**Viridian Power & Energy Limited**

Mill House
Ashtowngate
Navan Road
Dublin 15
**T**:+353-1-869 2000
**F**:+353-1-869 2040

Elena Ardines
Strategy Branch
Northern Ireland Authority Utility Regulator
Queen's House
Queen street
Belfast
BT1 6 ER

15 July 2008

Dear Elena,

**CONSULTATION ON ELECTRICITY AND GAS RETAIL MARKET COMPETITION IN NORTHERN IRELAND.**

The early meeting with NIAUR and Poyry Energy Consulting in February was appreciated, and thank you for this further opportunity to contribute to the development of retail competition in Northern Ireland.

We are pleased to see a renewed commitment towards retail competition for Northern Ireland and as NIAUR notes, the benefits that effective competition brings for customers is underpinned by authoritative research.

Effective electricity and gas competition for Northern Ireland faces a number of specific challenges. Equally however, it has demonstrated it can rise to these challenges as evidenced by its drive to change existing market practices for electricity. The implementation of the SEM at the wholesale level, and the significantly improved transparency surrounding the well defined PES hedging process under SEM, is evidence of getting some of these market fundamentals right[1].

This consultation points to a number of market issues that are restricting retail competition, many of which we highlighted in our previous response of 26 February 2008 following the Poyry investigation (see copy in Annex A). None are insurmountable, although they do require a serious regulatory commitment and call to action.

For example, the squeeze on electricity retail margins represents a serious issue and threatens the delivery of a sustainable competitive retail market. Retail margins are heavily influenced by the 'K'

[1] A recent issue has arisen within RoI which we are taking forward with the Commission. This does not change the general thrust of this statement.



**Registered Office**: 120 Malone Road, Belfast BT9 5HT, Northern Ireland

factor, a benefit conferred on incumbents under their price controls.  We agree with NIAUR, the 'K' factor acts as a hedge, and we argue it therefore allows incumbents to defend their markets by absorbing additional energy costs safe in the knowledge that costs (and therefore profits) will be recoverable under a rebalancing mechanism.   This not only impacts competition, but its presence also acts as a perverse incentive and therefore deterrent to an optimal energy hedging strategy – ironically impacting on retail prices for years to come.

The removal of the 'K' effect for gas and electricity is absolutely necessary to encourage healthy retail competition in the medium to longer term.  As far as it goes, we are therefore pleased that NIAUR is endorsing NIEES' voluntary step to remove 'K' for those electricity customers that are HV or MV (above 150MWh) from April 08, and for a 50% pass through for the remaining MVs.  NIAUR should now tackle the rest by formally mandating the removal of 'K' on a phased basis for all other customers.  For example, in electricity to ensure this is rolled out to the remaining MV customers by 2009 and all others (including domestic) within the next two years.

Aside from the 'K' factor issue commented on above, for this response we focus on three main aspects (please refer Annex B for our specific comments to the key consultation questions):

1. The benefits of competition for Northern Ireland.
2. The challenges and opportunities.
3. The key measures and actions.

**The benefits of competition for Northern Ireland**

Great Britain (GB) is often used as the competition 'yard stick' internationally.  Ofgem has carried out numerous energy competition studies into GB markets.  For example, at the cusp of effective retail competition in June 2003[2], it noted that by early 2002 competition was already bringing substantial benefits for customers (including vulnerable customer groups) – this was less than 5 years from full market opening.  Ofgem noted that competition had become an even more powerful influence on the behaviour of companies in the market and was creating a range of consumer benefits.

We firmly believe that electricity and gas competition can become a real force for change in Northern Ireland.  Competition has many distinct benefits as noted by NIAUR.  Competition responds to the wishes of customers, encouraging efficient production and investment, stimulating production differentiation and innovation, and passing these benefits onto customers.  However, these effects do not come about overnight, certainly not in the early years as customers and suppliers take time to adjust to new markets.  For example, in the case of electricity, the benefits from SEM will take time to fully materialise for retail customers, albeit there is more to be accomplished.

[2] Domestic gas and electricity supply competition  - June 2003

The examination of why some retail markets are more successful than others has been the subject of much academic study and debate[3]. These include regulatory failures to distinguish clearly between distribution, wholesale and retail activities (e.g. dealing with incumbent power, market transparency), to allocate regulated costs appropriately (through regulated price controls) and to make adequate provision for non-discriminatory access to transmission and distribution networks (e.g. via true independence of TSO/DSOs). We note from Stephen Littlechild's 2005 research, an important and widespread factor on retail competition has been the actions of governments and/or regulators imposing unrealistically tight price controls to protect customers. Littlechild notes their actions have had the effect of distorting or restricting the development of competition.

Northern Ireland is at a critical point in its market evolution. There are now almost 800,000 electricity customers and in excess of 120,000 gas customers (include franchise - and growing). The time is right to focus on the electricity and gas market fundamentals that will bring about real change and choice for customers in Northern Ireland.

**The challenges and opportunities**

NIAUR does not start from an assumption that further competition is an end in itself. Whilst we would tend to support this premise, this should not be used to dilute measures that could bring about serious change. A piecemeal approach will not do, as effective competition requires a root and branch approach to resolve the structural and operational issues affecting competition.

The electricity and gas retail markets in Northern Ireland are undeniably smaller than many other Member State markets. Its exposure to fuel poverty issues at the smaller domestic end is greater than most.

However, market scale is certainly not assisted with the delivery of a gas franchise model, which effectively denies new entrants access to sizable swathes of gas customers for a significant period of time[4]. Whilst the objectives are laudable in themselves, namely to stimulate network growth, they unfortunately play to the existing incumbent vertically integrated structures that stretch across both Ireland and Northern Ireland. A transportation network should be sustainable in its own right by the correct application of transportation tariffs, irrespective of which supplier serves the customer. We therefore find it difficult to justify any form of 'lock in' period for customers, and certainly when these exceed more than one year (as in the case for Firmus).

The GB Independent Gas Transporter (IGT) model may help throw some light on the challenge of growing networks whilst simultaneously supporting competition. Whilst not initially perfect, it has nonetheless stimulated network development to new housing developments the incumbent did not wish to take on. Just as importantly, customers are still able to switch supplier and distribution networks have grown.

[3] For example, see "Beyond Regulation" by Stephen Littlechild, 4 October 2005

[4] The franchise already in place for Firmus Energy (a wholly owned subsidiary of Bord Gáis Éireann), potentially denies competition to approximately 20% of the available gas market in Northern Ireland at any one time

In GB, competition has delivered bundled offers, dual fuel, airmile credits, loyalty points, charitable donations, green tariffs, energy efficiency packages, insurance cover, discounts, various social schemes (including hardship trust funds), financial products, innovative tariffs and contracts, single billing and many others. We argue, there is no evidence to suggest that competitive markets will not ultimately deliver benefits to all customers, irrespective of class or financial status. Northern Ireland customers can also benefit from competition, providing the Authority builds into its policy approach the competition 'read across' between electricity and gas, i.e. acknowledging how supporting the activities in one market will help the other - Dual Fuel is a good example how the two competitive markets may support each other.

NIAUR comment that acquisition costs of circa £100 per customer may be a reason why competition has not taken off. We agree, if acquisitions costs are of this order, new entrants would find it difficult to justify a business model that works. However, such costs can be significantly reduced by taking actions that resolve market imperfections (such as those noted above), and those which improve balancing risks for gas and removing Phoenix Natural Gas Supply's ability to lock in customers for 90 days. Additionally, taking a Dual Fuel market reform perspective will help new entrants reduce costs still further, and improving cost & tariff transparency will then help competitors understand what they are competing against.

Longer term, as energy policy across the island of Ireland increasingly converges, the shift towards an all-island energy approach will bring substantial benefits for both these markets and its customers. We should no longer think of these gas and electricity as 'energy islands', but as dual fuel markets that stretch beyond jurisdictional boundaries. Ultimately, the electricity and gas market on an all-island basis will be in excess of 3 million electricity customers and almost 700,000 gas customers (and growing).

In helping to deliver this vision, under Common Arrangements for Gas (CAG), there are potentially great opportunities to create a gas market 'back bone'. For example, we will be pressing for fully independent TSOs/DSOs in the present consultation for Gas Operational Arrangements. As we move forward under the auspices of European policy (under the 3rd liberalisation package) and the development of an all-island gas market, fully independent system operators must take centre stage. As such, they must embrace an approach that is capable of evolving, unhindered by any potential conflicts of interest.

We note that within the electricity industry, both Eirgrid and Soni (soon to be divested) are wholly distinct independent legal entities - an approach embraced by both the Commission and NIAUR. It therefore makes no sense to have a different outcome for gas. The independence of the electricity model sets an important all-island market benchmark.

Concluding this section, we note that competition in Northern Ireland will not be a possibility unless we get the fundamental structural issues addressed. Many of these issues have been identified by the consultation, and include issues such as the K Factor, supply margins, and incumbent advantages. But, at its foundation lies a significant and key issue: If we are serious about competition, then we must do so from an integrated energy policy approach. This will require joined up policy thinking across electricity and gas, and for NIAUR to press for a change to its primary duties for gas, i.e. it must have a mandate to 'promote competition', thus aligning with its mandate for electricity and the respective policy drivers on an all-island basis. Facilitation alone will not do.

**The key measures and actions**

In our response of 26 February 2008, we listed a number of market issues that warranted specific attention and we refer NIAUR to this response. This consultation has picked up many issues we recognise as inhibiting retail competition. Taken collectively, they represent a serious hurdle for smaller and new entrant suppliers to contend with.

We are concerned the measures for gas retail competition are light when compared with electricity. For example, we welcome a review of the inclusion to remove the K factor for electricity, but question why it should not equally apply to gas. These seemingly opposed actions seem to disregard the interplay between electricity and gas for customers – it ignores experiences from other markets that demonstrate how Dual Fuel products can drive competition[5], by reducing the costs to serve and managing risks for new entrants. We have no doubt, this difference in approach is principally down to the difference in primary duties for NIAUR. Further, we believe this difference in primary duty could potentially affect progress under CAG.

NIAUR asks (Q3 & Q4) whether their analysis has identified the major potential barriers to competition. We therefore submit three additional items that warrant particular attention:

1. NIAUR's primary duties: these are different for electricity (to promote) and gas (to facilitate). The successful launch of a sustainable retail competition model must be predicated on an integrated policy approach (e.g. Dual Fuel). Unless NIAUR's principal duties are better struck for gas, we believe the gas market will continue to play 'second cousin' to the electricity market, and the required reform measures will struggle to flow.

2. Market Size: NIAUR should focus on measures that expand, not restrict, the available retail market for new entrants. For example, the franchise arrangement has the effect of reinforcing vertically integrated incumbents, whilst limiting the number of customers that might avail of dual fuel offerings from competing independent suppliers.

3. Independent Gas TSO/DSO: for electricity, the SONI example is an excellent basis on which to secure a truly independent TSO/DSO arrangement. There is no logical reason for not carrying through the same for gas. Indeed, we believe this would materially help support an island wide approach and help deliver optimal transmission tariff arrangements that meet competitive market requirements.

[5] GB demonstrates how this can spear head competition, especially for the domestic sector - Dual Fuel represents 33% of the total energy market, and almost two thirds of the potential Dual Fuel market for GB domestic customers

To summarise our key points:

- Effective retail competition can be a real force for change, delivering many benefits for all customers, including a range of innovative products and services.
- We highlighted a number of very specific measures in our response dated 26 February 2008, that would go a long way towards supporting retail competition in NI.
- The K Factor should be removed for all electricity customers, and similar urgent consideration given for gas.
- We should not think of NI electricity and gas customers as ‘energy islands’, but as a market with Dual Fuel potential, ultimately across both NI and RoI.
- There is no place for a gas franchise model that prevents customers from switching. This restricts competition (fewer eligible customers) and reinforces vertically integrated incumbents (that are best placed to take advantage of these franchises).
- The incumbent advantage continues to restrict retail competition, and needs to be addressed.
- Creating the right market ‘backbone’, by securing legally distinct and fully separated TSO and DSO functions in gas and a single all-island balancing point, will help underpin retail competition.
- NIAUR’s primary duties for gas are at odds with delivering retail competition in NI and the developments under CAG, i.e. it must have a duty to promote gas competition (similar to electricity).

We hope this provides further insight into the Northern Ireland competition issues. Subject to direct action, we are relatively more upbeat about the possibility for gas competition for Northern Ireland than seems to be the case by NIAUR.

Please do not hesitate to contact us if you wish us to expand on any of the issues we have raised in this response.

Yours sincerely

A Thornton

Tony Thornton

Consultant – Energy Regulation
(on behalf of VPE/Energia)

**Viridian Power & Energy Limited**

Mill House
Ashtowngate
Navan Road
Dublin 15
**T**:+353-1-869 2000
**F**:+353-1-869 2040

**Annex A – Copy**

Kevin Shiels
Strategy Manager
Northern Ireland Authority Utility Regulator
Queen's House
Queen's street
Belfast
BT1 6 ER

26 February 2008

Dear Kevin,

**RETAIL COMPETITION – SUPPLEMENTARY**

Thank you for the opportunity to meet with you and Poyry Energy Consulting on 7 February 2008. At the back of this response we have included a summary of our energy specific retail market issues, and attached is our completed Poyry Questionnaire.

In compiling this supplementary response, we ask that you also refer to our response on NIAUR's Forward Workplan for 2008/09 (copied to yourself and Gareth Davies on 12 February). This will provide a valuable backdrop to our key concerns affecting retail competition in Northern Ireland and sets out seven market priorities for 2008/09, touching on many of the issues we discussed on 7th February.

You will already have noted that Energia has established a strong electricity market presence in Ireland and Northern Ireland in certain market sectors, and we have ambitions to grow our electricity and gas portfolio right across all sectors, including SME and domestic. However, for competition to be sustainable and to grow, it requires a strong regulatory market framework, one that acknowledges the challenges faced by small/new entrant suppliers.

For this response we build upon three particular core themes:

1. **the incumbent advantage**: which creates a significant 'hurdle' for any new supplier.
2. **Dual fuel:** which requires a joined up policy approach across the electricity and gas markets to facilitate a dual fuel market approach; and
3. **an all-Island approach**: that fully exploits an all-island energy policy approach, including energy efficiency and smart metering.

The incumbent advantage

We are convinced that, fundamentally, the incumbents (NIE and Phoenix Natural Gas Supply) obtain a significant commercial advantage. Born from a privileged legacy position, it confers on the incumbent an inherited diverse portfolio and a widely recognised brand, creating a significant hurdle for any new supplier.

For example, in gas, the transmission charging and imbalance penalty arrangements are framed in a manner that supports those suppliers with an established and broad portfolio of customers, but exposes small and new suppliers. As such, the incumbent is therefore able to spread its imbalance risks, i.e. to limit its exposure to gas imbalance charges. Whereas, smaller suppliers are exposed on two counts: first, because, it takes time to build up a sufficient customer base to help 'manage out' these imbalance risks; and second, Phoenix Natural Gas Supply[6] (PNGS) is able to benefit from a skewed Network Code treatment. This provides PNGS with a first-tier imbalance tolerance of 17% across its domestic and business portfolio, unlike smaller business suppliers that can be exposed to a tolerance of just 10%.

In electricity, we draw to your attention two particular examples. First, NIE is hedged by a 'K' factor and any deficiencies in its wholesale energy cost forecasts can therefore be offset. Consequently, in a rising wholesale energy market, retail prices are kept artificially low reducing the headroom for competing offers, but without affecting NIE's overall profitability, i.e. it merely rebalances the next year. Second, the PSO levy is applied in a manner by NIE that seriously questions whether this is being handled equitably for different customer classes, potentially favouring SME and domestic customers. By way of example, in 2007/08, the NIE levy cost for SME sites was reduced by 61%, whereas for Large Energy Users it was reduced by just 41% (suffice to say, we are unable to explain this anomaly).

With regard to the incumbent advantage, we therefore make the following observations and recommendations:

In the short term, we recommend:

- **Improving Gas Imbalance Charges:** immediate action is required to address the penal imbalance regime that favours the incumbent. We are willing to help develop a new approach, e.g. a model that incorporates site specific tolerances, and/or prices that better reflect SAP[7] and SMP prices in Great Britain (GB), providing this effort will not be wasted. NIAUR sponsorship would be helpful.

[6] PNGS supplies both domestic and business customers, this taking advantage of a 17% tolerance threshold for its business customers

[7] Under Code Mod 15, a change is expected on 1/3/08 that will move towards SAP prices, but more will be required to fully ameliorate the charging issue

- **Restricting PNGS Products**: some form of positive 'kick start' action is required to help non-incumbent suppliers build a credible customer portfolio. This could be in the form of restricting PNGS customer products to avoid customer 'lock ins'; for example, in the case of business customers, contract terms that do not exceed 12 months.

- **Increasing PNGS Regulatory Scrutiny**: including whether its present customer contract terms and conditions are creating restrictive market practices. For example, contract terms that require customers to provide 90 days termination notice cannot be justified and should be disallowed. Indeed, we question whether this constitutes an unfair contract term. Either way, NIAUR needs to take immediate action to address this.

- **Avoiding Regulatory Barriers**: As a precursor (and a temporary surrogate) to effective retail competition in Northern Ireland, NIAUR is proposing to introduce a price control on PNGS. This places an important responsibility on NIAUR to define what is most conducive to efficiency on the one hand and the advancement of competition and responsiveness to change on the other. Effective competition is more adept at judging how best to manage the market, not regulatory control. However, if handled correctly, stronger regulatory scrutiny, improved transparency, and increased accountability for PNGS could provide an important foundation for a pro-competitive market. Providing that is, the outcome does not then act as a constraint. NIAUR should carefully consider how the construct of the price control on PNGS could act as catalyst for competition.

- **Improving Market Transparency:** for both electricity and gas, there are two aspects to consider. First, the lack of customer data transparency introduces a level of commercial risk that independent suppliers are struggling to underwrite, and this is frustrating the development of competitive offers. NIAUR should implement arrangements to make customer profile data available to all suppliers, albeit in a form that will continue to safeguard and protect individual customer data protection rights.

  Second, competitive market information enables suppliers to become better informed, thus enabling better offers, tailored services, and equips suppliers with the means to assess market risks more accurately. Critically, it also provides a competition 'health check' for the future development of policy actions. We therefore recommend NIAUR publishes detailed competitive market data.

- **Removing the 'K' factor for NIE:** this will redress a key commercial advantage conferred on NIE, making it more responsive to natural competitive market forces. The 'K' Factor can (and should) be decoupled from NIE's price control.

- **Improve PSO Levy Governance:** greater accountability and transparency is required in how NIE apportion this across different customer classes/groups. We are concerned that greater benefit attributes towards SME and domestic customers (distorts the market).

- **Treatment of under/over recovery by NIE PPB:** NIE PPB trades its generation portfolio into the SEM. Whilst this portfolio is traded through the Directed and Non Directed Contract process, the fact that fuel hedging to match the contracts is not permitted by NIAUR can lead to substantial under/over recoveries year on year. Historically these have been reconciled via the PSO levy process. Rules should be defined and agreed between NIAUR and market participants as to the value of the adjustment sought via the PSO process, and the allocation across those customers supplied by the PES v's those supplied by second tier suppliers.

- **Directed Contracts:** it is inappropriate for NIE to reapply the regulated tariff for customers returning to NIE. These customers will not be hedged off under the existing Directed Contracts purchased by NIE, and are effectively being cross-subsidised at the expense of the losing supplier. These customers should be exposed to SEM prices and managed on a fully competitive market basis.

In the short to medium term, we recommend:

- **Independent Gas Meter Reading Services**: it is perverse that, competing suppliers must rely upon the incumbent gas supplier for these services. Going forward, a tendered independent service could provide the platform for greater efficiencies and a future competitive data meter reading service, potentially also embracing future smart meter data services. As an interim step, NIAUR should consider transferring responsibility and execution of these services to Phoenix Natural Gas Networks (within the ring fenced arrangements).

Taken collectively, along with other incumbent benefits (e.g. brand strength, significantly greater industry resources to deal with conflicts of interest, and operational advantages that allow them to exploit industry processes and technologies), it is not hard to see why smaller suppliers and new entrants find it difficult to get a foot hold in the market.

NIAUR needs to tackle this in a manner that redresses this market imbalance, if necessary by deliberately shifting the emphasis towards the smaller supplier.

<u>Dual Fuel</u>

Experience from GB demonstrates how this can spear head competition, especially for the domestic sector - Dual Fuel represents 33% of the total energy market, and almost two thirds of the potential Dual Fuel market for GB domestic customers. However, the differing evolution of the electricity and gas markets in Northern Ireland, present particular challenges for the effective development of a Dual Fuel market.

Any measures that serve to restrict this market still further should be avoided. For example, the future tendering of connections and supply franchises to particular towns should not be allowed.

The franchise already in place for Firmus Energy (a wholly owned subsidiary of Bord Gáis Éireann), potentially denies competition to approximately 20% of the available gas market in Northern Ireland at any one time. Whilst this is for a limited period and subject to connection rates, it nonetheless frustrates the development of dual fuel market proposition.

Dual Fuel also requires a harmonised regulatory market strategy. NIAUR needs to develop a better appreciation of how a change in one market, may have unintended consequences in the other. As a matter of course, NIAUR should proceed with a twin competition strategy, i.e. recognising the co-dependency of the electricity and gas wholesale and retail markets.

Whilst harmonisation of industry codes and processes should not be a goal for their own sake, alignment in some areas may reduce costs for suppliers and help facilitate a dual fuel market. We are therefore pleased to note this will be considered within the All Island Programme for gas.

Improved market transparency will also assist suppliers to effectively tailor and target their energy product offers. NIAUR could introduce detailed retail market monitoring for both electricity and gas, much along the same lines as occurs in other countries such as Australia and GB. It could also arrange for the release of customer class profile data, enabling new suppliers to develop Dual Fuel customer propositions more aligned to a customer's actual energy usage. We have recently written to the Commission for Ireland with a proposal, and would be happy to share this with NIAUR.

<u>All Island Programme</u>

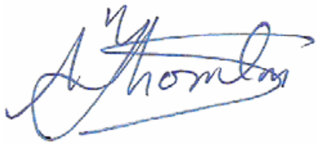
The All Island Programme is a tremendous achievement, and VPE does not underestimate the significant commitment required of both NIAUR and the Commission. However, we believe there are significant opportunities to be had, by increasing the engagement on island wide energy issues. For example:

- Ensure the SEM review delivers material improvements in order to resolve the emergent issues and improve its governance.
- Undertaking regulatory measures that maximise the available electricity and gas customer base on which new entrants can compete, e.g. harmonised retail customer transfer processes that are sufficiently robust to cater for volume transfers.
- Implementing an Island wide energy efficiency supplier incentive model.
- Securing an all island approach to smart metering, such as common standards and protocols.

As you will observe, there are a wide range of underlying market issues. Taken collectively, they have the potential to provide a strong basis on which new and small suppliers can effectively engage head-to-head with the incumbents. However, first it requires recognition that small suppliers need additional help, supported by tailored measures that 'kick start' the development of competition.

Please do not hesitate to contact us if you wish us to expand on any of the issues we have raised in this response, or if you require further information in support of retail competition.

Yours sincerely



Tony Thornton

Consultant – Energy Regulation
(on behalf of VPE/Energia)

CC: Gareth Davies (Poyry)

## ANNEX B

### Main Questions

**Q1: (Ch 3) Do respondents agree with our overall summary of NI energy retail market competitiveness and do you feel we have missed anything of significance that should have been noted at this stage?**

***VPE Response:*** *we agree that NIAUR has provided a good overall summary of the NI energy retail market - as it stands today.*

**Q2: (Ch 3) Are there additional indicators of the current state of competition in the retail markets that we should be considering?**

***VPE Response:*** *the consultation does not specifically spell out the competition 'indicators' being relied upon by NIAUR - this makes it difficult for VPE to comment. However, if we make a distinction between the comments made in the consultation that reflect on the current state of competition, and the indicators that will deliver sustainable and effective retail competition, we suggest the following should be considered:*

- *The degree of effective market information and market transparency.*
- *To what extent can any companies leverage their scale?*
- *Are the supporting competitive market processes and services truly independent and are they anticipating future market requirements?*
- *How much market share by volume and number has been lost by the incumbent?*
- *How many customers are exercising choice through switching?*
- *What innovation has there been?*
- *Do prices reflect a reasonable rate of return?*

**Q3: (Ch 4) Do respondents agree that the analysis has identified the major potential barriers to competition in the domestic and non-domestic electricity markets or are there additional barriers that you feel we should take into consideration?**

***VPE Response:*** *broadly we agree with the analysis, however we do not believe that NIAUR has fully taken account of the interplay between electricity and gas retail competition, i.e. driving gas retail competition will help deliver improvements to electricity retail competition (and vice versa).*

**Q4 (Ch 4) Do respondents agree that the analysis has identified the major potential barriers to competition in the domestic and non-domestic gas markets or are there additional barriers that you feel we should take into consideration?**

***VPE Response:*** *NIAUR has identified a number of the key issues. However, until there is a common regulatory push to secure competition across both electricity <u>and</u> gas, competition will be slow to develop, particularly for the SME and domestic market. The following additional barriers should be considered:*

- <u>NIAUR's primary duties</u>: these are different for electricity (to promote) and gas (to facilitate). The successful launch of a sustainable retail competition model must be predicated on an integrated policy approach (e.g. Dual Fuel). Unless NIAUR's principal duties are better struck for gas, we believe the gas market will continue to play 'second cousin' to the electricity market, and the required reform measures will struggle to flow.

- <u>Market Size:</u> NIAUR should focus on measures that expand, not restrict, the available retail market for new entrants. For example, the franchise arrangement has the effect of reinforcing vertically integrated incumbents, whilst limiting the number of customers that might avail of dual fuel offerings from competing independent suppliers.

- <u>Independent Gas TSO/DSO:</u> for electricity, the SONI example is an excellent basis on which to secure a truly independent TSO/DSO arrangement. There is no logical reason for not carrying the same through for gas. Indeed, we believe this would materially help support an island wide approach and help deliver optimal transmission tariff arrangements that meet competitive market requirements.

**Q5 (Ch 5) Have we missed anything important in relation to the potential actions – are there additional regulatory actions that the Utility Regulator should consider beyond those described above?**

*VPE Response: we do not believe NIAUR has fully considered the potential benefits that will flow from the all-island market reforms, or the benefit of leveraging gas competition to secure a Dual Fuel market push**.** Nor does it look at ways that will maximise the available market for new entrants, i.e. the impact of the franchise model.*

**Q6 (Ch 5) Do you agree with the initial assessment of the impacts of the proposed regulatory actions on the electricity and gas retail markets? Do you think we have materially mis-estimated potential impacts?**

***VPE Response****: it is difficult to assess the summary assessment without having access to the specific inputs. That said, the 'effects of market structures' seem to have been understated when compared to other regulatory impacts. These market structures include not only brand and scale, but also the effects of price controls and impact on margins – see main letter.*

**Q7 (Ch 6) Do respondents agree with our analysis above in relation to scenarios and their interplay with options, and our proposed actions?**

***VPE Response:*** *NIAUR should not try to predict what type of 'competition model' may evolve. It is for government and regulators to strive to reduce competition barriers, and then let the market drive the solutions. These barriers will include:*

- *Restrictions on effective market information and market transparency.*
- *Market size restrictions brought about by franchise arrangements in gas.*
- *Companies that can leverage their inherited scale, market position and brand.*
- *Supporting competitive market processes and services that are not yet truly independent.*
- *Incumbents with a reduced market risk advantage, due to their extensive customer portfolio.*
- *Regulated tariffs that do not reflect a reasonable rate of return for a sustainable energy market (margin squeeze).*
- *Additional costs for new entrants and smaller suppliers when trying to compete with incumbents.*

*With regard the listed actions, the electricity proposals should include a full roll out of the 'K' factor reduction, whereas for gas they should include (as a minimum):*

- *Implement a wholly independent TSO/DSO model, legally distinct from Phoenix Natural Gas Networks.*
- *Further improvements to the gas balancing charge regime.*
- *Restricting PNGS products, for example customer products to avoid customer 'lock ins' through 90 termination periods and contract terms that do not exceed 12 months*
- *Independent gas meter reading services, PNGS secures commercial and operational advantage from these services being integrated within its own business model*
- *Improvements to data availability and transparency.*

- *Full cost pass through and a removal of K factor.*
- *Price control transparency comparable with electricity.*