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Dear Barbara

NIE ENERGY SUPPLY PRICE CONTROL 2009/2010 - PROPOSALS

Thank you for the opportunity to comment on the Allowed Revenue for NIEES (i.e. its operating costs and margin).

First, we understand your rationale for a one year extension to the Price Control. In view of a number of market reviews that are underway it may be sensible to defer any substantive changes until further information is available. However, we do have a few comments with regard the detail of these current proposals, especially on the effect on retail competition.

Margins.

We question whether the net margin of 1.68% is adequate particularly given the increased risk of wholesale energy costs and the effects on tariffs.

A positive move now by NIAUR to support a realistic competitive retail sales headroom will make it more attractive for new entrants to do business - the significant drop in wholesale commodity prices creates an ideal opportunity to move this process forward. Typically, competitive energy markets require net sales margins in the range of 5-7% to sustain their business and investment profile[1]. It therefore makes perfect sense to consider a more realistic margin, one that moves in the right trajectory towards securing a competitive market for Northern Ireland.

We understand the need to keep prices as low as possible for customers, especially during this economic downturn. However, this must be balanced against the increased risk for NIEES and a longer term goal to secure the development of a sustainable competitive model

[1] Ofgem Energy Supply Probe, Oct 2008, page 73, a Centrica perspective.

for Northern Ireland. This requires a sensible margin model that rewards investors, drives competitive offers, innovation, and supports the investment needed to meet sustainable energy and security of supply policy goals.

Now is the time to start this process.

Bad Debt Provision

Maintaining a Bad Debt provision of £2.489m (0.4% of regulated turnover) for the forthcoming year appears unrealistic when set against the present economic downturn.

Ofgem has noted that in GB, debts for domestic gas and electricity consumers have increased significantly in recent years[2], and perhaps mores so in the last six months. In Ireland, the Allied Irish Banks has doubled its estimate for bad debt provisions this year on fears of a worse-than-expected recession and warned that problem loans may only peak in 2011.

Closer to home, individual and company insolvencies are showing a worrying deterioration (just under 40% increase[3]) and Citizens Advice, Northern Ireland reported in October 2008, debt money advice had increased by nearly 40% in the 12 months to September 2008[4].

Notwithstanding NIEES' willingness to accept the 0.4% provision for one year, we challenge whether such a low figure is warranted given the economic downturn and the need to ensure that NIEES is able to adequately finance its business activities, for each and every year. The fact this is a one year price control extension should not be allowed to detract from this fundamental objective.

Removal of the Price Control

NIEES has recommended (and NIAUR is minded to accept) the removal from the regulated Price Control mechanism those customers with an annual consumption of more than 150MWh. We recognise this as a positive first step towards a lighter regulatory approach where markets can support it and customers would benefit. It is therefore important for this separation to be fully transparent and cost reflective, and this will require the allocation of costs being properly accounted for and accurately directed to this customer segment. We look forward to understanding more on how this will be achieved, and the measures that NIAUR will undertake to ensure this is done.

[2] Ofgem – Energy Supply Probe – proposed retail market remedies (April 09)

[3] See DETI statistics: comparing Qtr 4 2008 with Qtr 4 2007.

[4] CAB Press Release dated 24 October 2008

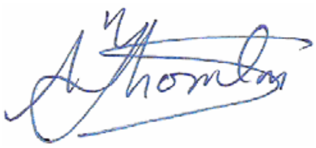
Going forward, we also recommend the consultation and development of criteria that would help guide and underpin future price control modifications. Policy decisions of this stature require careful consideration and objective analysis, and this would benefit from understanding the qualifying criteria (or market tests) against which any future decisions might be formed. We suggest this is handled via a separate consultative process.

<u>MBIS Costs</u>

Finally, the ‘MBIS’ cost bucket seems to cover an awfully large number of items. It represents the second largest item (after IT costs), it is twice as large as the ‘Salaries’ and ‘Bad Debt’ provision, and is in fact larger than the cumulative total of all the other itemised operating costs (bar IT). We therefore recommend that for future reviews, this is further broken down to allow for a more informed review to take place, a point that is particularly pertinent in light of the deregulation (as noted above) for some customers.

We look forward in particular to your thoughts on the allowed margin for NIEES for this price control year and please do not hesitate to contact us if we can help further.

Yours sincerely,



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