FLOGAS RESPONSE TO UTILITY REGULATOR CONSULTATION ENTITLED

'ELECTRICITY AND GAS RETAIL SUPPLY PRICE CONTROLS 2017 (SPC 17)'

UR APPROACH CONSULTATION OCTOBER 2015

Response date: 8th December 2015

Flogas Natural gas is currently active in the Industrial and Commercial natural gas markets in both the Greater Belfast and Ten Towns distribution zones. Flogas is not active in the residential gas market nor the electricity sector. Our comments are therefore restricted to the Gas sector except to the extent that an Electricity market issue has parallel significance in the gas market.

Q1. Do respondents agree that where this consultation has an impact on the groups listed, those impacts are likely to be positive in relation to equality of opportunity for energy consumers?

We support the Utility Regulator in meeting its obligations under Section 75 of the Northern Ireland Act 1998.While we consider that this consultation will have limited impact on the groups listed we do believe that any impact will be positive in relation to equality of opportunity for energy consumers. The increase in competition in the market place with new entrants having recently entered the market is a positive trend.

Q2. Do respondents consider that the approach needs to be refined in any way to meet the equality provisions? If so, why and how? Please provide supporting information and evidence.

We have no reason to believe that the approach adopted by the Regulator needs to be changed.

Q4. Do respondents consider that the proposed review of the gas supply licences are appropriate? If not, please explain your reasons.

We believe that the general structure of the price control mechanism is appropriate. We agree that it makes sense to introduce a licence modification to include the price control mechanism within the licence.

Q6. Do respondents agree with the UR proposal to review price regulation in the 73,200kWh to 732,000kWh (EUC 2) sector of the market? Please provide suitable evidence, including legal opinion if applicable, as to why price regulation should or should not remain in this sector.

At present there is a high level of competition within the Industrial and Commercial market within the Greater Belfast area. Under the current Retail Market Monitoring framework small Industrial and Commercial customers using less than 73,200 kWh per annum (EUC 1 customers) are included with residential customers for reporting purposes. This makes it extremely difficult to determine the level of competition and switching within this commercial sector. In contrast all commercial customers are reported separately in respect of the Ten Towns area. The relevant information in respect of the Greater Belfast Area is available to the Network Operator and should now be published by the UR. We now formally call on the UR to make this information available and correct the anomaly.

In relation to I&C customers using more than 73,200 kWh and less than 732,000 kWh (commonly known as EUC 2 customers) the following market characteristics apply:

- There are six suppliers active in the sector
- No one supplier is dominant (one supplier has a circa 40% market share)
- Significant price competition exists
- The annual switching level is in excess of 15%

It is clear from the above the commercial customers do have the opportunity of taking gas from a range of gas suppliers and their interest is safeguarded by the competitive nature of the market place.

Having regard to the above it is clear that it will be appropriate to remove price regulation in the EUC 2 sector on the 31 march 2017. The same may apply to the EUC 1 sector but it is not possible to form a judgment until the relevant market data is published.

Q7. Do respondents agree that it is reasonable to retain the scope of the price control for firmus at the under 732,000kWh sector of the market?

The Industrial and Commercial market is respect of customers using less than 732,000 kWh has only recently been opened to competition. The incumbent supplier still retains a market share of in excess of 85%. We support the Regulators assessment that it makes sense to retain the scope of the price control in respect of this market sector.

Q8. Do respondents feel that a duration of three years for the next price controls for electricity and gas is appropriate?

We do not agree that three years is the appropriate period for the next review of price controls for the Industrial and Commercial sector (customers using less than 732,000 kwh per annum)in the Greater Belfast area.

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Having regard to the above it is clear that it will be appropriate to remove price regulation in the EUC 2 sector on the 31 march 2017. The same may apply to the EUC 1 sector but it is not possible to form a judgment until the relevant market data is published.

In respect of the appropriate period for the next review of price controls for commercial gas in the Ten Towns distribution zone we would recommend a review on the 31 March 2018.

Q11. Do respondents consider the approach outlined for assessing the treatment of costs for the gas supply companies appropriate? If not please explain what approach you do consider to be appropriate and the reasons why.

We agree with the mechanism whereby wholesale gas costs and transportation costs are treated on a 'pass through basis'. In relation to Supply Operating costs we believe that all of the actual costs incurred (or current best estimate of same) in operating the retail business should be allowed. In our experience it is incorrect to presume that some of the costs incurred are somehow magically avoidable. There is a danger in seeking to disallow validly incurred costs. If genuine operating costs are excluded then it becomes impossible for new market entrants to compete. There is evidence in the market of new market entrants being subsequently forced to withdraw from the market as the businesses could not be rendered financially viable. This is of course counter to consumers longer term interests, and creates a general negative sentiment in the market.

In determining the allowed Revenue under the control formula it is important that the volume assumptions are realistic. In general customer usage is falling due to improved energy efficiency. Volume predictions (and hence tariffs) should allow for these volume trends.

Q13. What are respondents’ views on the proposed approach to establishing a margin for the gas supply companies?

It is our considered view that the current allowed margin on gas of 1.5% is too low and does not reflect the investment and commercial risk involved in the business. In our experience and having reviewed margins in other jurisdictions the minimum margin needed to sustain a retail gas business and provide resources for future growth is 2.5%. Insistence on inadequate margins runs the very real risk of forcing new market entrants out of the business after having invested in marketing and switching campaigns. In order to offer customers real choice and innovative products a reasonable margin % is required. It should be appreciated that new market entrants face many costs and risks in establishing and running their businesses. It is in consumer’s interests that a healthy number of competitors are retained in the market place.