taking natural gas further
firmus energy

16 July 2008

Elena Ardines
Strategy branch
Utility Regulator
Queen's House
14 Queen Street
Belfast
BT1 6ER

Dear Elena

Thank you for providing firmus energy with this opportunity to respond to the "Electricity and Gas retail competition in Northern Ireland" consultation document.

Having recently entered the Belfast supply market, and given our longer term strategy to market a dual fuel offer across Northern Ireland, we are pleased to provide an insight into what we believe are the hurdles to retail competition in Northern Ireland.

Leveraging off our experiences to date, we have provided a frank view of what we believe needs to happen to encourage supply market competition in both gas and electricity.

You can contact me direct on 9442 7840, should you wish to discuss this response in detail.

Yours sincerely

Michael

Michael Scott
Business Development Manager

Context:

firmus energy was awarded a conveyance and supply licence for 10 towns outside Greater Belfast and operates under a franchise for 5 years (IC) and 8 years (residential) under a no profit, no loss arrangement during exclusivity. To date over 320 km have been laid and gas is available to 9 of the 10 towns. This is in line with our overall business plan targets.

firmus energy's focus is on 4 specific customers groups. These include large industrial and commercial customers (IC), small IC, new build housing and the housing executive public sector estates. firmus energy also markets natural gas to owner-occupier residences along the existing gas mains and our regulatory model anticipates over 60,000 customer connections by 2035.

In December 2007, after a protracted process, firmus energy entered the Greater Belfast competitive gas supply market, contracting with Allied Bakeries who became our first Belfast industrial and commercial gas customer.

firmus energy's ambition is to compete fully in the Greater Belfast gas market both in terms of industrial and commercial users and ultimately domestic customers. Additionally, firmus energy is interested in exploring options around a competitive dual fuel offering (gas and electricity) in the medium term.

Against this background firmus energy would welcome any proposals that would help to reinvigorate an economic and co-ordinated gas roll-out to new areas and existing distribution and supply areas and encourage increased competition in retail electricity. We believe that there are a number of ways of doing this, including:

- actively addressing issues over data availability and transparency. *This in fact was one of the key points we made when we met with Poyry, the Utility Regulator's consultants.*

- a review on the mechanisms by which the Utility Regulatory can address the specific and sometimes complex issues surrounding the barriers to open competition.

- retail market synchronisation – as part of an All-island energy company, we believe that it is imperative that coordination happens particularly across the island to ensure that opportunities for economies of scale are realised, for the benefit of customers.

- improved transparency over the tariff make-up and transparency associated with both Phoenix's and NIE's price controls, both in terms of supply and distribution. As a new competitive supplier in both the gas and electricity markets in Northern Ireland, we would argue that increased transparency in both the network costs associated with serving customers and the costs associated with the incumbent gas and electricity supply companies is imperative if economic competition is to flourish.

- We would welcome an approach by the Utility Regulator that would encourage market opening to consumers and new entrants alike. We have outlined our thoughts on how this could be delivered as part of this consultation response.

Q1. (ch3) 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?

Natural gas:
In principle, the Greater Belfast gas market is fully open to supply competition. However, there are a number of significant issues that we feel need to be reviewed before the benefits of full and effective competition can become a reality for both business and domestic consumers.

Having only switched one large IC customer, we recognise that our experience cannot be viewed as exhaustive. However, our experience has highlighted a number of critical areas that do not appear to promote or facilitate effective competition. These issues are documented below as part of Question 4.

firmus energy agrees that there are high risks and associated costs for new suppliers entering the Greater Belfast supply market. This can be due to a number of factors, not least the scope and size of the incumbents business verses the other gas suppliers and the fact that the incumbent has the potential to offer “loss leader” prices. Additionally, it must be recognised that, given the existing size of the Greater Belfast gas supply market (over 100m therms p.a.), the net rewards for a successful new entrant targeting, for example, a 30% share of the market are minimal. New entrants must be cognisant of the customer service offer possible given the potential returns from customer acquisition.

We feel that the Utility Regulator should determine what role it plans to play in proactively addressing and overcoming each of the detailed issues which are necessary to be addressed if new suppliers can compete on a level playing field with the incumbent supply company. Only by addressing these issues will suppliers want to actively participate in the market, ensuring choice for consumers.

firmus energy is of the opinion that whilst the Greater Belfast gas market and the retail electricity market are technically open for competition, little competitive pressures are evident. Whilst firmus energy are not supportive of a regulated tariff formulae for IC gas per se within Greater Belfast, new suppliers must have confidence that they are competing on a level basis with the incumbent. We have concerns that the incumbent could freely use their existing, diverse customer base to artificially price discount – whether on NBP price or their supply costs - on specific contract renewals to keep new suppliers out of the market.

firmus energy would welcome discussions with the Utility Regulator on how **all** suppliers can continue to offer best prices to customers on a level playing field of competition.

<u>Electricity:</u>
Clearly there is a high degree of switching which has occurred between the incumbent and the new supply entrants in the large IC sector and whilst this is encouraging, the fact that the majority of small IC consumers have remained with NIE energy may point to competitive issues in this sector.

Indeed high level discussions between firmus energy and their existing large IC gas customers highlights a perceived lack of real choice in terms of contract and supplier options in electricity.

In developing our thinking around a future dual-fuel offer across gas and electricity, firmus energy has a number of concerns which could hamper efforts to economically enter the electricity market. These include:

1. <u>Regulated supply margin of 1.8%</u>
   Given the lack of headroom between the NIE Energy tariff and the potential cost of supply for a new market entrant, the regulated supply margin of 1.8% may preclude new suppliers from entering the market. Established customer market research would indicate that the key to customer switching will be on price and this will prove economically difficult to achieve given NIE Energy's low allowable supply margin.

2. <u>NIE direct debit discount</u>
   At present NIE Energy offer 4% discount for customers who move to direct debit. firmus energy is not aware as to the quantification of this discount by the incumbent and would challenge the appropriateness of this level of discount. Indeed, in its current form, this discount is a simple way for the incumbent to keep other suppliers out of the market as new suppliers would need to offer a discount of *at least* 4% on NIE Energy's published tariffs to encourage switching.

3. <u>Supplier obligation to fit ½ hourly meters</u>
   Given the margin available to new suppliers, firmus energy believes that the requirement of new entrants (or their customers) to fit a ½ hourly meter at a cost of circa £295 is a barrier to competition. In many instances, the costs of fitting a new meter cannot be recovered over the lifetime of the supply contract (typically 12 months).

   Given the new meter responsibilities of the NIE T&D division, we would argue that meters are a network asset and as such should be available for all customers free of charge to help facilitate competition. Again, the consolidation of all metering with the network company would also encourage technological developments in smart metering for the benefit of all users in the longer term.

4. <u>Transparency of PSO, SSS and UoS charges</u>
   Through the experience of our parent company, firmus energy is aware as to the potential for unexpected / unexplained changes to PSO, PSS and UoS charges to dramatically effect the economics of contracting with customers

Improved transparency in both the consultation around UoS etc. charges and the timeliness of their introduction is paramount if suppliers are able to compete profitably in the electricity market. firmus energy welcomes the opportunity to discuss further with the Utility Regulator on our views as to how transparency can be improved.

Q2. (ch3) Are there additional indicators of the current state of competition in the retail markets that we should be considering?

firmus energy considers that the relatively few numbers of IC customers who have switched suppliers in gas to be reflective of the reality of the lack of competition within the market. The reasons we believe can be defined by a number of key issues:

- the potential for the incumbent supplier to price discount on specific contracts to retain customers
- the potential for the incumbent supplier to offer (previously unavailable) flexible contracts for customers, replicating new entrant contracting options

firmus energy is concerned that the perceived lack of competition within the Greater Belfast market may have driven IC users back to using fuel oil (as indicated in the Utility Regulators paper) and resulted in the overall reduction in consumption in this sector of 27% by volume between 2006 and 2007.

Q3. (ch4) 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?

firmus energy believes that the Utility Regulator has correctly identified a number of the key high-level barriers to competition in the electricity market.

Q4. (ch4) 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?

As indicated in our response to question1, firmus energy has identified a number of specific barriers to equitable competition in the Greater Belfast area. These are listed below.

Additionally, firmus would concur with the Utility Regulator that the allowed margin of 1.5% for the incumbent supplier may not be significantly attractive enough for new entrants to compete for business, particularly given the costs and risks associated for gas purchasing in the small IC and domestic sector. This is not withstanding the regulatory ‘safety net’ offered to the incumbent in relation to the k factor and the ability to recover gas purchasing costs at times of market volatility.

firmus energy would also like to comment on the GMOG and its usefulness in removing any technical barriers to competition. firmus energy would question whether the GMOG process has ensured that the necessary processes were put in place to facilitate full gas market opening as commented in the consultation paper. firmus energy considers that GMOG has been a useful forum for new entrants to raise issues. However, we feel GMOG requires strong chairmanship coupled to an agreed terms of reference that ensures that the high level barriers to entry, as outlined below, are tacked, addressed and resolved promptly.

firmus energy learnings on customer switching in Greater Belfast

Access to Customer data

- firmus energy have experienced a number of issues relating to accurate customer information in relation to consumption profiles, AQ's etc. upon which to develop appropriate, competitive customer offers. We remain concerned as to the accuracy of the information provided by the network operator and would welcome discussions on how this can be improved upon.
- firmus energy's view is that this information should be held centrally, by the distribution company, and accessed remotely by customers or potential new suppliers through web access or similar (i.e. without direct request to the incumbent).

Publication of Conveyance Charges

- The delay in publishing a full years conveyance charges has proven impossible to make definitive, fixed price offers to customers upon which they can accurately budget. It is unfortunate that only charges from 1st January – 31st March 2008 were previously published.

Application of Conveyance Charges

- We feel that it would leave less scope for ambiguity if worked examples were provided along with the conveyance charge statement.
- firmus energy also had particular difficulty establishing how peak day capacity was defined in the Distribution Network Code.
- All of these issues reduce customer confidence on any new supplier entering the market.

Publication and Application of Transmission Charges

- firmus energy is of the view that it would be easier for suppliers if transmission and distribution charges were harmonised in terms of publication dates.
- It is not clear how the reconciliation of postalised capacity charges should be handled; for example, can a supplier refund or charge customers that have switched to another supplier?
- Under the current regime, Phoenix Distribution charge postalised capacity on a commodity throughput basis to suppliers regardless of customer type. firmus energy is concerned that this could encourage price discrimination across customer types.

Distribution Network Code Modifications

- It would be useful if Phoenix Distribution published past and ongoing Code Mod proposals, consistent with PTL.
- This would aid clarity for new suppliers and ensure that accurate costing models for market participation can be prepared.

Customer Switching Process

- Timescales and deadlines still remain uncertain. We feel that the ability for the incumbent supplier to object to a customer switching supplier up to D-8 is unsatisfactory as this potentially exposes the new supplier to being left long on gas. Any objection should be dealt with at the SMP confirmation stage.
- In any case, the currently proposed 90 day switching process does little to encourage customers to switch between suppliers and adds significant risk to the new supplier in terms of backing-out or hedging their gas purchasing commitments on behalf of the new customer.

Competition in Practice

Billing:

– (Section K1.15), There is only an obligation on the part of Phoenix Distribution to "submit invoice documents as soon as reasonably practicable after the billing period to which they relate". This is wholly inadequate for the purposes of timely customer billing by new suppliers and has consequences on the customer service offered by those same supply companies.

Meter Reads:

– Actual meter reads are being taken every month by firmus energy and billing done on this basis because of ambiguity/uncertainty regarding telemetry reads from the network operator. Whilst firmus energy have their own specific capabilities with regard to meter reading given our own requirement in the 10 towns, we recognise that meter reading costs (based on the larger numbers undertaken by the incumbent) could be a disadvantage to a new supply entrant.
– firmus energy is of the view that meter reading services should be a regulated activity, undertaken by the network operator, and offered to all suppliers on a non-discriminatory basis. This approach is consistent with that in electricity in NI (via NIE T&D) and gas in RoI (via BG Networks).
– This would however need to be done on a regular enough basis to allow each supplier to facilitate their own specific frequency of billing runs, e.g. in RoI BG Networks currently reads domestic meters 6 times per annum, with suppliers free thereafter to bill in accordance with the needs of its customers.
– Allocation of meter reading activities to network operators would also allow for the economic investment in smart metering services which could benefit all gas (and electricity) users.

Calculation of Shrinkage:

- Shrinkage is published by PNG Distribution as a % of a shippers' off-take nomination that is added to delivery nominations each day. In other words, if a shipper nominates 1,000 therms for a customer Phoenix then issue a Delivery nomination of 1,060 therms (based on current shrinkage rate of 0.6%). The shrinkage quantity applicable to our final nomination (or re-nomination) is the additional gas we must deliver to the Phoenix distribution system.
- There is no reconciliation of shrinkage based on allocations. Shrinkage is therefore an additional unknown cost.

Provision of Calorific Values**:**

- CV's only made available on D+7. This is wholly unsatisfactory for the purposes of monthly customer billing and needs to be addressed.
- Again firmus energy has had to implement a 'work around', using BGE Transportation to provide CV data on D+1.

Within-Day telemetry updates:

- firmus energy has requested this as a service from the network operator but this has been denied as there is no obligation to provide under Network Code.
- firmus energy would welcome a situation where data transparency can be provided in order that an improved service to customers by supply entrants can be facilitated.

Q5. (ch5) Have we missed anything important in relation to potential actions – are there additional regulatory actions that the Utility Regulator should consider beyond those described above?

We note on page 29 of the consultation that "…the paper does note some of the detailed technical and operational issues raised during the consultations between Poyry and gas industry participants as they are relevant to this overall strategy paper, we consider that the full detail and possible solutions will be explored in the forthcoming GMOG work rather than at this stage"

We are unsure whether GMOG is the correct forum to progress supply competition. firmus energy has noted a number of points regarding this section of the consultation;

<u>Chairman ship and decision making</u>

It appears that the consultation suggests that GMOG will help to deliver supply competition. In order for this to happen, firmus energy believes that GMOG needs;

(a) strong chairmanship by the Utility Regulator
(b) agreed terms of reference
(c) powers to ensure incumbents duties are discharged
(d) to ensure new supplier issues are both raised and addressed to prevent and avoid market dominance by the incumbent

<u>Role of the incumbent</u>

firmus energy has been concerned that, at times, issues raised have been attempted to be addressed by the incumbent *supplier* rather than the network operator. By their very nature, the majority of new supplier issues will be around network code, meter point data etc. and we continue to be concerned about the nature of separation or otherwise between GMOG participants from the incumbent supply and Network Company.

Role of the suppliers
firmus energy is concerned at the implications of the proposed working of the GMOG (as set out by the Utility Regulator) relating to the requirements for suppliers to put forward code modifications which can be "determined on" by the Regulator. Given the costs vs. rewards of entering the competitive market, we are concerned as to the time and resources required for individual suppliers to 'fix' the issues associated with competition.

Q6. (ch5) Do you agree with the initial assessment of the impact of the proposed regulatory actions on the electricity and gas retail markets? Do you think we have materially mis-estimated potential impacts?

As part of the initial consultation by *Poyry*, the Utility Regulator's consultants, firmus energy suggested that they meet with Allied Bakeries to understand the switching process from a customer's point of view.

As we understand it, Allied Bakeries were not contacted as part of the process but have asked for a meeting with the Utility Regulator to debate the issues that it experienced as part of the process. firmus energy believes that this could provide important learnings as part of the overall consultation process.

Q7. (ch6) Do respondents agree with our analysis above in relation to scenarios and their interplay with options and with our proposed actions?

firmus energy believes that there needs to be much more clarity around the change of suppler switching process and we would feel that the Utility Regulator should take a lead role in implementing changes to this process as outlined in our response to Q4 above.