

Consultation on the options for co-ordinating the relinquishing of firmus energy's supply exclusivity in the ten towns area

September 2010

The following response details the comments of Phoenix Natural Gas Ltd (PNG) to the Utility Regulator's (UR) consultation on the options for co-ordinating the relinquishing of firmus energy's (firmus) supply exclusivity in the ten towns area.

In considering its response, PNG has drawn on its own experience as a distribution Network Operator whose licence, similar to firmus's conveyance licence, requires it to facilitate supply competition and co-ordinate market opening in its Greater Belfast Licensed Area.

General Comments

firmus was granted a licence to supply gas in the ten towns area in March 2005. This licence sets out the conditions of firmus's supply exclusivity in these towns. UR established phased market opening within the ten towns and it is reasonable to assume that this decision was given due consideration having also been widely consulted on publicly at that time. It therefore comes as a surprise that UR should now consider the merits of this decision given that it was taken a little over 5 years ago and PNG is not aware of any justifiable rationale to suggest why firmus's supply exclusivity should be reviewed.

PNG is the facilitator of supply competition in the Greater Belfast area and has, in the years following market opening, acquired considerable knowledge of the processes required by a Network Operator. As the consultation paper indicates, supply exclusivity was similar in the firmus Licensed Area to that previously granted to Phoenix and therefore, as mentioned above, we believe PNG's experience of market opening should inform any decision taken by UR when considering how firmus's supply exclusivity is to be dealt with.

Codes, Switching System and Associated Cost Issues

The first supply meter point (SMP) was switched from one gas supplier to another by PNG in November 2006. In the early stages of market opening there were three active suppliers in the market. There are now four active suppliers, with several other suppliers currently considering entry

into the Greater Belfast gas market. By the end of August 2010, PNG had facilitated the successful switching of over 940 SMPs from one natural gas supplier to another.

PNG believes and indeed gas suppliers in Greater Belfast have indicated that switching activity is on the rise. PNG is currently developing a semi-automated system to facilitate the anticipated increase to ensure that all suppliers are provided with a service which is appropriate to the level of investment PNG has been afforded by UR to develop such a system. To date PNG has successfully managed suppliers' demands using a largely manual system. In fact, when the Greater Belfast market initially opened, PNG was in a position to manage switching activity using its existing resources. PNG therefore sees no reason why firmus's systems or firmus's resources should be used as an excuse to delay competition in the ten towns given that the licence allows the market to open gradually with only large industrial and commercial sectors eligible to choose alternative suppliers in the coming years.

We would further argue that rather than cause confusion for the c.300 companies impacted, the gradual opening of a market is a more structured and sensible approach. This allows an Operator to develop its processes in a coordinated manner, allows UR to assess requirements which do not lead to development of stranded assets or stranded resources, and most importantly will guarantee a better customer experience of switching gas supplier. We would further point out that the Greater Belfast gas market is not the only example of this phased approach to market opening in Northern Ireland. A similar approach has been adopted in the electricity sector with Airtricity's entry limited to 6,000 switches per month.

Furthermore domestic and small industrial and commercial competition in the ten towns is not expected until as far off as 2015. This significant timeframe provides UR and firmus with ample time to develop a more automated switching system to facilitate increased switching levels given that UR deemed it appropriate to allow PNG just 9-months to deliver a semi-automated switching system for Greater Belfast.

We disagree with the cost arguments provided within the consultation. The consultation identifies numerous, readily available resources from which a low cost "interim" solution may be developed:

The costs which UR allowed PNG to develop its semi-automated switching system were low. Notwithstanding this, PNG successfully switched over 900 SMPs (three times the number of large industrial and commercial SMPs in the ten towns) using a manual system which could easily be replicated by firmus (at little or no cost) to facilitate market opening under the terms of its current licence while a long-term solution is developed.

It is our understanding that the Common Arrangements for Gas (CAG) are currently a work towards principle agreed by UR and the Commission for Energy Regulation. No political timeframe has been sanctioned in relation to if and when these arrangements could become acceptable and therefore there is still no agreed timetable for the legislative requirements to implement such changes. Indeed, to date, much of the preparatory work has been focused on harmonisation of gas transmission regimes and not gas distribution or gas retail regimes. It is almost certain that the latter may require agreed changes to existing distribution licences, of a nature not yet identified. Therefore much of the development of CAG is unknown and uncertain.

Therefore, is it in the gas industry's interest and that of the customers in the ten towns to withhold market opening until the outcome of the CAG review and therefore the implications for Northern Ireland's Network Operators identified and politically agreed? CAG has already been delayed by many years and it would not be correct to have a supply competition solution that relies on a process that has no end date and may continue to be delayed in the future. This solution may mean that supply competition in the ten towns experiences continuing delays which is unacceptable to all concerned. Therefore implementing PNG's Network Code seems the only viable option to consider and one which would deliver a single set of processes for Northern Ireland. This would facilitate any future expansion of the gas network into new areas – such as bringing gas to the West, which we understood would be granted on the potential basis of no supply exclusivity period with competition being active from day one of availability. If this is the preferred option of DETI or UR, how will this be delivered if CAG is not agreed, or existing Network Codes, such as PNG's, are not used?

Under current legislation an Operator can under its licence, with UR's approval, enter into other transportation arrangements other than a fully developed Network Code. This would allow quite simple transportation arrangements to be delivered allowing the 300 larger industrial and commercial customers to have alternative supplier options at an early stage. It is our view that these interim arrangements would have limited impact on firmus's resources and systems.

We accept that there will be some changes to firmus's back office systems but surely it is in the interest of Northern Ireland's natural gas industry to allow consumers to benefit from supply competition at the earliest opportunity? Under firmus's current licence, around 22% of its large industrial and commercial volumes will be eligible to choose supplier in 2011 with another 20% in 2012. It seems appropriate that these consumers should be allowed to benefit from market opening at the earliest opportunity. In fact one important piece of analysis missing from UR's consultation is an estimate of the financial benefit to consumers. We accept that there may be limited stranded costs when CAG eventually materialises but surely the financial benefit to consumers will significantly outweigh such a low cost solution to enable firmus to comply with its licence obligations? Have the potential savings that the 300 customers impacted by this consultation been estimated independently? If so would it be helpful if these potential savings are made available alongside the cost estimates that have been provided through the consultation?

UR has in the past retrospectively allowed costs following a price control determination and we therefore do not agree that a decision on supply competition should be withheld until the next price control review.

Supplier and Customers Confusion and Complexity Issues

UR suggests that a non co-ordinated approach to market opening will lead to confusion for customers and suppliers. We disagree. It will be apparent to the 300 large industrial and commercial customers which of the ten towns they are located in.

We understand that suppliers tend to offer large industrial and commercial customers individually negotiated contracts. Phased market opening should not therefore impact upon market and advertising campaigns of suppliers who will, presumably, continue to market large industrial and commercial customers individually as they do within PNG's Licensed Area. Large industrial and commercial customers will therefore have bespoke information from each supplier from which they can choose who best meets their individual needs. Customer confusion amongst the large industrial and commercial customers should therefore be negligible. To ensure that there was no confusion in the Greater Belfast area, UR wrote to all businesses and clearly outlined to them what their options were in relation to changing gas supplier. This exercise was extremely effective and there is no reason why it could not be replicated in the ten towns.

The consultation suggests that, under phased opening, customers will be confused in understanding which towns are open within the ten towns and why. This may or may not be true, but if we take small industrial and commercial customers as an example; currently these consumers are able to choose their natural gas supplier within Greater Belfast. However if they have operations in Belfast and Coleraine say, they will be able to choose their natural gas supplier in Belfast, but not in Coleraine. There is therefore an argument that the current situation is already confusing for customers.

Another example is the electricity sector which has recently seen a new entrant into the supply market; Pay-As-You-Go customers are currently prohibited from switching electricity supplier yet we are not aware of any evidence to suggest that this has caused market and advertising difficulties for suppliers entering the market.

In fact in summary it could be argued that the only way to mitigate customer confusion is to ensure that both the PNG and the firmus ten towns distribution areas are fully open to supply competition in as short a timescale as possible.

Published Network Charges

In addition it is vitally important that the correct economic signals are given to current and potential natural gas customers in the firmus area. An underlying element of supply competition is producing and publishing the applicable long term sustainable network charges (transportation charges) for the customer sectors in question, regardless of any decision to delay competition. These charges should be produced and published in line with the current licence requirements because, irrespective of what option is ultimately taken regarding the timing of supply competition in the firmus Licensed Area, there are no reasons mentioned within the consultation that would prevent network charges being published in 2011. This would also simplify customers', and potential customers', understanding of the make up of the price they are paying for natural gas and as such reduce confusion. In addition clarity should be provided as to the mechanism currently being adopted by firmus with regards network charges. As an operator who constantly keeps under review opportunities for expansion, PNG would seek clarity as to how new network extensions within

'phase 2' of firmus's licence have been justified i.e. are these expansions delivering the underlying sustainable network charge or is a facility and an agreement in place whereby network charges are being discounted by firmus in order for its supply business to break even. If so could it be argued that operators such as PNG are being disadvantaged in that there is not a level playing field to allow other operators to consider these gas network extension opportunities on an equal basis with firmus. If gas to the West becomes a reality, how will this be impacted by a lack of understanding and transparency of published network charges in the two other Licensed Areas of PNG and firmus.

Conclusion

UR cites difficulties in relation to tariffs, customer confusion and costs under the "Do Nothing" option. PNG has provided substantiations dismissing each of these in this response. The "Do Nothing" approach is in fact the most appropriate action as it requires firmus and UR to deliver competition in the ten towns in line with the vision created just over 5 years ago and detailed within firmus's licence.

UR has identified a number of low cost options that would enable firmus to meet its current licence obligations and ensure that consumers benefit from market opening at the earliest opportunity. PNG will have operated a manual switching system for almost 4 years and phased market opening within the ten towns would suggest that a similar manual system could be employed for the ten towns.

Under firmus's current licence, over 40% of large industrial and commercial volumes will be eligible to choose supplier in 2011 and 2012. Delaying competition would, in PNG's opinion, discriminate against consumers in the ten towns who should be allowed the freedom to choose their gas supplier at the earliest opportunity.

The exact timings and detail of CAG are still unknown and therefore relying on CAG to deliver the solution for the ten towns is not an option; this can only deliver further uncertainty as to when supply competition will be introduced in the ten towns.

The publication of network charges for the ten towns must continue in line with the current licence obligation as irrespective of what decision is taken over the supply exclusivity issue, there is no reason why the publication of these charges should be delayed.