



Neil Bingham  
Northern Ireland Authority for Utility Regulation  
Queens House  
14 Queen Street  
Belfast  
BT1 6ER

Energia House  
62 New Forge Lane  
Belfast  
BT9 5NF

Tel: +44(0)28 9068 5941  
Fax: +44(0)28 9068 5935

28th August 2008

Dear Neil,

### **Consultation Paper on Phoenix Supply Ltd. Price Control from 2009 – High Level Options**

Thank you for the opportunity to comment on the above consultation in respect of the Phoenix Supply Limited (PSL) Price Control from 2009. VPE, and our supply arm Energia, recognise the importance of this consultation for supply competition in the Northern Ireland gas market. With a view to stimulating competition in this market, the key actions VPE would recommend are as follows:

1. A trajectory for complete removal of the PSL Price Control should be established. We would suggest that a price control beyond one year would not be in the interests of competition.
2. PSL should be required to implement a clear transparent replicable hedging strategy visible to other suppliers so that other suppliers can compete with the Phoenix Tariff. This is particularly important in the current climate of volatile wholesale gas prices.
3. Consistent with point 1, the Utility Regulator should be prescriptive about how PSL price their wholesale gas in advance of procurement and setting of tariff. If NIAUR are minded to have a fixed price tariff then VPE would suggest that gas should be hedged on a monthly basis using the ICE Front Month Index.
4. Larger Industrial and Commercial customers (consuming greater than 25,000 therms per annum) should not be included in a price control as this will damage existing competition. Efforts should be made instead to stimulate further competition in this sector by for example restricting PSL product offerings.
5. No retrospective cost recovery adjustments should be allowed. This not only impacts competition, but its presence also acts as a perverse incentive and therefore deterrent to an optimal gas purchasing strategy.

6. The supply margin should be sufficient to sustain competition and should therefore reflect market rates. We understand this is a difficult decision for the regulator to take but it is crucially important that the supply margin be driven by competitive forces.

A key issue for us in this consultation is that continued end-user price regulation in the retail gas market, as proposed, is generally regarded as undermining competitive markets to the ultimate detriment of consumers. This proposition is supported by authoritative research and international experience<sup>1</sup>. The European Regulators Group for Electricity and Gas (ERGEG) published a position paper on this issue in July 2007 which strongly opposed end-user price regulation on the grounds that such regulations distorted the functioning of markets and jeopardised both security of supply and efforts to fight climate change<sup>2</sup>. ERGEG subsequently called for all countries to abolish end-user price regulations. VPE agrees with this informed view and would therefore urge NIAUR to consider a more pro-active approach in promoting competition by breaking down competitive barriers that currently exist in Northern Ireland's gas market (see our previous correspondence to NIAUR on 15 July 2008 included with this response).

Even in the current context where there is only one supplier (PSL) serving the market for customers who consume less than 25,000 therms per annum it is not clear that a price control is appropriate. A price control cannot be justified per se on the basis of protecting vulnerable consumers as other methods can achieve the same goal without distorting the market (e.g. tax breaks, subsidies and social benefits). At the very least, and as advocated by ERGEG, it is imperative that NIAUR urgently progress towards a competitive market by committing to a road map that includes specific and attainable steps for establishing the necessary conditions for a well functioning market without the need for end-user price regulation. This road map should be the subject of industry consultation and forum and should be driven by a NIAUR mandate of promoting competition in gas.

VPE is strongly opposed to any extension of the existing price control to larger customers as this would be a set back to the competitive dynamic, albeit limited, that has already entered this sector of the market. Again the emphasis should be on breaking down existing market barriers rather than erecting new ones in the form of end-user price regulation. We do note however that other forms of regulatory intervention may be necessary to promote competition. An example would be some form of positive 'kick start' action to help non-incumbent suppliers build a credible customer portfolio. This could be in the form of restricting Phoenix Supply customer products to avoid customer 'lock-ins'.

The proposed PSL Price Control should be viewed in the wider context of promoting electricity and gas retail competition in the island of Ireland. Having previously submitted our

---

<sup>1</sup> See for example "Beyond Regulation" by Stephen Littlechild, 4 October 2005.

<sup>2</sup> See "End-user energy price regulation- An ERGEG Position Paper", Ref E07-CPR-10-03, 18 July 2007.

views about this on 15 July this year we would again reiterate that effective competition brings substantial benefits to consumers. It is well established by authoritative research that competition responds to the wishes of consumers, encourages efficient production and investment, stimulates production differentiation and innovation, and passes these benefits onto consumers. These benefits can be best realised through an integrated energy policy approach that fully appreciates the synergy between gas and electricity. This is borne out in the experience of other markets where Dual Fuel products have driven competition by reducing costs and managing risks for new entrants.

VPE are confident that a stronger mandate for NIAUR of 'promoting competition' in gas will bring about real progress. Consistent with ERGEG's policy recommendations noted earlier VPE would urge NIAUR to move away from end user price regulation in favour of pro active measures to promote competition. VPE assume that NIAUR will carefully consider how the construct of the price control on Phoenix Supply could act as a catalyst for competition. Effective competition faces a number of specific challenges but VPE are confident that NIAUR can play an important role in this regard as evidenced by its drive to change existing market practices for electricity<sup>3</sup>.

Concluding, it is vitally important that sufficient transparency in PSL's Price Control is given as much prominence as possible, and to a sufficient level of detail for market participants to be able to sensibly comment and replicate their hedging strategies. VPE suggest that NIAUR set out a road map that includes specific and attainable steps for establishing the necessary conditions for a well functioning market without the need for end-user price regulation. We assume this road map will be the subject of industry consultation and forum and will be driven by a NIAUR mandate of promoting competition in gas. VPE strongly oppose a Price Control for larger consumers (those consuming in excess of 25,000 therms per annum) and the retrospective recovery of costs in any price control. Finally, it would prejudice a future competitive market if the proposed price control were extended beyond one year.

These issues are of significant concern to VPE and we would therefore be willing to arrange a meeting with NIAUR to explain our concerns in more detail. In the meantime, please do not hesitate to contact us if we can provide any further information.

Yours sincerely



Garrett Blaney  
Head of regulation

---

<sup>3</sup> We note in particular a welcome review by NIAUR to remove the K factor for electricity.