



PHOENIX SUPPLY LTD
RESPONSE TO UTILITY REGULATOR'S
ENERGY RETAIL COMPETITION WORK PROGRAMME CONSULTATION
July 2009

This document sets out the response of Phoenix Supply Ltd ("PSL") to the Utility Regulator's ("UReg") Consultation on its Energy Retail Market Competition Work Programme.

Consultation Question 1

Respondents are asked to comment on the impact of this paper with regard to equality of opportunity and good relations (paragraphs 9 to 12).

No comment.

Consultation question 2

General comments are invited on our overall approach to analysing the cost, benefits and options relating to supply competition.

Customer Switching

It is concerning that permeating this Consultation and indeed previous Consultations, that there appears to be the acceptance that the measure of successful competition is the number of customers who transfer supplier. We strongly disagree with this assertion.

As we commented in our response to UReg's Consultation on Electricity and Gas Retail Market Competition in Northern Ireland in April 2008, competition is fundamentally about providing customers with choice. In respect of the supply of

natural gas, customers will presumably choose supplier primarily based on two factors - price and the level of customer service offered by each supplier. (Other factors will inevitably influence customer choice, however, studies have shown these two factors are the primary considerations when customer choose energy supplier.) By suggesting that the development of competition is measured by the number of customers who have transferred supplier, indicates the incumbent does not offer competitively priced products or customer service excellence. This supposition cannot be substantiated by the facts.

For example, in recent months a significant proportion of businesses in the Greater Belfast area have put their natural gas requirements to competitive tender. Any gas supplier holding a licence to supply in this area is at liberty to tender and seek to win these customers and a number of natural gas suppliers, including PSL, have provided quotations and offered a range of gas purchasing products to these businesses. Ultimately the choice of natural gas supplier must rest with the customer, and this may well be the incumbent. Therefore to monitor competition by the number of customers who switch supplier alone is, in our view, fundamentally flawed. It is our view that a more appropriate measure of the level of competition is the level of choice offered to consumers.

General comments

The Consultation identifies some of the direct costs facing suppliers following the introduction of competition however it does not comment on the impact competition will have on a Supplier's fixed overheads. Clearly if the number of Suppliers increases, the aggregate value of fixed overheads will increase. These costs would be spread across a fewer number of customers per Supplier and therefore ultimately costs to consumers will increase.

We note that paragraph 39 of the Consultation comments that the benefits of competition would include:

- *Competitive pressure to procure wholesale energy efficiently* – we would strongly argue that PSL is already incentivised to do this. We endeavour to keep costs as low as possible for consumers to ensure that our customer base continues to grow and our business continues to develop. Ultimately, if the cost of the network is shared amongst a larger customer base, overall costs to customers may be maintained at their current level or even reduced.

- *Competitive pressure on supply margins* – PSL is a regulated business and its costs are scrutinised by UReg as part of its Price Control process. UReg has recently completed its second Price Control for PSL which sets out the costs PSL is allowed to recover from consumers in the period 2009 to 2011. As part of this process, UReg set the level of margin that PSL is allowed to recover at 1.5%. This is exceptionally low and we believe that it is highly unlikely that other suppliers will be able to enter the market on this basis.

We would also like to clarify the comments made in paragraph 53 of the Consultation. Whilst it is true that the risks of movements between periods lie entirely with the consumer if a tariff is fixed on the basis of cost predictions, the converse is also true – the reward associated with movements between periods also lies with the consumer. It would have been helpful if the Consultation paper had included this balance.

Finally, paragraph 59 identifies frequent instances of problems arising from the change-of-supplier process and we would add that “erroneous transfers” was, and continues to be, a major issue in Great Britain. The issue arises when a customer is transferred to a new supplier in error which undermined public confidence in the switching systems, and indeed in competition generally, and took many years to address. We believe that the development of processes and systems in Northern Ireland must take this issue into account and ensure that it is not possible to switch customers erroneously.

Consultation question 3

To what extent is segmentation of the retail sector inevitable and indeed healthy? What kinds of segmentation (or inequality of outcome) would respondents see as undesirable, and at what level might regulatory intervention be justified?

As we commented in response to UReg’s April 2008 Consultation, we believe that the small size of the NI market is a natural barrier to competition. Lessons can be drawn from other competitive markets, most notably Great Britain where competition has been operational for a number of years. At one time there were 23 gas suppliers operating in the market and today it is recognised there are 6 main gas suppliers in a



market with c.20 million customers. It has been suggested that a customer base of c.5 million customers is required to sustain a viable gas supply business.

It is our view that because of the small number of customers currently available, c.125,000 in Greater Belfast, other suppliers are sceptical of potential returns and are therefore hesitant to invest in the NI gas industry. We would therefore question the validity of the assertion that a number of suppliers can effectively compete in such a small market whilst ensuring that competition delivers economic benefits for consumers in the long-term.

We would also recommend that UReg considers the impact of competition developing in one market sector and not others. This may lead to unintended and unsatisfactory impacts on sectors of the market where effective competition has not been delivered.

We are also aware of recent calls in Great Britain to reintroduce regulatory price controls as the perception has been that competition has not been effective. However at this time, domestic customers in Northern Ireland have the reassurance that each element of the charge they pay has been scrutinised by UReg as part of its Price Control processes. This is an important advantage of the current arrangements in Northern Ireland which would be lost with the development of a competitive market.

Consultation question 4

The paper suggests that the Utility Regulator should monitor with particular care levels of competition for rural customers, pre-payment customers and those not on the gas network. Also that we should monitor closely whether current meter-reading obligations are sufficient. Comments on these priorities are invited. Do respondents wish to suggest other areas that require particular attention from us?

We would reiterate that we do not agree that customer transfers should be the sole benchmark to assess whether competition in Northern Ireland is successful; competition is fundamentally about providing customers with choice and customers



will presumably base their decision on price and the level of customer service offered by each supplier. If the incumbent offers competitively priced products or customer service excellence, it is not surprising that customers may well choose to continue to have their gas supplied by them; ultimately the choice must rest with the customer. Therefore to monitor competition by the number of customers who switch supplier alone is, in our view, much too simplistic and a more appropriate measure of the level of competition is the level of choice currently available to consumers.

We believe that it is also relevant to note that rural customers who use heating oil as their fuel source are not afforded the regulatory protection natural gas and electricity customers are provided with. Heating oil is used by around 70% of households in Northern Ireland and we believe that now is the appropriate time to regulate this industry to ensure that heating oil customers are not disadvantaged.

Consultation question 5

Comments are sought on our proposed approach to continued regulation of tariffs in the coming years (paragraphs 75 to 78).

No comment.