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Dear Elena

ENERGY RETAIL COMPETITION WORK PROGRAMME: GENERAL OVERVIEW AND RATIONALE

Thank you for the opportunity to comment on the Utility Regulator's work programme for 2009/10.

The positive level of engagement with stakeholders and now, the set up of the new Senior Stakeholder Group to help drive through reform, are indeed encouraging signs. We would like to reassure the Utility Regulatory of our continued commitment to the development of competition, particularly on an all-island basis, and we look forward to contributing to the 'Skyplex' and 'POYRY' Consultant reports that have recently been published for electricity.

The retail barriers affecting retail competition for Northern Ireland are well documented, and we see some of these important measures being picked up within the work programme for 2009-10, including 'K' factors, margins, information transparency and branding.

But lack of progress in retail gas competition is a fundamental impediment to delivering consumer choice in Northern Ireland. And this is particularly pertinent for Dual Fuel market strategies, where the acquisition of both electricity and gas customers reduces costs of acquisition, reduces the ongoing cost to serve, and so encourages competition. Taking a view that Dual Fuel is unlikely to play a serious role in Northern Ireland (as the Utility Regulator seems to¹), is unhelpful and can become self fulfilling.

¹ Energy Retail Competition Work Programme: General Overview and Rationale, Consultation April 2009, para 73, p.19

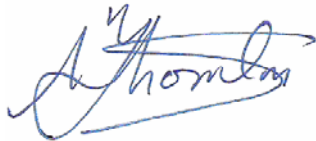
We therefore make the following observations:

- **Work Programme 2009/10:** issues such as K and margins must be tackled for both electricity and gas. In particular, we note there are some items missing from the work plans, items such as: gas retail tariff structures, gas imbalance exposure, and systems development and code improvements. Of course if the Common Arrangements for Gas (CAG) is given political support then the programme will also need to address the process of integration with the RoI.
- **Competition:** if gas competition is to have a serious chance of developing, it requires the same level of positive activity as seems to be the case for electricity - it must not play second fiddle. This means ensuring the Utility Regulatory embeds this philosophy into all policy reviews, strategy groups, and any workstreams that evolve. We gained comfort however from the recent meeting of the Senior Stakeholder Group that gas retail competition will now be brought under the purview of this important group.
- **Segmentation:** comes in many forms and guises. For example, this could mean niche market entry strategies, tailored products and services, or even acting as a platform for competition to get a foot hold. These are all perfectly acceptable market development strategies, all of which benefit consumers. We must therefore not allow regulatory policy to constrain the development of competition by trying to predict, and then apply, ex ante regulatory measures for the 'just in case' scenario. Regulatory policy must enable and not try to predict.
- **Consumer Protection:** we accept there are likely to be measures to ensure the most vulnerable consumers of our society are afforded a proper level of protection. This is not to suggest that competition will necessarily fail them, but that the costs of serving these customers can be much more expensive (e.g. debt management, social policy). These can often be well managed under targeted Codes of Practice and social welfare policies, whilst enabling markets to be free to operate without distortions and unintended consequences. By encouraging the efficiencies of a free market economy to develop, the competition benefits ultimately feed back to all customers, including those that are vulnerable.

Finally, we do not believe it is necessary to wait for the CAG to be sanctioned, before delivering important market reforms for Northern Ireland. Urgent action must be taken to ensure Northern Ireland's electricity and gas customers do not lose out on the wide ranging benefits of competition.

We trust these comments are helpful and as always, please do not hesitate to contact us with any specific questions. Our specific comments to the consultation response can be found in the attached Annex A.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Tony Thornton', with a stylized flourish above the name.

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ANNEX A

RESPONSE TO LIST OF CONSULTATION QUESTIONS

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)

VP&E RESPONSE: *no comment.*

QUESTION 2: General comments are invited on our overall approach to analysing the cost benefits and options relating to supply competition.

VP&E RESPONSE: *competitive markets can be a very powerful force for change. Business interests become focused on efficiency and service and this is reflected in the prices paid for by customers. They also innovate in ways that cannot always be predicted, but which nonetheless are often beneficial for customers. The consultation paper provides a reasonable 'round-up' of these positive experiences and benefits.*

However, we are puzzled by NIAUR's comment that a market structure is unlikely for Northern Ireland where Dual Fuel is the norm - we fundamentally disagree with this view. The most successful markets have launched predominantly from a Dual Fuel product offering. Indeed, we note that BGÉ is now making serious headway into the electricity market in the South, principally predicated on a Dual Fuel product.

Northern Ireland may be a relatively small market, but there is much that can be done now to maximise the competition opportunities. We have noted from the work programme actions to address K factors, allowed margins, data transparency, and branding separation – these are all very important and to be welcomed. But the Utility regulatory should also consider:

- **Gas Tariffs:** *regulated gas tariff structure reform to provide a benchmark for competition (e.g. the FVT and RTF schemes in the RoI provide a solid foundation)².*
- **Gas Imbalance:** *penalties are restrictive and reforms are necessary to reduce a barrier to market entry.*
- **Dominance:** *this is about informational asymmetry as much as it is about branding separation.*
- **Gas Agenda:** *pushing the gas competition agenda with the same vigour as seems to be happening for electricity.*
- **Gas Footprint:** *increasing the gas footprint, by reducing customer 'lock outs' caused by the franchise arrangements.*

² These provide a common and transparent pricing regime for customers using between 73,000 KWh to 264 GWh pa.

- **Connections:** securing increased gas connections via better incentives targeted at networks.

These are some of issues that exist today, and which act as a real constraint on the development of competition.

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?

VP&E RESPONSE: *segmented strategies come in many forms and guises. However, the Utility regulator seems to perceive these in a negative sense, e.g. that competition which develops first in certain geographical patches is a bad thing. We do not share this view and would not want segmentation strategies to be confused with consumer protection issues – these are not the same and will warrant different considerations.*

For example, segmentation could mean niche market entry strategies, tailored products and services, or even acting as a platform for competition to get a foot hold. These are all perfectly acceptable market development strategies and all benefit consumers. We must therefore not allow regulatory policy to constrain the development of competition by trying to predict, and then apply, ex ante regulatory measures for the ‘just in case’ scenario. Regulatory policy must enable and not try to predict outcomes.

With respect to how effective competitive markets are formed, and whether this is a marketing driven or a customer pull, is complex. Because it is so complex, we do not hold with the view that it is predominantly the former. It is difficult to establish whether marketing initiatives are actually pre-empting customer need, or indeed driving requirements (as suggested by the Utility Regulator). The fact remains, there is much evidence of customers voting with their feet when companies get it wrong – they simply do not survive.

Nor should we confuse consumer protection measures with segmentation strategies. Consumer issues can arise in any market where there is an imbalance of power. Indeed, we suggest that the greatest example of this imbalance, are those markets where monopoly characteristics exist.

We understand the Utility Regulator’s concern that some consumers, especially those that are the most vulnerable, may require additional protection. We do not necessarily disagree, however it needs to be well balanced and proportionate.

QUESTION 4: The paper suggests that the Utility Regulator should monitor with particular care levels of competition for rural customers, prepayment 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?

VP&E RESPONSE: We note that from the Utility Regulator's prepayment consultation³ over 50% of gas customers in the Belfast area now have a pay-as-you-go meter. We also note that over 70% of homes still use oil for heating⁴ i.e. those not on the gas network, notwithstanding those customers deemed to be resident in rural areas.

By any measure, to monitor all these customers is a formidable task. The Utility Regulator therefore needs to take a focused approach; for example, publication of competitive market analysis (such as the retail reports now published for RoI) can have a very positive effect, helping to inform regulatory policy as well as advancing the aims of effective competition. We would be happy to provide more information on what this means in practice.

QUESTION 5: Comments are sought on our proposed approach to continued regulation of tariffs in the coming years (paragraphs 75 to 78).

VP&E RESPONSE: We agree that for now at least, tariff regulation has a role to play. However, in doing so we must make sure that competition is also given an opportunity to 'breathe' and develop and this means providing schemes for the market to compete against. For example, in gas the development of 'RTF' and 'FVT' type schemes as deployed in RoI for the larger gas users, would be a significant step forward.

We also strongly recommend the publication of data that will enable new entrants to meet the incumbents on a level playing field, and this means access to information. Incumbents clearly have an information advantage, developed from their large diverse portfolios. This represents a sizable threshold for new entrants to meet, and can mean difficulties assessing risks. We therefore welcome the data transparency initiative by the Utility Regulator, which we believe is a key component for the development of effective retail competition. Such data might include:

- *Detailed Hedging information used by incumbents for regulated tariffs.*
- *Detailed regulated tariff breakdowns.*
- *Supply point profile breakdowns by category, including by volume and number.*
- *Market reports detailing, market shares, customer numbers by payment type, trends etc.*

³ NIAUR (June 09), Consultation on Prepayment Gas Meters, p. 6

⁴ NIAUR (Jan 09), Draft Social Action Plan, p.29