Supplier of Last Resort (Electricity)

Consultation on dealing with customer credit balances

June 2017

Phoenix Natural Gas Limited ("**PNGL**") welcomes the opportunity to respond to the consultation issued by the Utility Regulator ("**UR**") on dealing with customer credit balances ("**the Consultation**") in a Supplier of Last Resort ("**SoLR**") event in the electricity market.

Although the Consultation focusses on electricity, we note that the decisions for electricity may influence decisions with regard to the process in a gas SoLR event, in particular:

- UR consider that the most fair approach, which will ensure consumers are protected, is to provide full recompense to <u>all</u> domestic customers i.e. keypad customers and non-keypad credit customers with outstanding credit balances and deposits; and

- UR consider the most appropriate funding for this approach would be to adopt the hybrid method of cost recovery, where the SoLR would cover a proportion of the credit balances costs and the remainder would be recovered via a regulatory levy paid for by all other domestic electricity customers. This would be collected by the network company most likely via use of system or PSO tariffs.

As a Gas Distribution Network operator ("**GDN**"), PNGL is not best placed to comment on the options presented by UR in the Consultation to deal with customer credit balances and deposits in electricity. However PNGL believe it important to state from the outset that UR's proposed decision for electricity cannot simply be transposed for gas. This response aims to set out why PNGL believe this to be case.

The current agreed coverage of protection for gas consumers in a SoLR event is similar to the current approach for electricity and foresees the protection of consumers with PAYG credit balances only in a gas SoLR event. If UR determines that it would be more balanced to protect <u>all</u> domestic consumers with a decision based on replication of the proposals for the electricity sector in gas, UR must firstly review the level of credit balances and deposits currently held by gas suppliers in Northern Ireland. Although some indication is given based on Ofgem estimates and the Open Electric event, an assessment must be undertaken before UR can make an informed decision for gas. A critical part of this assessment must be the relative impact on the natural gas market given the continued roll-out of the network and the ultimate customer base compared to GB and to the Northern Ireland electricity market e.g. the protection of credit balances and deposits in a SoLR event may have a more significant impact on domestic consumers, the sector targeted to realise significant growth.

It must also be recognised that the gas SoLR cost recovery process is fundamentally different. Notably there is no distribution use of system ("**DUoS**") or PSO mechanisms for gas like there is for electricity which would allow the relevant GDN to collect the costs recouped by the SoLR on a targeted and timely basis.

UR has attempted to address this imbalance by including a ring-fenced monetary sum in its GD17 Final Determination. However this amount did not anticipate providing full recompense to all domestic customers in a SoLR event. Expanding the coverage of protection would make it more likely that the costs to be recouped would significantly exceed the costs allowed upfront in the GD17 price control. Although any variance would be allowed for at the start of the next GDN price control period in 2023, GDNs are more exposed to short-term cashflows than their electricity counterpart who, we understand, can immediately utilise a PSO mechanism to recover costs. UR has said that it would consider interim measures if the GDN can demonstrate that waiting for such an adjustment would be inappropriate, however GDNs could gain comfort if the arrangements relating to the recovery of SoLR costs were agreed in advance and allowed GDNs, like their electricity counterpart, to recoup the costs from suppliers, and hence <u>all</u> gas consumers, in a more timely manner.

In terms of electricity, the regulatory levies allow for the recovery of costs from a particular tenure (i.e. from domestic or from industrial and commercial consumers) and UR considers it appropriate that the costs of an electricity SoLR event are recovered via domestic consumers only e.g. via the domestic DUoS charges. There is no equivalent regulatory levy for gas. In fact as gas distribution tariffs are set based on end user category (i.e. on annual consumption rather than tenure), there is no methodology which would allow GDNs to recoup the costs of the SoLR event from domestic consumers only. UR's agreed approach for gas anticipates the relevant GDN recouping the costs of the SoLR event from <u>all</u> gas consumers.

The Consultation also makes reference to cost recovery arrangements in other industries. Relevant precedent should always be a consideration however the fundamental difference between the energy industry and the other industries cited in the Consultation e.g. the motor and travel industries, is that these industries have an ongoing collection of funds to manage failed supplier events. This approach has a number of merits as it smooths the recovery of costs in a SoLR event and ensures that the failed supplier has contributed to an element of the costs of the SoLR event.

The key to delivering UR's proposal to provide full recompense to <u>all</u> domestic consumers is the need for accurate account balance information to be provided by the failing supplier. We note that UR will take all possible measures to secure this customer account data but there is no indication as to what would happen if the supplier simply exited the market without notice and the customer account data for the SoLR was not made available.

We note the assumption that the SoLR will receive some reward from the increased customer base and therefore UR considers the hybrid method of cost recovery appropriate for the electricity industry. It is our understanding that this hybrid approach has already been adopted in part by UR when considering the ring-fenced monetary sum for gas and therefore it seems appropriate to extend this approach to all credit balance and deposits costs.

Ofgem's approach to a SoLR event differs from UR's in that it asks suppliers to indicate willingness to act as a SoLR. We note UR's opinion that it is in the best interests of consumers that a nominated SoLR is in situ to ensure protection in the event of a supplier failure. This allows UR to have approved procedures and limited IT system development for managing a SoLR event in advance and is the approach adopted for both electricity and gas - Power NI being the nominated SoLR for electricity and the incumbent supplier in each Licensed Area being the nominated SoLR for gas. This approach was considered appropriate for gas as it properly assesses the risk of a SoLR event versus the cost of delivering an appropriate solution. UR indicates that it will consider a further process to give other suppliers the opportunity to compete for the position of electricity SoLR in the future. Any similar consideration for gas would need to assess the level of industry development, and in particular to GDNs systems, to facilitate such a competitive process.

In the example given whereby the customer is in the process of switching away from the failed supplier, UR has concluded that any credit balances or deposits would not be honoured as it would be extremely difficult to administrate the requirements. Although this seems a sensible approach to PNGL, there will be instances where the new chosen gas supplier and the SoLR will be the same entity and therefore we would imagine that these customers could be protected.

PNGL note the Law Commission's recommendation to give preferential status to a limited category of consumer, including those of an insolvent energy company, in the event of retailer insolvency. PNGL would therefore question whether it would be more appropriate to await the outcome of this workstream to determine whether consumers with account credit balances can simply be reimbursed via the failed supplier.

Given the potential implications for the natural gas industry, we welcome continued engagement with UR and the natural gas industry to ensure that the gas SoLR process allows the seamless transfer of consumers to the nominated SoLR, strengthens customer confidence in the competitive market and provides appropriate and timely cost recovery processes for GDNs.