



**Response by Viridian Power & Energy to
Northern Ireland Authority for Utility
Regulation Consultation Paper**

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

21 September 2010

1. Introduction

The Northern Ireland Authority for Utility Regulation (NIAUR) has sought responses to its consultation on options for co-ordinating the relinquishing of firmus energy's (fe's) supply exclusivity in the 10 towns area.

Viridian Power and Energy (VPE) have reviewed the options forwarded in the paper and consider there to be no compelling arguments for preventing eligible customers from benefiting from competition in the Northern Ireland gas market (10 towns). Given this considered view, it is important for the Northern Ireland gas market that all delays to market opening are rejected and further options are considered for accelerating the opening of all markets to competition.

Within the consultation paper a number of arguments are forwarded for delaying market opening. This response addresses these arguments and highlights a number of inherent contradictions and invalid and/or confusing statements that serve to unnecessarily complicate the issue for consideration. Section 2 of this response summarises VPE's views on the appropriate course of action for co-ordinating the relinquishing of fe's supply exclusivity in the 10 towns area. The appendix of this response includes VPE's views on the specific questions contained in the consultation paper.

2. Summary of VPE's response

Firstly, VPE would call on NIAUR to consider all options available to it in relation to accelerating the opening of the 10 towns to retail gas competition. In accordance with the views expressed by fe to NIAUR on gas market competition in Greater Belfast¹, it is important that a protracted process is avoided and that all suppliers can offer best prices to all on a level playing field of competition. The continuation of exclusivity is clearly contrary to this preferred outcome and the views expressed by fe. Therefore, we would call for the opening up of all markets at the earliest possible opportunity, April 2011.

In advocating this approach VPE is aware of the current licence terms that provide for periods of exclusivity of 5 and 8 years for large I&C, and small I&C and domestic customer segments, respectively. As amendment to such conditions may be difficult to advance, such that exclusivity is ended sooner, VPE urges NIAUR to view these periods of exclusivity as absolute maximum terms. After the pre-defined periods in each of the respective towns has elapsed, customers should be able to avail of the benefits of competition as a result of market opening. Arguments forwarded that such benefits should only be made available to all customers concurrently, is clearly contrary to the views of NIAUR when determining the conditions of the licence.

¹ Firmus Energy's Submission to NIAUR consultation on Electricity and Gas Retail Market Competition, 16 July 2008.

Such arguments also fail to acknowledge the accepted segmentation of the market, with large I&C customers viewed as a distinct group. This view has been shared by fe in the past.²

In the determination of these periods of exclusivity in the licence, it must have been NIAUR's considered view that such periods were both necessary and sufficient to ensure the introduction of a retail gas market in these areas. It is unclear from the consultation what factors have changed to alter NIAUR's views of this, as set out in the licence.

As already noted, any extension of the periods of exclusivity, beyond those contained in the licence, would represent an unnecessary and inappropriate regulatory barrier to market entry. Such a barrier would isolate customers from the benefits of competition and the potential for choice, improved customer service and importantly, lower prices. In the current economic environment it is important that firms, whose survival is contingent on the market economy, are allowed to access a market for one of its most significant input costs. Competitiveness is a key to the survival of firms and every effort should be made to ensure Northern Ireland can offer firms the benefits of both natural gas and competition in its supply.

Even if one considers the impact of competition in the Greater Belfast area, fe offer I&C customers in this area a discount on the regulated Phoenix tariffs (7.5% in year 1; 5% in year 2). The fe I&C tariffs in Greater Belfast are below those offered in the 10 towns. Therefore, not only should competition be introduced as soon as possible under the licence terms, it should be introduced to ensure the benefits of competition can be passed to customers.

Considering some of the issues advanced as reasons why one might consider delaying the introduction of competition in certain towns and in certain categories for up to two years, VPE considers some of these to be overstated, irrelevant, and potentially damaging to the development of the retail gas market in Northern Ireland.

Firstly, the issue of stranded costs is incorrectly defined in a number of instances and is somewhat overstated. Market entry will not signal an end to regulation of fe tariffs in the towns that are opened up to competition. As such there is a ready made mechanism for fe to recover any costs incurred from a requirement to change back office systems. This is an accepted and common approach applied in other jurisdictions. Furthermore, to the extent that these changes will be required to facilitate market opening at some point, they cannot be specifically attributed as an additional cost to accelerated opening, or even opening in accordance with the terms of the licence.

The assertion that back office system costs would be reduced to zero marginal cost if one was to wait for the introduction of the CAG is somewhat disingenuous as one could similarly argue that the cost of CAG was at zero marginal cost given significant investment required to undertake the changes to allow market entry. This misrepresents the cost and as such is unhelpful as a comparison.

² Ibid.

Considering the magnitude of the estimated costs involved, as outlined in the consultation paper, the possibility that NIAUR would fail to enforce the terms of the licence granted to fe and prevent customers from accessing competition, and suppliers from entering these markets, represents a significantly greater regulatory cost. With acknowledged rules on the nature and duration of the exclusivity granted to fe having been public since 2005, considering changing these arrangements just six months prior to the opening of the first large I&C market in Ballymena, and introducing uncertainty into the dates for other towns and markets, NIAUR threatens the development of retail gas market competition in Northern Ireland.

Competition in this market is currently at an early and vulnerable stage and should be facilitated through certainty in the regulatory process and ensure consumers can access the benefits of competition. Furthermore, in the interest of development of competition regulatory certainty will minimise the risk of sunk costs being incurred by potential market entrants in assessing the opportunities available, carrying out market research and developing internal process required, including a hedging strategy. We further caution that any regulatory delay to the introduction of competition in the relevant towns/segments may not only deter new entrants but also customers from switching to gas in the knowledge that they are insulated from competition for an indeterminable period. Associated secondary effects are likely through further unwillingness on behalf of new entrants to enter a stagnating market. Such a development would be detrimental to the future of the emerging retail gas market in Northern Ireland.

In relation to the proposed postponement of the opening up of the large I&C markets in the respective towns, there is not an issue with customer confusion. Large I&C's are run by experienced business people who will understand, but may not readily accept, the regulatory barriers in the market preventing them from accessing their supply at the lowest cost. In addition to this, there is no evidence that the existence of a competitive market in Greater Belfast has led to confusion in the 10 towns over the product offerings available to customers.

Finally, on arguments that costs can be avoided through postponing market opening until the introduction of CAG, (transmission or retail), such arguments are superfluous and risk the development of retail gas market competition in Northern Ireland. At present the outcome of the CAG (transmission) process and the associated timelines are uncertain. CAG (retail) is to follow this process and as such discussion of both the outcomes and timelines is accompanied by significant uncertainty. Clearly any postponement of market opening for the uncertain outcome associated with either of the CAG processes (transmission or retail) would represent an unnecessary, unjustifiable and indeterminate wait for customers in Northern Ireland, (in all towns and customer segments), in being able to access competition in the retail gas market.

Considering further issues in relation to the timing of market opening and of this consultation, VPE has already noted in this response that holding the consultation just six months prior to the planned opening of the large I&C sector in Ballymena, is not in keeping with best regulatory practices, risks sunk costs for potential market entrants and as such, is not appropriate. Details of the fe supply licence have been in the public domain since 2005, any such consultation should have formed part of a medium term review and been undertaken at the very least, 18 months before the first planned opening up of an exclusive area/segment to competition.

Additionally, the motivation for holding this review after the NIAUR decision on fe's Price Control 2 (2009-2013) has been published, wherein no provision was made for the imminent market opening, is questionable.

In relation to the short amount of time left for the development and/or adoption of a gas code ahead of planned market opening, to the extent that it is a barrier to market opening, it is a result of poor regulatory process. Market opening of the large I&C market in Ballymena in April 2011 has been an expectation of the market for at least five years. NIAUR were similarly aware of this situation as they included it in fe's supply licence. The failure to have an agreed code at this time should not be used as a reason to prevent customers from availing of the benefits of competition as the issue was wholly avoidable.

Finally on the arguments put forward in relation to CAG and the potential benefits, principally accruing to fe, of waiting for this it is important to be acknowledge the stage of development CAG is at, both in terms of transmission and retail arrangements. VPE would consider the timelines presented in the consultation paper to be somewhat optimistic, given current level of uncertainty in the market in relation to the timelines and outcomes of the CAG process. By proposing to stall the introduction of competition in retail gas in these 10 towns, NIAUR is proposing that customers bear an unnecessary and indeterminable cost, namely the inability to access competition, such that the costs for the regulator and fe may be reduced in the future, upon the future completion of, as yet uncertain CAG arrangement. There is no reason why in a competitive market customers should bear the cost of accessing competition. This appears to be an erroneous assertion contained in the consultation paper.

In summary, it is VPE's considered view that NIAUR should adhere to the licence terms of 5 and 8 years in respective towns and market segments, as an absolute maximum term. In accordance with the arguments forwarded by fe in relation to the Greater Belfast area, exclusivity should not be prolonged and market opening should be introduced such that customers can access gas at the lowest price, resulting from competition on a level playing field. Arguments over customer confusion and stranded costs are found to be largely superfluous and incongruous when compared to the regulatory risk imposed by any move to delay the opening of these relevant markets to competition.

Finally, we caution stalling the process of market opening based on the uncertain timetable of CAG development. Customers should be able to access competition and competitive prices as soon as possible, arguments for delaying this should only be entertained if advancing market opening is found to be detrimental to the welfare of customers and the market. This is similarly consistent with the objectives of NIAUR under Section 14 of the Energy (Northern Ireland) Order 2003. No such arguments are presented.

APPENDICES

A.1 Response to Specific Consultation Questions

Q1. Do respondents agree that the current staggered market opening timetable presents potential difficulties and confusion for customers in understanding the different tariffs across the same sectors in different towns? What impact, if any, do respondents consider this could have on the development of competition in the ten towns area?

The introduction and promotion of competition in Northern Ireland's retail gas market is necessary for the development of the market beyond this initial phase. Competition should be advanced as quickly as possible to allow customers avail of the associated benefits, principally lower prices. Any postponement to the current market opening timetable is likely to deter potential market entrants. This deterrent effect is likely to affect the Greater Belfast market too with potential entrants prevented from realising synergies and affecting competition in a relatively small market. Furthermore, any delay in the current arrangements may deter customers from entering the market knowing that they are to be beholden to a monopoly supplier for an indeterminate time.

At present there are effectively two retail gas markets in Northern Ireland, one competitive in Greater Belfast and one a regulated monopoly in the ten towns. This does not present significant problems in relation to difficulties and confusion for customers in understanding different tariffs across the same sectors in different towns. It is uncertain why it is argued that it may be the case in this instance. Furthermore, we note that fe currently offers two different tariffs to its customers in the same sectors in Greater Belfast and in the 10 towns.

As far as it is considered to be a problem in this context we would call for a pro-competitive response and accelerate the opening up of all towns and customer segments, as opposed to an anti-competitive one extending, beyond the licence terms, the duration of exclusivity. Arguments that a staggered market opening timetable would cause confusion and affect competition similarly apply and have clearly been rejected in relation to Greater Belfast and the rest of Northern Ireland. Failure to acknowledge this represents an inconsistent and unjustifiable approach to regulation of the retail gas market in Northern Ireland.

Q2. Do respondents consider that under the current arrangements there is potential for confusion for customers in understanding which sectors in which towns are open to competition? If so what is the impact on the different sectors and on how suppliers advertise?

Notwithstanding our call for accelerated market opening arrangements to be introduced, the current arrangements are not considered to lead to confusion beyond the point which it may already exist, between Greater Belfast and the 10 towns.

For the large I&C market, this is characterised by a relatively small number of customers, each consuming large volumes. Adept at managing large businesses, these customers are not accessed through advertising and are fully capable of understanding when the fe licence exclusivity is due to expire from the publicly available material and through discussions with other businesses. VPE's experience is that such customers may in fact seek out a price from a competing supply company and will pro-actively pursue the lowest price gas for their business. Any delay in market opening, beyond the terms of the licence, will disadvantage business in these areas and place them at an unjustified competitive disadvantage vis-à-vis similar businesses located in the Greater Belfast area.

The end of fe's exclusivity in the small I&C and domestic market is not expected until April 2015 at the earliest. Consideration should be given to accelerating this process. Notwithstanding this, it is somewhat speculative and inappropriate to consider the likelihood of customer confusion five years hence in a market advancing rapidly and considering substantial developments on the customer side, particularly in relation to smart meters and demand side management.

In addition to this we reiterate the point that two tariffs already exist in different areas of Northern Ireland for retail gas across different customer sectors. In this regard we would call for vigilance on behalf of NIAUR to correctly determine marketing and advertising costs allowed in subsequent price controls. Even at present, with the presence of two retail markets, vigilance is required to ensure only appropriate costs are allowed in the fe price control and that such resources are scaled to ensure they do not support fe's efforts in the competitive Greater Belfast market.

Q3. What are the views of respondents on the choice of network codes and associated costs? What considerations are most pertinent for switching system implementation and the associated costs?

Of the options forwarded by NIAUR in the consultation paper, the adoption of the PNGL code is considered to be the most appropriate. Adoption of this code has a low estimated cost, could be done in a timely manner and would not jeopardise the timeline of the current arrangements. Furthermore, this code provides for only one set of retail processes in Northern Ireland and this should be seen as a distinct advantage over a two-process system that would likely deter market entry. Additionally, fe are already very familiar with the PNGL code from their presence in the Greater Belfast market.

In the immediate timeline of market opening, fe will not incur significant costs associated with system switching arrangements. Similarly, the PNGL code represents one of two lowest cost options for future opening of the small I&C and domestic market. We wish to reiterate that the costs associated with waiting for CAG (retail) are not zero but given the required changes this will bring about, there are no additional costs associated with a number of these costs. The associated costs are not zero and as such it is somewhat disingenuous to present the costs in this way.

On the estimated costs to fe's back office systems, this is considered to be approximately £100k under the adoption of the PNGL code. However, fe currently operate under this code in Belfast and as such claims of excessive costs, over and above Gaslink code and Bespoke code, should be further investigated.

In addition there is a presumption in the consultation paper that customers ultimately pay for these costs in a competitive market. This assertion is erroneous as it does not relate to the current system wherein fe enjoy significant privileges from their netback position. The costs associated with changing back office systems are incurred only as a result of market opening. With market opening fe will continue to be regulated and as such may pass these costs through the tariff offered to consumers. However, the market will now have competing suppliers offering competing products and customers will be free to avail of the benefits of competition and switch to the lowest tariff provider. In this scenario customers will benefit from competition, not be adversely affected by it, and fe will be incentivised to procure the necessary back office systems at the best price. Such practice is common in regulatory price controls.

Ultimately, the once-off costs to fe will be far outweighed by the recurring benefits of competition accruing to customers. Nevertheless, we would continue to call for a more accelerated process than the one currently outlined.

Q4. Which option do respondents consider presents the best alternative, based on considerations of minimal costs, least confusion for customers and availing of effective competition at the earliest possible opportunity for customers? What arguments are there (based on cost, market clarity and competition considerations) for the alternative options? Is there an alternative option not presented in this paper or a refinement of one of the options that might be more optimal?

VPE call on NIAUR to consider all options available to it in relation to accelerating market opening beyond the timelines outlined in the current arrangements for the 10 towns. Given the views outlined in this response, it is important for the Northern Ireland gas market that all delays to market opening are rejected and both customers and the market can benefit from competition. Therefore, we would call for the opening up of all segments and towns at the earliest possible opportunity, April 2011.

Acknowledging the potential impediments imposed by the licence terms to adopting this preferred approach, VPE still call for the principle of accelerated competition to be adhered to and as such for the current timetable for market opening to be adhered to at the very least. Under this approach, adoption of the PNGL code is appropriate and it ensures a low cost, timely and consistent basis from which to develop the Northern Ireland gas market. As such it ensures one retail process in Northern Ireland and is a code already operated under by fe, and some of its potential competitors, in the Greater Belfast area. It has been argued already that claims that the customer will ultimately pay the cost of interim code and switching arrangements is fundamentally flawed.

Overstated claims of customer confusion are found to be without basis as the situation currently exists in Northern Ireland and no regulatory action has been deemed necessary to address it, principally because it is not an issue. A far greater issue would be preventing large I&C businesses from availing of competition from as early as next year, particularly in this challenging economic environment where cost competitiveness is fundamental to continued survival. Large I&C customers in Greater Belfast can already avail of the benefits of competition and interestingly, fe offer lower tariffs to its customers in Greater Belfast (inclusive of discount) than they do to those in the 10 towns.

In relation to the expected benefits of CAG, we caution that stalling the liberalisation process in Northern Ireland's retail gas market for an indeterminable period, awaiting and uncertain outcome is a flawed approach that detrimentally affects the promotion and facilitation of competition in the market and as such is not in the interests of customers. The approach outlined herein, notwithstanding the calls for a more accelerated process, will deliver the benefits of competition to customers at the nearest possible opportunity (principally lower prices), harmonise retail arrangements in the market making it more attractive to potential new entrants and provide a stable regulatory setting from which the objectives of CAG can be pursued.