

# **MINDED TO PAPER**

**Options for co-ordinating the  
relinquishing of firmus energy's  
supply exclusivity in the ten towns  
area**

**December 2010**

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# 1 Executive Summary

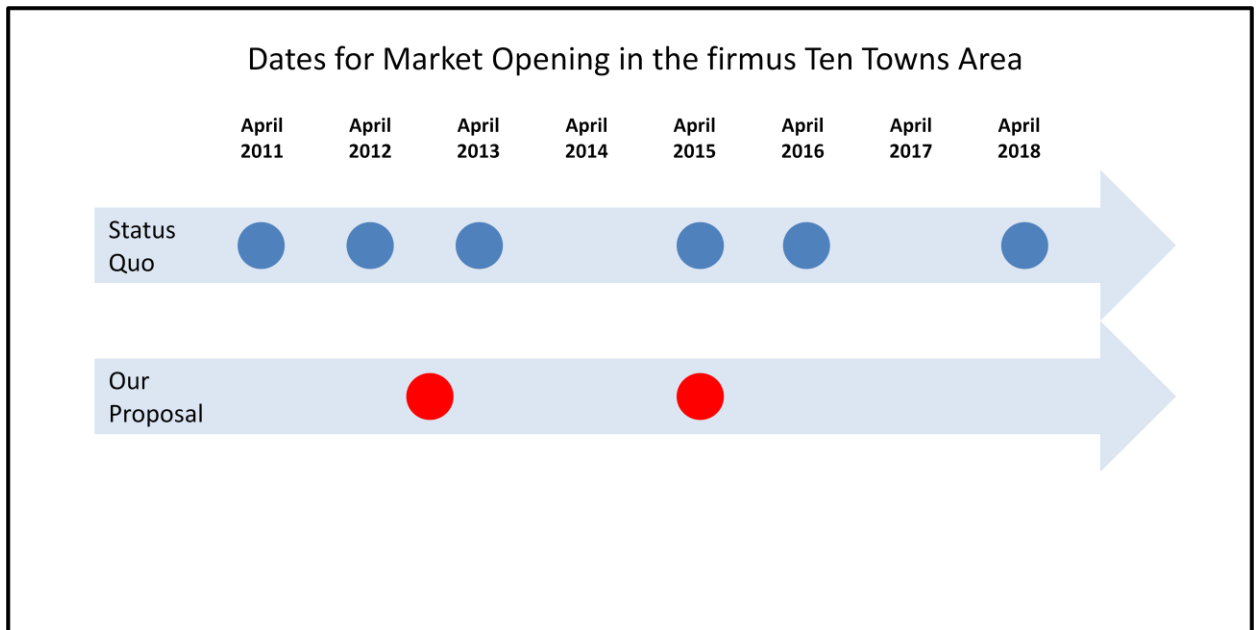
- 1.1 The Utility Regulator issued a consultation paper on 24 August 2010, seeking the views of stakeholders on the options for coordinating the relinquishing of firmus energy's supply exclusivity in the ten towns area<sup>1</sup>. In total we received 17 responses, and have carefully reviewed and considered each.
- 1.2 We have now reached a "minded to" position and plan to start a statutory consultation on the necessary modifications to firmus energy's gas conveyance licence.
- 1.3 To recap, the reason for considering consolidation of market opening dates by better coordinating market opening is to avoid a prolonged opening up of the ten towns over at least eight years. This prolonged opening has the potential to produce a difficult and uncoordinated market opening experience for all involved as different categories and different towns open at different times. It would also result in some unnecessary development costs which would ultimately be borne by customers. We also want to make the market attractive to as broad and wide a range of supply companies as possible in order for effective competition to develop. We would emphasise that the consultation was not about whether there should be competition, or whether the period of exclusivity granted to firmus should be extended or reduced in totality.
- 1.4 In order to initiate discussion the consultation presented three non-exhaustive possible options for consideration:
  - Option 1 – maintain the status quo. Specifically, the large industrial and commercial (I&C) market would open on a staggered basis between April 2011 and April 2015; and for the small I&C and domestic market, between April 2015 and April 2018.
  - Option 2 – open the whole large I&C market at one time and the whole small I&C and domestic market also at one time but at a separate later date. A median date of April 2013 was proposed for the large I&C market, and the earliest possible date of April 2015 for the small I&C and domestic market.
  - Option 3 – open the whole market at the same time. A date of April 2015 was proposed.
- 1.5 We have reached a "minded to" position of having two dates for market opening, as suggested by Option 2. However we are proposing a slight variation of Option 2 as our "minded to" way forward, whereby the large I&C market would open in October 2012 instead of April 2013. The small I&C and domestic market would open as per the

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<sup>1</sup> ["Consultation on the options for coordinating the relinquishing of firmus energy's supply exclusivity in the ten towns area," August 2010.](#)

original proposal of April 2015. We believe this provides a good balance as a date that lies in the middle of the current market opening dates. Our proposal is presented in diagrammatic form below:

**Diagram 1 – Dates for Market Opening in the firmus Ten Towns Area**



- 1.6 While the goal of Utility Regulator in making this proposal is to consolidate the dates for market opening into two dates rather than a whole stream over eight years, we recognise that that this will have some impact on customers which we outline below.
- 1.7 Overall the proposal brings competition forward for the majority of customers, both when measured for customer numbers and when measured for volumes (as set out in the table below).

	Competition earlier	Competition later	Net Impact
Customer numbers	6,708	-127	6,581
Volumes (MWh)	726,354	-359,000	367,354

- 1.8 The proposal will mean that for a number of customers competition will be delayed compared with the current licence. We have carefully considered the responses to our consultations from those customers and their representatives. (As the effected are large I&C customers, we have taken their representatives to include CBI and NIM). We have taken on board that both these organisations and Michelin are supportive of moving on two consolidated dates.

- 1.9 While most responses were supportive of a single date for domestic market opening, there was a variety of responses with respect to the large I&C market. We would note that many of the responses were focused on the pros and cons of delaying competition. Some parties argued that we should retain the current licence conditions as delaying competition would mean customers lose out on the significant benefits of competition. Given that our “minded to” position brings forward competition both in terms of customer numbers and volumes and given the responses from customers and their representatives we believe this should address the concerns of those respondents. See Section 4 for further details.
- 1.10 The statutory public consultation is being issued today and responses are due by 31 January 2010 Please see separate document for more information.

## 2 Introduction

### Background

- 2.1 The Utility Regulator issued a consultation paper on 24 August 2010, seeking the views of stakeholders on the options for coordinating the relinquishing of firmus energy's supply exclusivity in the ten towns area.
- 2.2 The paper explained that under the current firmus energy licence there exists a staggered market opening timetable for the two market sectors, namely: (1) large I&C customers; and (2) small I&C and domestic customers. This arrangement would see different towns opening up to competition at different times and across differing market sectors, beginning in April 2011 and continuing through until April 2018.
- 2.3 Under these arrangements, the Utility Regulator anticipates some potential problems.
- Opening the ten towns area in a staggered fashion rather than in a coordinated manner is difficult and complex. The whole ten towns area is very small in terms of customer numbers as it is
  - An uncoordinated market opening could pose market and advertising difficulties for new entrant suppliers and be difficult for domestic customers to understand
  - There would be potential for stranded resources associated with interim codes and switching systems
  - There would be cost implications (ultimately borne by customers) of implementing a network code prior to Common Arrangements for Gas (CAG) and having to amend this post CAG
  - There would be implications for allowance setting in the next price control review.
- 2.4 The paper went on to consider the merits of doing something different (i.e. changing the staggered timetable) and set out a number of possible options.
- Option 1 – maintain the status quo. Specifically, the large I&C market would open on a staggered basis between April 2011 and April 2015; and for the small I&C and domestic market, between April 2015 and April 2018.
  - Option 2 – open the whole large I&C market at one time and the whole small I&C and domestic market also at one time but at a separate later date. A median date of April 2013 was proposed for the large I&C market, and the earliest possible date of April 2015 for the small I&C and domestic market.
  - Option 3 – open the whole market at the same time. A date of April 2015 was proposed.

- 2.5 Each option was further defined in the paper, including a preliminary assessment of the likely issues associated with each. Stakeholders were then invited to share their views.

# 3 Minded To Position

## Considerations

- 3.1 Our consultation considered three options that, whilst not exhaustive in terms of all possibilities, cover in general the full range of realistic alternatives. That is: (1) maintaining the status quo of staggered opening; (2) introducing a single but separate date for opening in the large I&C market and the small I&C and domestic market; or (3) introducing a single date for opening both market sectors simultaneously.
- 3.2 In formulating a decision we have had due regard of the Utility Regulator's (the "Authority") statutory duty to promote the development and maintenance of an efficient, economic and coordinated gas industry under "The Energy (Northern Ireland) Order 2003" as follows:

***"The principal objective and general duties of the Department and the Authority in relation to gas***

*14.—(1) The principal objective of the Department and the Authority in carrying out their respective gas functions is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland."*

- 3.3 We consider each aspect of these duties in turn.

**Development should be efficient**

Market opening requires the development of a network code and appropriate systems to facilitate customer switching, the costs of which will be borne by customers. These developments cannot be avoided as market opening is a requirement under European law. However the timing of when they take place will impact on the magnitude of the costs, given the potential to save time, effort and cost if the work to be done as part of the CAG project can be availed of.

**Development should be economic**

The Utility Regulator's statutory duty in relation to competition under "The Energy (Northern Ireland) Order 2003" is as follows:

*"14.—(5) Subject to paragraph (2), the Department and the Authority shall carry out their respective gas functions in the manner which it considers is best calculated - ... (d) to facilitate competition between persons whose activities consist of or include storing, supplying or participating in the conveyance of gas" of an efficient, economic and co-ordinated gas industry in Northern Ireland."*



We wish to create a market structure and environment which attracts as wide and broad a range of new entrant supply companies as possible so that effective competition can develop in the ten towns area. The aim is for effective competition to deliver on putting downward pressure on tariff prices, improve standards of service and provide a range of products.

We have thus given due consideration to the impact of our proposed options, by looking at the market as a whole in terms of customer numbers and volumes and analysing how each option would make differing percentages of the overall market contestable at different points in time. This is illustrated in the diagrams at the end of this section.

### **Development should be coordinated**

The arrangements being examined in the consultation specifically look at a way to better coordinate the relinquishing of firmus energy's supply exclusivity and the associated opening of the market to competition. It is important to have as few barriers to entry as possible to encourage as much interest as possible from supply companies to what is a very small market in the ten towns by any measure. There are currently only around 8,000 customers across the whole ten towns area, which will rise to about 18,000 by April 2015. The Greater Belfast area currently has about 120,000 customers. This is why the Utility Regulator is seeking to remove any unnecessary complexity from the ten towns market when firmus energy's supply exclusivity is relinquished by coordinating the market opening time for each sector.

## **Options Sifting**

- 3.4 We consider the problems identified in paragraph 2.3 to be significant enough to warrant a move away from the status quo. The arrangements put in place at the time the licence was granted to firmus energy were in line with the arrangements put in place for Phoenix Natural Gas Ltd in the Greater Belfast area. The licence was granted to firmus energy in March 2005. Subsequent experience with market opening in the Greater Belfast area and an examination of the issues has presented an opportunity to look at a better way of doing things. We do not however want to extend or reduce the period of exclusivity as a whole but rather consolidate it and in so doing better coordinate market opening. This would rule out Option 1.
- 3.5 We do not believe Option 3 represents an optimal solution either. Opening both the large I&C market and the small I&C and domestic market at the same time fails to recognise the different considerations that should be applied to each market sector.

### **Small I&C and domestic market**

Option 2 or Option 3 is preferable to the status quo given that all customers in this sector would open simultaneously in April 2015 under each. This would benefit: (1) customers, by way of less confusion and bringing forward the date that some 6500

customers would otherwise be able to switch; and (2) potential competing suppliers, by way of making more of this market sector contestable at an earlier stage.

Furthermore 2015 is sufficiently far away to allow firmus to take advantage of the arrangements that will come out of CAG and introduce arrangements in a cost effective manner.

### **Large I&C market**

Option 3 also proposes delaying the opening of the large I&C market to April 2015, thus coordinating the opening of both market sectors to a single date. There is however no rationale for an overall delay in the opening of the large I&C market in order to open it at the same date as the small I&C and domestic sector. Indeed supply companies could make offers and enter the large I&C market sector separately from the other market sector as the switching numbers are lower so infrastructural requirements are less onerous on the supply companies. None of the respondents to our consultation expressed a clear preference for Option 3. The Utility Regulator was not seeking to delay the relinquishing of exclusivity as a whole, as is the case in Option 3, but rather consolidate it.

- 3.6 We would therefore also rule out Option 3. On the basis of the options set out in our consultation, this would leave only Option 2 as a *potential* preferred option.

## **A Further Look at Option 2**

- 3.7 The general principal behind Option 2 as proposed in our consultation is to introduce a single but separate market opening date for the large I&C sector and the small I&C and domestic sector. In our consultation our suggested dates were April 2013 and April 2015 respectively.
- 3.8 As stated 3.5 above we believe that a single date for opening the small I&C and domestic sector is preferable to the status quo. We further consider April 2015 to be an appropriate date. Therefore our “minded to” decision would see the entire small I&C and domestic sector opening for competition in April 2015. Our analysis shows that some 6,500 customers would benefit from access to competition earlier under this proposal.
- 3.9 The arguments are not so clear for the large I&C market. Some respondents preferred that we retain the staggered opening, or even that we bring forward market opening for this sector as early as possible. Others preferred that market opening be delayed. In our initial proposal for Option 2 we selected April 2013 as a median date between the beginning and end of market opening in this sector i.e. between April 2011 and April 2015.
- 3.10 However bearing in mind the magnitude of volumes that will become contestable under the current market opening timetable, along with the views expressed by

respondents, we have decided that an earlier date than the one originally proposed represents the best way forward. Our revised suggested date is **October 2012**, six months earlier than currently proposed under Option 2. We acknowledge this delays opening the large I&C market in those towns that would under the current regime open in April of 2011 or 2012. However, we would also point out this brings forward the opening date of those towns not due to open until April of 2013, 2014 or 2015. On balance we believe a date of October 2012 is a fair compromise.

- 3.11 We are therefore minded to implement a variation of Option 2, referred to from hereon as Option 2a, which for the avoidance of doubt would mean: market opening of the large I&C sector on a single date of October 2012, and of the small I&C and domestic sector on April 2015.
- 3.12 The date of October 2012 for opening the large I&C market will also still allow for the possibility of availing of the cost benefits from CAG transmission arrangements.
- 3.13 Overall the proposal brings competition forward for the majority of customers, with respect to both customer numbers and volumes (as set out in the table below).

	Competition earlier	Competition later	Net Impact
Customer numbers	6,708	-127	6,581
Volumes (MWh)	726,354	-359,000	367,354

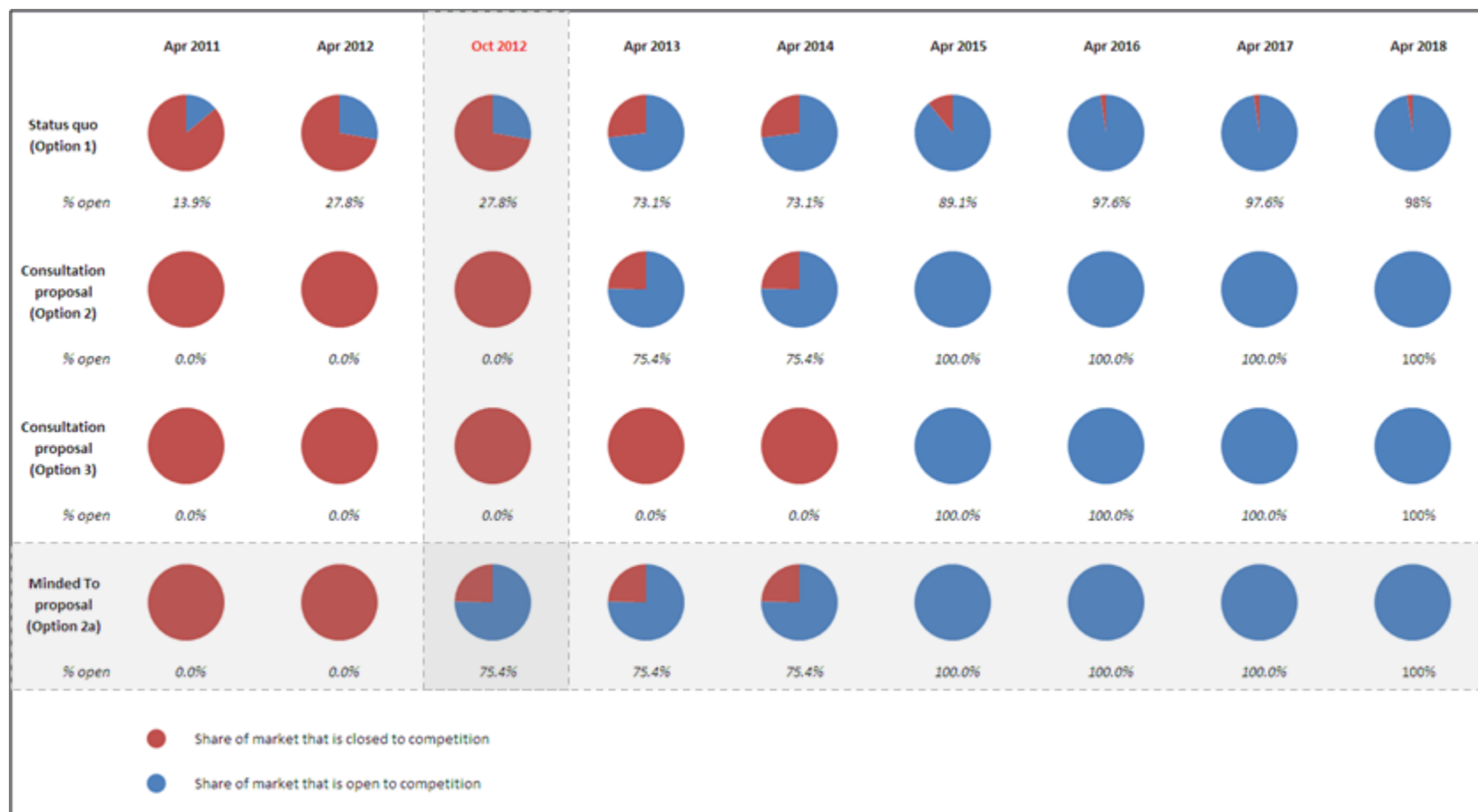
***Further diagrams to demonstrate the impact on customer numbers and volume are presented overleaf.***

**Diagram 2 – Timing and Extent of Market Opening Under the Proposed Options, by Customer Numbers**



*This diagram is indicative of the proportion of the overall firmus market (assessed by customer numbers) that will become contestable under each option proposed in the consultation. These proportions were assessed using forecasts provided by firmus (the data can be seen in Appendix 1).*

**Diagram 3 – Timing and Extent of Market Opening Under the Proposed Options, by Volumes**



*This diagram is indicative of the proportion of the overall firmus market (assessed by volumes) that will become contestable under each option proposed in the consultation. These proportions were assessed using forecasts provided by firmus (the data can be seen in Appendix 1).*

# 4 Consultation Responses

## Summary of Responses

4.1 The Utility Regulator received 17 responses to the consultation, listed below. All of these responses have been posted on our website along with this decision paper.

- Ballymena Borough Council;
- Bord Gais Energy (BGE);
- Confederation of British Industry (CBI);
- Energy Saving Trust;
- Federation of Small Businesses (FSB);
- firmus energy;
- Gaslink;
- Michelin;
- National Energy Action Northern Ireland (NEA NI) (warm homes);
- Northern Ireland Energy Agency (member of Bryson Charitable Group);
- Northern Ireland Housing Executive;
- Northern Ireland Independent Retail Trade Association (NIIRTA);
- Northern Ireland Manufacturing (NIM);
- Phoenix Natural Gas Limited (PNGL);
- Phoenix Supply Limited (PSL); and
- The Consumer Council NI;
- Viridian Power & Energy Limited (VPE).

## Our Analysis and Response

4.2 Respondents were invited to nominate a preferred option, and/ or to suggest alternative options. The range of responses fell broadly into four categories. These are set out below along with the number of respondents and their preference.

Preferred approach to market opening	Number of respondents indicating a preference
Open the market to competition as soon as possible	2
Retain the current timetable	4
Delay the current market opening timetable	4
Coordinate the timetable for the different sectors	7

- 4.3 A number of issues were raised in the responses, on which our developing view is outlined below:

**Issue 1: Competition should be introduced into all areas now**

The aim of the consultation was not to extend or reduce the supply licence exclusivity arrangements, but rather to consider the appropriateness of consolidating the periods of exclusivity.

Our “minded to” view, which envisages a single market opening across the towns, with a different date for (1) the large Industrial and Commercial (I&C) sector of October 2012 and (2) the small I&C sector and domestic sector of April 2015, will see more customers (some 6500 small I&C and domestic customers) receiving competition earlier than the status quo.

For the large I&C sector, compared to the status quo, this would delay market opening for an estimated 127 meter points (for large I&Cs the number of meter points is proportional to the number of customers, but averaging about 2 meter points per customer) with an expected annual consumption of around 360,000 MWh. However market opening would be brought forward for around 230 meter points with an expected annual consumption of over 600,000 MWh. For the small I&C and domestic sector this would bring competition forward for around 6,500 customers, with an expected annual consumption of around 110,000 MWh.

When the firmus licence was granted it was felt that exclusivity was necessary to allow firmus the flexibility required to grow the gas network in a new area. As the gas market in an area matures the requirement for exclusivity reduces and this is why it is time limited. This was the same principle used for Phoenix in Greater Belfast. We are satisfied with this model of allowing a period of supply exclusivity to ensure that gas starts to flow in the newly installed distribution pipes in the important early stages of network development. We have not seen any arguments put forward as to why the principle of exclusivity should not apply to the firmus licence. Similarly, we do not feel it would be appropriate to extend the overall period of exclusivity by unduly delaying the current market opening timetable.

In the Greater Belfast area the domestic sector of the market opened at the end of Phoenix's Supply exclusivity period in January 2007. Phoenix Supply Ltd. have had a monopoly position in Greater Belfast in the domestic sector since exclusivity was relinquished and it is only very recently that we have seen a competing new supplier enter this market, in the form of firmus energy on 1<sup>st</sup> November 2010.

It is one thing to open up the market to competition it is another thing entirely to attract effective competition. We in Northern Ireland are dependent on suppliers' willingness to enter the market and their ability to do so. Any supply company looking at the market will look at the size of the market and the retail market processes and infrastructure (switching systems) that they will have to work with. They will have to

invest in understanding the area, the market structure and advertising to enter the market.

## **Issue 2: Market opening will increase distribution prices**

Some respondents questioned or expressed concern over the impact that market opening would have in increasing the distribution charge.

As explained in the consultation paper, firmus is incentivised through the current distribution price control to maximise customer connections and volumes throughput. firmus therefore price as competitively as possible relative to alternative energy sources in order to get customers to connect to gas.

Supply exclusivity was granted to facilitate competitive pricing. That is, during supply exclusivity firmus is not required to publish a distribution tariff and therefore have flexibility in setting charges for individual connections.

Once exclusivity ends firmus will be required to publish distribution tariffs for all categories of user (categories tend to be based size of customer) and all suppliers will be faced with the same distribution tariffs.

Flexibility in pricing is necessary at the early stages of development. It allows firmus the ability to deal with issues on a customer by customer basis which is important when gas is new to an area and there is limited knowledge or acceptance of it as a standard fuel choice. Flexibility can also enable customers to offset the set up costs used in switching over to natural gas from their previous fuel source. When exclusivity ends and prices move from their current flexible setting to fixed published prices, some customers may experience an increase in prices. This is to be expected when moving to a single set of distribution charges. The distribution charges to be employed when exclusivity ends will be fully transparent and based on economic regulated costs.

It should be noted that firmus will have to recover the allowed costs of developing and operating their network over the period of their licence and they will do this via distribution charges (and increasing them where necessary) whether there is exclusivity or not.

## **Issue 3: Potential for price reductions from competition**

An issue was raised regarding the potential for competition to reduce prices and the lack of discussion on this in the consultation paper. We would again repeat that the goal of the consultation was not about whether to introduce competition in the firmus area. Competition is a requirement of EU law and will be introduced in the firmus area. We would also emphasise that the Utility Regulator will continue to regulate the market proactively, even when competition is introduced, to ensure customers are protected.

Local experience has shown that competition can be beneficial for I&C customers in both the electricity and gas markets. Furthermore the recent experience of market



opening in the domestic electricity sector and Greater Belfast domestic gas market is further evidence of the benefits that competition can bring in terms of lower prices, different product offerings and the expectation of better service.

**Issue 4: Customer confusion regarding different opening dates across the towns and for different sectors**

Several respondents questioned our assertion that staggered market opening would be confusing for customers, in particular that I&C customers should be sophisticated enough to avoid any confusion.

We consider that confusion would exist in the domestic market if we retain the existing staggered opening timetable. This position is supported by the majority of consumer representatives who responded. It will be confusing for customers in understanding when they can switch and will be difficult for suppliers to explain to customers how they can offer products in one town but not another. Suppliers will also have marketing issues in getting this message across. Our “minded to” view, which envisages that the domestic market opens at the same time across all the towns, will address this.

With respect to the I&C market, we believe that having a single date for market opening will bring benefits for suppliers and customers although we acknowledge that customer confusion may not be as significant an issue as it is for the domestic sector.

**Issue 5: Uncertainties around the benefit of waiting for CAG**

Several respondents questioned the logic of timing the consolidation of market opening such that tailgating on the CAG arrangements remains a possibility.

Both the Commission for Energy Regulation and the Utility Regulator/Department of Enterprise, Trade and Investment (DETI) and the Department of Communications, Energy and Natural Resources are continuing to work towards implementation of CAG in October 2012 which has the potential for firmus to use an all-island unified code of operations in their area. This would avoid the need for firmus to develop their own code of operations and would save on costs and provide a streamlined service for gas shippers to the firmus area.

**Issue 6: Network code development costs**

Several respondents expressed a view that our cost estimates for network code development were too high and even if they were not the costs are more than covered by the benefits of competition.

In response we would comment that these cost estimates were independently assessed by qualified consultants. There is no compelling evidence from responses to support the view that our estimates are too high.

On the costs being covered by the benefits of competition, our “minded to” position will see more customers availing of competition earlier than under the status quo.

Therefore, our “minded to” position should bring even greater benefits than the status quo.

**Issue 7: Extending exclusivity benefits firmus**

A number of arguments were put forward suggesting that firmus would gain competition benefits from extending the exclusivity period. While there may be merit in some of these arguments if we were proposing to extend the period for exclusivity, we do not believe the arguments hold where we are proposing to consolidate the dates for market opening. Our “minded to” position on this would see more customers availing of competition earlier than the status quo.

In terms of firmus receiving a benefit from using their ten towns area to cross subsidise their other businesses we can assure all parties that we actively monitor such issues to ensure this is not the case and will continue to do so. This is part of our regular work and we carry this out in relation to other companies we regulate as well as firmus.

# **5 Conclusion**

## **Summary**

- 5.1 We are minded to implement an amended Option 2, defined in paragraph 3.11 and designated Option 2a, subject to statutory consultation. This would see the whole of the large I&C market opening to supply competition in October 2012. A single date for market opening will apply to the small I&C and domestic market, that date being April 2015.

## **Next Steps**

- 5.2 The statutory public consultation is being issued today and responses are due by 31 January 2010. Please see the separate consultation document for more information.

**END**

# Appendix 1

## Customer Numbers and Volumes

In the tables below we set out the forecast customer numbers and associated annual gas consumption that, under the current market opening arrangements, would become contestable from April of each year from 2011 to 2018. These forecasts have been provided by firmus, and are based on the company's view of future connections and gas consumption.

Domestic and small I&C market		
Exclusivity end date	Number of customers	Volumes (MWh)
April 2015	11,422	208,000
April 2016	6,005	109,354
April 2017	0	0
April 2018	473	8,600

Large I&C market		
Exclusivity end date	Number of meter points	Volumes (MWh)
April 2011	28	180,000
April 2012	99	179,000
April 2013	221	586,000
April 2014	0	0
April 2015	0	0
April 2016	9	30,000