New South Wales found that a number of reforms (notably removing most fee advertising restrictions on solicitors and allowing licensed conveyancers to compete with solicitors), resulted in a 17% decrease (1994 to 1996) in the average fees charged by small firms for conveyancing, yielding an estimated annual savings to consumers of US$86 million (Barker, 1996). In the United States, conveyancing is open to non-lawyers, and in the United Kingdom, conveyancing is open to notaries and licenced conveyancers, as well as solicitors. Reform under consideration in New Zealand would open conveyancing to non-solicitors. Thus, the predominant model in other common law jurisdictions is not to reserve conveyancing to solicitors.

Almost anyone who wishes — or must — go to court must employ a solicitor in order to access a barrister. The custom of barristers not taking instruction from anyone but a solicitor (with the exceptions noted earlier), and the practice of solicitors not advocating in courts beyond District Courts, means that any person not in the excepted categories must usually employ a solicitor in order to speak with a court advocate. The exceptions appear to be professionals who would routinely instruct barristers in technical cases, and the exceptions apply only for non-contentious business. It is reasonable to ask whether other professions, or indeed government departments and bodies, would not be in a similar situation and should be accorded similar privileges.

9.3. Fee setting

Clients and professionals are free to negotiate fees. Before the Competition Act 1991, there was a history of recommended scale fees for solicitors. There is evidence that the since discontinued recommended scale fees for conveyancing still provided a "focal point" from which solicitors discounted their fees some years later.

Changes in the law have made it more feasible for clients to "shop around" for legal services. Solicitors must provide to clients, on taking instruction or as soon as is practicable thereafter, the actual charges, or if not feasible an estimate, or if that is not feasible, the basis on which charges are made. (Sect. 68, Solicitors Act 1994) The solicitor must also tell the client the barrister's fees. Reportedly, clients have begun to contact several solicitors to try to obtain a reduction in the fee for conveyancing. This change may be related, too, to the substantial rise in the price of property in Ireland and the fact that the fee for conveyancing is normally expressed as a percentage of the price of the property.

Developments in the market for conveyancing illustrate the practical effect of the recommended scale fees. Before the Competition Act 1991 was introduced, the Law Society set the fee for conveyancing as 1.5% of the price of the property sold for the purchaser and 1% plus Ir£100 for the seller. In principle, clients and solicitors could negotiate an alternative agreement, but the scale fee was the maximum that could be charged if no agreement could be reached. After the introduction of the Competition Act 1991, the Law Society could not publish compulsory scale fees, but as late as 1996 the Dublin Solicitors Bar Association published a "Survey of Costs" that included the 1% figure. (The "Survey of Costs" did not contain any recommendation that solicitors actually charge the fees listed.) A study shows that, in 1994, solicitors quoted fees for hypothetical transactions that were discounted from the scale fee. Within each region, discounts were sensitive to location; local markets showed systematic deviations from the recommended fee scale. However, the study could not distinguish between local markets of solicitors being competitive or cartelised. Interviews with solicitors provided support for the view that the discontinued recommended scale fees provide a "focal point" from which solicitors discount in order to set their fees (Shinnick and Stephen, p. 13). (A "focal point" means that there is a particular fee that all solicitors know is associated with a particular task, and know that all other solicitors know it has this association.)

The study of conveyancing raises two points about where competition is likely to be less vigorous. First, the three requirements for successful cartelisation – to reach an agreement, to detect cheating on it, and to punish cheating – would appear to be easier to satisfy in rural areas, where the small number of competitors makes undercutting more detectable. Second, many services performed by solicitors are less standard than conveyancing. Requesting fee estimates for less standardised tasks imposes a time cost, which discourages clients' "shopping around." If fewer clients actually make comparisons, then solicitors may engage in less vigorous competition for non-standard tasks.

Fee setting by barristers takes place in a somewhat different market environment. Solicitors are regularly "in the market" for barristers' professional services, so if solicitors act as clients' agents then they would effectively cumulate their clients' indirect demand for barristers' services and reduce the effect of such a "focal point" in barristers' fees. While a recent study (Bacon) could not rule out some incidence of anti-competitive behaviour among barristers, it concluded that high fees charged by a few barristers could not in the main be attributed to anti-competitive behaviour. The perception that some barristers have "too much" work and others have "too little" supports this view. Also supportive is the absence, or at least weakness, of one of the key requirements for collusion to work, the ability to detect cheating on the cartel.

The Fair Trade Commission's *Report of Study into Restrictive Practices in the Legal Profession* reported that solicitors' representatives said, in 1982, that "in practice the amount of price competition (among solicitors) was limited but maintained that there was instead competition in the quality of service given" (FTC, p. 209). At that time, the Law Society's scale fees were not mandatory minima, and the representatives pointed out that prospective clients could shop around.

It was reported by the FTC in 1990 that the Bar Council had issued a recommended table of fees for certain basic services. The Bar Council had stated that they saw them as useful guides for Taxing Masters – who would not allow fees higher than shown on the scale in the taxation of costs – and that the Circuit Court Rules Committee had, in the past, adopted the table, sometimes with amendment. The Bar Council had stated for the 1990 Report that it understands that, in the main, the tables of published fees are adhered to by the Bar (FTC, p. 210).

The FTC concluded in 1990 that, "Although we accept that there is some shopping around by clients for fee quotations, we now believe that the existence of fee scales in respect of own client charges by lawyers, particularly conveyancing fee scales, is a serious detriment to competition, without compensating advantages, and that such scales are unfair and contrary to the common good" (FTC, p. 219). It went on to recommend that the Law Society be requested to withdraw any recommendations on fees, and

that rules regarding fees for conveyancing, and for solicitor's costs and barrister's fees on a party and party basis, be revoked and the power to make such rules be withdrawn (*Ibid.*, pp. 220, 223). After the Competition Act 1991, any recommended scale fee would be of great interest to the Competition Authority.

9.4. Advertising

Solicitors may, and do, advertise, but barristers are prohibited from advertising by the Code of Conduct of the Bar Council. A solicitor may advertise her fees for specified legal services and, if qualified under the regulations of the Law Society, may designate herself as having specialised knowledge in an area of law or practice. However, the solicitor cannot assert specialist knowledge superior to other solicitors, and cannot advertise in ways that are likely to bring the solicitors' profession into disrepute. The Law Society may make regulations that prohibit the advertising of fees, but only with the consent of the Minister and where the Minister is satisfied that such regulations are in the public interest (Sect. 69, Solicitors' Act 1994). At present, regulations prohibiting the advertising of fees have not been made. Under the now-replaced Law Society's 1988 regulations, solicitors could not advertise their fees (FTC, p. 254).

There is a concern in Ireland that solicitors' advertising might have induced greater litigiousness, and a recent report recommended consideration of restricting the content of solicitor's advertising aimed at the general public (Bacon, p. 44). However, advertising by solicitors is already required to be not "false or misleading in any respect" (Sect. 69, Solicitors' Act 1994). Because litigation is inherently uncertain, presumably boasts about the likelihood of success in a lawsuit could be prohibited under such a general standard. Further, newspaper coverage about a series of successful plaintiffs, which can induce more people to sue, would not be stifled under these rules. Indeed, advertising by solicitors and newspaper articles both overcome a market failure by providing information about the cost and benefits of professional services, thus expanding services and access to justice to under-served populations. If the underlying issue is too many tort suits damaging Irish competitiveness, then perhaps a more direct reform would result in a more efficient justice system. Hence, any restriction on content of advertising should be circumscribes so as to be least restrictive of advertising that supports the competitive process.

Representatives of the Bar Council argued to the FTC that barristers, in a sense, advertised all the time on their feet in court. Further, solicitors have directories of barristers and their specialities (FTC, p. 248). Nevertheless, the FTC recommended that barristers (and solicitors – the change had not yet occurred at that time) be permitted to advertise fees, since it felt that this would benefit clients and not lead to any diminution in professional standards (FTC, p. 257). A more recent report also recommended that the Bar Council be persuaded to allow comparative advertising by barristers to solicitors and their clients (Bacon, p. 44).

9.5. Business forms

Ireland restricts the form of business in which solicitors and barristers may practice. Solicitors may practice only in partnerships with other solicitors, and barristers may practice neither in partnerships nor companies. New Zealand also prohibits legal professionals from incorporating. By contrast, salaried lawyers in the United Kingdom and in the United States are nevertheless considered to be independent. In both cases, they may work in partnerships with non-lawyers. The professional responsibilities do not seem to have been altered by permitting these other business forms, as the same codes of conduct and disciplinary mechanisms apply regardless.

9.6. Conclusions and Policy Options

Clients hire legal professionals, making choices among solicitors but, with few exceptions, not among barristers. Solicitors choose among barristers, except when experienced clients make that choice. Hence, from an economic perspective, for inexperienced clients, solicitors compete for clients, and barristers compete for solicitors.

In the market for barristers' professional services, the clients or solicitors tend to be well informed. If an individual solicitor feels insufficiently informed about barristers' characteristics to make a choice in a particular case, then she normally consults others in the same firm or in an informal network. The quality of a barrister's advocacy is relatively apparent to solicitors. Barristers win or lose in public court, where the quality of their advocacy, as well as the solidity of the underlying case, are apparent to observers. In a small legal system such as Ireland's, the repeated exposure of solicitors, especially those who have specialised in an area of the law, to the same set of barristers would allow numerous quality comparisons to have been made. The quality of a barrister's legal analysis would also be signalled in court, but the informal network of solicitors and barristers is also a source of information.

The role of solicitors in the barristers' market – that they make the choice of barrister but do not bear the cost – raises the possibility that barristers' fees could be above the competitive level. If the market for solicitors' services is not competitive, then solicitors would not have incentives to seek the barrister who provides the best value for money because cost would be paid by the client.

But there is little reason to be concerned that barristers' fees are above the competitive level, at least on average. The high rate of exit suggests that barristers' remuneration, at the low end, is not higher than for alternative careers for those with a barrister's training. The correspondingly high rate of entry implies that any excessive remuneration for barristers would be not persist, but would instead be competed away by attracting more barristers into the profession.

By contrast, the market for solicitors' professional services has a different structure from that for barristers. The difference is largely that solicitors' clients – at least those who are infrequent – are relatively uninformed. While clients have begun to "comparison shop" for relatively straightforward tasks, such as conveyancing, this is impractical where the task is non-standardised. Further, at present there is excess demand for solicitors' training. Together, these characteristics mean that the market for solicitors' services raises more concerns than does the market for barristers' services.

Ireland has already implemented substantial reform in the legal professions. Advertising by solicitors is already liberalised. Further, the self-governing body of solicitors has already taken steps to increase the capacity of its Law School. However, further reform is likely to have positive effects.

Entry

Entry and education are in the hands of the professions' self-governing body. While their stated purpose is to guarantee a minimal quality of professional knowledge and skills, the logical connection between the input, education, and output, quality enhancement, is tenuous. The contrast with the absence of mandatory continuing legal education[3] is marked. There is also a difference in the interests of the professional bodies and the public, where the latter would prefer a wider choice of professionals at lower cost.

Therefore, move the control of education and entry of legal professionals from the self-governing bodies, but maintain close ties as regards quality of entrants and content of education and training.

Advertising

Advertising by solicitors encourages consumers to shop around for cost-efficient legal services, which in turn encourages competition among solicitors.

Therefore, maintain the freedom of solicitors to advertise their fees and areas of specialisation.

NOTES

1. This study did not address the question of whether the legal profession should continue to be divided into barristers and solicitors.

2. Included are: Ombudsman for Credit Institutions, Ombudsman for Insurance Industry, Association of Chartered Certified Accountants, Association of Chartered Accountants in Ireland, Institute of Certified Public Accountants in Ireland, Chartered Institute of Management Accountants, Institute of Chartered Secretaries and Administrators, Institute of Secretaries and Administrators.

3. "21 Years On: The Changing Face Of CLE" by Sarah O'Reilly in the Law Society Gazette December 1999 on http://www.lawsociety.ie/GazDec1999.htm on 9 June 2000. "The future development of CLE is currently under review by a Law Society task force. The law societies of England & Wales and Scotland have in recent years introduced mandatory CLE. While the suggestion of mandatory CLE in Ireland has previously been discounted, there are some signs of change of attitude among the profession."

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