

Phoenix Supply Ltd

Response to the Utility Regulator's Consultation on the Options for Co-ordinating the Relinquishing of Firmus Energy's Supply Exclusivity in the Ten Towns Area

September 2010

1.0 Introduction

This is the response of Phoenix Supply Ltd ("Phoenix Supply") to the Utility Regulators ("Utility Regulator") consultation document in respect of the postponement of the introduction of competition in the Ten Towns in Northern Ireland: Ballymoney, Ballymena, Londonderry, Limavady, Coleraine, Antrim, Craigavon (including Lurgan and Portadown), Armagh, Banbridge and Newry.

Phoenix Supply is the largest natural gas supplier in Northern Ireland supplying natural gas to over 130,000 homes and businesses in the Greater Belfast licence area. The company does so in a market that is fully opened to competition.

There is a clear strategic need to extend the availability of natural gas to more customers. We understand that the basis upon which future gas extensions would be sanctioned would be on the basis of customers being free to choose their gas supplier at point of initial connection. Phoenix Supply is therefore concerned that competition has not been introduced in the Ten Towns to date and that two of the three options outlined in the consultation document proposes postponing the introduction of competition in the Ten Towns for between 2 and 4 years. It is clearly not in the interests of customers in the Ten Towns to deny them the benefits of competition.

On these grounds we therefore wish to make clear our objection to the granting of any further supply exclusivity to the existing monopoly supplier (Firmus Energy) in Ballymoney, Ballymena, Londonderry, Limavady, Coleraine, Antrim, Craigavon (including Lurgan and Portadown), Armagh, Banbridge and Newry. To do so will further delay the introduction of full competition in the supply of natural gas across Northern Ireland and it will deny competing gas suppliers the ability to supply gas on level terms.

We are also disappointed that issues raised previously by us have not been addressed in this consultation paper.

Our response is set out as follows:

- Section 2 addresses the failure of Firmus Energy to provide a Network Code within the existing licence timescales;

- Section 3 examines the Utility Regulator's rationale for postponing competition in the Ten Towns;
- Section 4 highlights some of the significant competition issues raised by the further postponement of competition; and
- Section 5 deals with other issues.

2.0 Failure of Firmus Energy to Provide Network Code

We have had concerns regarding the introduction of competition in the Ten Towns for some time. Firmus Energy has a licence obligation to both prepare and publish a Network Code. The relevant licence extracts are included below:

“2.4.2 The Network Code

The Licensee shall:

(a) by the earlier of the date:

(i) 12 months after the Authority issues a direction requiring the Licensee to do so;

(ii) 12 months before the Supply Licensee is scheduled (in accordance with its licence) to cease to have the exclusive right to supply a premises it was previously entitled to supply exclusively; and

(iii) two months after the Supply Licensee ceases to have the exclusive right to supply a premises it was previously entitled to supply exclusively,

prepare and provide the Authority for its approval a “Network Code”, that is to say a document setting out the arrangements established under Condition 2.4.1 and the terms on which it will enter into such arrangements with gas suppliers for the conveyance of gas;”

“2.4.8 Publication of Network Code

The Licensee shall:

(a) publish the Network Code and the modification rules as modified from time to time in such form and manner as the Authority may from time to time direct; and

(b) send a copy of the Network Code and modification rules as modified from time to time to any person who asks for one on payment of a charge in respect of the cost incurred by the Licensee in complying with this requirement which does not exceed such amount as the Authority may from time to time direct.”

Extract from Firmus Energy (Distribution) Ltd Conveyance Licence

These licence conditions (2.4.2 (a) (ii)) require Firmus Energy to prepare and provide to the Utility Regulator the Network Code for the Ten Towns area by 1st April 2010. Firmus Energy also has a licence obligation to publish the Network Code and provide a copy to anyone who requests a copy.

Phoenix Supply wrote to Firmus Energy on 12th April 2010 requesting a copy of the Network Code. We have received no formal response. We have also drawn this

non-compliance to the attention of the Utility Regulator and the Department of Enterprise Trade and Investment (“DETI”). To date we have still not received the Network Code, almost six months after making our request.

3.0 Utility Regulators Rationale for Considering Postponing Competition

The Utility Regulator outlines what is presented as a rationale for changing the current Firmus Energy licence terms. We address each of the issues in turn in this section.

3.1 Confusing for Customers – Tariffs

We suspect there may be some misunderstanding in respect of this issue.

Large industrial and commercial customers are offered individually negotiated contracts which will vary in their specific terms and prices depending on the requirements of the customer. Large industrial and commercial customers understand this and have experience of conducting negotiated tender processes for the provision of some of their energy requirements. For example, large industrial and commercial customers in the Ten Towns already conduct competitive tendering processes for the provision of their electricity requirements and we see no reason why the Utility Regulator should continue to deny them the same opportunity in respect of their gas requirements.

In respect of domestic customers in the Ten Towns presumably the Utility Regulator would regulate Firmus Energy retail tariffs until such times as competition in the Ten Towns becomes established. Therefore, we do not agree there would be confusion in respect of tariffs. Is the Utility Regulator really suggesting that providing customers with a choice of supplier and therefore tariffs would be confusing? If this is the case, on what basis has competition been introduced for the electricity industry in Northern Ireland and the natural gas sector in Greater Belfast?

3.2 Confusing for Customers – Competition

The consultation document states that it would be confusing for customers in understanding which towns are open within the Ten Towns. We do not agree with this suggestion.

We do not believe that a large business customer in Ballymena could possibly think their business resides within Newry or Antrim or any of the other Ten Towns. To suggest that customers would be confused by the introduction of competition is to underestimate the ability of customers to understand what are clearly laid out timescales and clearly identifiable towns. Phoenix Supply has every confidence in the competence of customers in the Ten Towns to analyse and choose between competitive options.

Furthermore, the Greater Belfast licence area for large industrial and commercial customers opened on a phased basis – the licence area being opened on a phased basis across 12 districts.

Given that the Greater Belfast licence area opened on a phased basis and covered a relatively small geographical area we find it surprising that the Utility Regulator should suggest that there would be confusion in the Ten Towns. The Ten Towns are distinct and clearly identifiable towns and there is no prior experience of confusion in Northern Ireland to support the Utility Regulators suggestion.

It may be possible to construct a rationale for consolidating domestic market opening dates, to say 2012. However, this does not create a basis for postponing competition for large industrial and commercial customers.

3.3 Confusing for Suppliers

The Utility Regulator believes that a non co-ordinated approach to market opening in the Ten Towns will be confusing for suppliers. The Utility Regulator has had no discussion with Phoenix Supply in relation to their belief that suppliers could be confused in relation to market opening. As the largest natural gas supplier in Northern Ireland we would have been happy to confirm that we are in no way confused about the timescales for market opening or the implications of such.

Phoenix Supply is not confused about entering the market and there are no “market and advertising difficulties” for us.

3.4 Potential for Stranded Resource

The Utility Regulator has not indicated in the consultation document any of the financial savings which would be delivered to customers by competition.

In a consultation document which is considering the postponement of competition it must surely be essential to consider the benefits, including financial benefits, which competition would bring to customers in the Ten Towns. These benefits are not presented in the consultation document.

On the basis of the discussions we have had with customers and the experience in other areas of the benefits competition has delivered we have estimated, prudently, that the annual financial benefits of competition in the Ten Towns would be in excess of £1 million in one year alone. We do not believe customers should be denied the financial and other benefits of competition any longer.

The consultation paper highlights that the development of a Network Code could cost £100k. We regard this as overestimated as there already is a Network Code in use in Northern Ireland and also the Republic of Ireland, either of which could easily be amended for the Ten Towns at minimal cost. We consider it possible to introduce competition for the large industrial and commercial sector for significantly less than £100k, which would include the Network Code and necessary manual systems.

Even if the cost is £100k, as we have indicated above, the benefits for customers would far exceed this number.

3.5 Cost Implications of Implementing a Network Code prior to CAG

The arguments in respect of CAG and the potential for stranded resource (section 3.4) seem to be the same and therefore we have addressed the cost issue in section 3.4 of our response.

CAG timescales are uncertain. The Commission for Energy Regulation has already indicated that if there is a general election in the Republic of Ireland then the CAG timescales for delivering initial 'enabling' legislation will not be met. The postponement of competition in order to align with CAG timescales is therefore creating further uncertainty and unnecessary delay.

3.6 Implications for Allowance in the Price Control

Firmus Energy is currently operating within a 5 year Price Control which covers the period from 2009 to 2013. This covers the period when competition is currently due to be introduced. Firmus Energy has been aware of their obligation to introduce competition since 2005, therefore, the Price Control will contain costs associated with implementing competition from 2011.

As a result there will be no additional costs required by Firmus Energy to deliver their obligation to put in place systems and processed to introduce competition from April 2011.

If the Utility Regulator decides to postpone the introduction of competition in the Ten Towns then the costs associated with the introduction of competition in the Ten Towns need to be recovered from Firmus Energy. Otherwise customers are paying the costs associated with the introduction of competition but are not receiving any of the benefits. We also would expect the Utility Regulator would make this amount known through the Gas Market Opening Group.

We would also expect the Utility Regulator to publish actual pricing schedules for the Ten Towns identifying the cost build up of prices to customers so that there can be no cross-subsidising of costs across the Firmus Energy group of companies. This would ensure that customers in the Ten Towns are not subsidising lower Firmus Energy prices in other areas and that the current netback of supply costs is ended.

3.7 Summary

The legal and regulatory framework to support competition is well established and a model Network Code is easily available to Firmus Energy for application in the Ten Towns licence area. There is no legal or financial impediment whatsoever to introducing competition at the earliest opportunity and we ask the Utility Regulator to ensure that Firmus Energy moves to implement a suitable Network Code at the earliest opportunity and in line with the terms of its licence and also publish conveyance charges to enable suppliers to prepare for competition. Conveyance

charges should be published from 1st January 2011 regardless of the decision in respect of the postponement of competition.

4.0 Competition Issues

There are a number of very significant competitive issues associated with the postponement of competition in the Ten Towns. We have sought to highlight some of these here as we believe that a number are so significant that they could lead to justifiable challenge in the future by anyone of the existing or future gas suppliers.

4.1 Multiple Site Customers

Firmus Energy is able to supply natural gas throughout Northern Ireland. This opportunity is being denied to Phoenix Supply. Continued exclusivity in the Ten Towns licence area will have the effect of preventing competition and giving Firmus a clear competitive advantage when it comes to supplying businesses with sites in both the Greater Belfast and Ten Towns licence areas. This is unfair and we do not believe there are any grounds at all on which the Utility Regulator could reasonably grant a request for a longer exclusivity period for large industrial and commercial customers.

There is already clear evidence that relationships created and developed in the Ten Towns are being used by Firmus Energy to attract related customers in the Greater Belfast licence area.

We also believe allowing Firmus Energy to offer gas contracts to businesses in both licence areas will distort the development of competition, and we would expect the Utility Regulator to be very concerned about this.

4.2 Dual Fuel Offerings

The Utility Regulator is permitting, and potentially advocating the continuance of, a practice which the gas and electricity Regulators in Great Britain would not permit and stated caused significant competition issues.

At the time of the introduction of competition in Great Britain the gas market was opened to competition prior to the electricity market. There the Regulators would not permit an electricity supplier who had exclusivity to offer dual fuel contracts as this would distort and restrict competition in the gas and electricity markets.

As Firmus are enjoying natural gas exclusivity in the Ten Towns a parallel situation exists. Phoenix Supply and other gas suppliers are prejudiced, opportunities are being denied to competing gas suppliers and competition is being restricted.

4.3 Netback and Cross-subsidy

Phoenix Supply has significant concerns in respect of the operation and company structure of Firmus Energy.

The Firmus Energy supply business enjoys an arrangement in the Ten Towns where it cannot incur a loss (called a netback arrangement). The same statutory entity is competing in the Greater Belfast licence area. We have concerns there is a cross-subsidy of resources, marketing, advertising and other costs within the Firmus Energy supply business.

Phoenix Supply is firmly of the view that competition should be introduced in the Ten Towns without any further delay. However, should the Utility Regulator proceed with the postponement of competition in the Ten Towns we believe that the netback arrangement in the Ten Towns should be ended immediately.

Should the Utility Regulator, as an independent body, postpone the introduction of competition in the Ten Towns and continue to allow a netback arrangement within Firmus Energy we believe there would be serious competition issues. The Utility Regulator would be required to guarantee that the costs within Firmus Energy's business are ring-fenced and there is absolutely no cross-subsidy within their operations. For example, in respect of TV advertising Firmus Energy's supply operation within Greater Belfast is obtaining significant benefit from this and we would require clarity from the Utility Regulator that these costs are being fully and appropriately allocated.

5.0 Other Issues

5.1 Exclusivity Periods

The consultation paper notes that the supply exclusivity arrangements for Firmus Energy are similar to what was granted to Phoenix Natural Gas in Greater Belfast. For the largest industrial and commercial customers this is not the case.

Phoenix Natural Gas was granted 3 years exclusivity for the largest industrial and commercial customers and had in place appropriate Network Code arrangements and manual systems to facilitate competition once this period expired. Firmus Energy has already benefited from 5 years exclusivity and the consultation document indicates that this may be delayed for a further period of between 2 and 4 years.

The 3 year period of exclusivity granted to Phoenix Natural Gas was in the context of natural gas being introduced to Northern Ireland for the first time. Considering the huge changes to the market since 1996 we would expect exclusivity periods to be getting shorter and not longer – especially considering Northern Ireland remains the only part of the UK where full gas competition does not exist.

5.2 Customer Choice

The Utility Regulator Chairman commented at the recent Utility Regulator Annual Report launch that the Utility Regulator had listened to customers and the message heard was that customers want competition. We agree. We therefore do not

understand why the Utility Regulator could therefore propose to postpone the introduction of competition.

We know the current situation in the Ten Towns is having a significant negative impact on customers. We have been contacted by a number of businesses seeking terms for the supply of gas in the Ten Towns licence area. The existing regulatory situation prevents Phoenix Supply (and all other gas suppliers) from responding to such requests. This is unhelpful to the customer, who is again denied the ability to compare different prices and standards of service so as to make an informed choice about its gas supplier. It also runs counter to the continued development of a fully competitive gas market in Northern Ireland.