

**Energy Retail Competition Work Programme Consultation
Phoenix Natural Gas Response
29th June 2009**

Phoenix Natural Gas Limited (PNG) welcomes the opportunity to comment on the Utility Regulator's (UReg's) Energy Retail Competition Work Programme consultation paper.

Detailed below are PNG's general comments on the consultation paper. The specific questions posed by UReg are answered by PNG in the second section of this response.

PNG is supportive of the objective to provide consumers with choice and that they should be able, if they so wish, to effectively switch to a new Supplier. We would however state that competition should only be encouraged if it will be effective, cost beneficial to the consumer and considered appropriate and not simply to ensure compliance with legislation. We therefore disagree in part with the original suggestion in the executive summary that the question of whether retail competition is the right goal for Northern Ireland is to be ignored with the focus primarily on how we promote retail competition. It is imperative that competition within the gas and electricity markets is encouraged and developed if it is ultimately going to achieve benefits for Northern Ireland consumers and not delivered at any cost. As paragraph 25 points out, the appetite to switch may be based on a view held by consumers that competition will deliver lower prices and therefore any agreed approach on retail competition must ultimately achieve this.

As the consultation paper has indicated 'few autonomous energy jurisdictions in the world are as small as Northern Ireland' and we strongly believe that any proposals must consider the ultimate size of the Northern Ireland market and the level of competition that it could support. We would argue that up until now strong regulation has worked effectively in the gas market in the absence of actual supplier competition in the domestic and smaller commercial sectors and the question could be asked by some as to why this approach would not work going forward in achieving the desired effect for the Northern Ireland consumer.

In relation to the development of switching systems for Northern Ireland's electricity market, PNG note the considerable amount of costs associated with the introduction of switching systems and in particular the £24m spent delivering a system for the domestic sector which has yet to be utilised. We also note that this system requires further work to remove the limitations on the number of switches it can handle.

Suppliers operating in Belfast have now indicated a 'willingness to enter' the domestic market in Greater Belfast and we would ask if this is now sufficient

for UReg to authorise the development of a customer switching system for the PNG network. PNG understands the need to co-ordinate the development of new systems with the all island Common Arrangements for Gas (CAG) project but, as noted in a recent CAG Retail Strategy paper, it is envisaged that retail processes will not be aligned until 2015. We would therefore ask if it is appropriate to delay system development in the gas market for any further significant period of time if supply competition is to be realised across all sectors.

Furthermore PNG would ask for clarity on the use of the word 'suspicion' when referring to the manual systems it currently has in place. The current system, albeit manual, is fully transparent, completely compliant with the conditions set out in the PNG Distribution Network Code and has proven effective to date in dealing with the number of customers switches which have already taken place. PNG has always accepted that further automation of its switching system would be required when Supplier activity increased and in fact has been extremely proactive in this area having submitted a development proposal to UReg in November 2008. It is our understanding that the approval of this system by UReg will now only be given when the recent CAG project to review systems operated by both Bord Gáis and PNG is completed. At recent Gas Market Opening Group (GMOG) meetings new Suppliers in Belfast have indicated that the lack of automated systems is hindering their entrance in to the market and therefore every deferment on a decision on this project may be delaying the development of competition which UReg is attempting to deliver.

Given the ultimate size of the gas market in Greater Belfast, PNG has never envisaged developing or requiring a system similar to NIE's customer switching system for electricity in Northern Ireland or indeed Bord Gáis' system in the Republic of Ireland (RoI). As a result, the cost of the proposal which PNG has submitted is significantly lower than either of these systems but we believe will still manage the development of supply competition adequately. Based on the figures provided in this consultation paper and our understanding of development costs for Bord Gáis' new system, the cost per customer for each system is as follows:

- NIE: £53 per customer (*assumes current customer base of 790,000*)
- Bord Gáis: £43 per customer (*assumes development costs of €33m, a customer base of 650,000 and an exchange rate of £0.85 / €1*)

This compares to the PNG proposal which would cost in the region of £1 per customer or an approximate increase of 0.005pence to the current distribution charge for the domestic sector.

In addition PNG provided UReg with a proposal to automate the switching of Pay as You Go customers which would ultimately reduce the overall cost of the customer switching process. This proposal was also provided to UReg in November 2008 and again as yet no decision has been taken by UReg to

allow PNG to commence the implementation of the system and the associated processes.

As the paper references the limited amount of switching in the gas market we also felt it worthwhile to provide an update on the progress in this area:

To date 28 Supply Meter Points (SMP) have selected to switch Supplier equating to 6.3 million or 5.6% of the total current volume throughput. Approximately 46% of these SMPs are in the daily metered sector (annual consumption \geq 2.196m kWh) with 21% in the non daily metered industrial and commercial sector and 32% in the domestic sector.

Phoenix notes that in paragraph 17 on Consumer preferences, UReg advises that it receives 'frequent complaints' from business and household customers regarding the issue of limited or non-existing supply competition. PNG would be keen to understand the figures behind this in relation to gas. Our own records do not support this statement and we would welcome further discussion with UReg regarding this.

Whilst PNG is actively engaging with UReg and suppliers to ensure that natural gas competition can develop smoothly throughout its Licensed Area, the electricity and natural gas industries are at very different stages of development. The electricity network covers the whole of Northern Ireland with the natural gas network concentrated in the Greater Belfast area and the ten towns along the North-West and South-North pipelines. We therefore believe that it would be useful if any future papers on Energy Retail Competition clearly distinguished between the electricity and gas markets. There are several fundamental differences between the markets and we have identified examples throughout the paper where it is not always evident to which the paper refers e.g. the conclusions drawn under 'impacts of wholesale market structure and regulation' tend to focus on SEM and the electricity market and therefore it is often unclear what provisions are in fact being proposed for gas. Furthermore we would suggest that future research into customer preferences considers the electricity and gas markets separately.

In relation to the paper's assessment of countries who have introduced retail competition, PNG would comment:

- In relation to the markets in Norway the paper comments that competition has squeezed retail margins. It could be asked, has effective regulation to date not achieved this in the Northern Ireland gas market?
- The paper refers to a possible alternative solution of 'different regulatory approaches' and whether 'lower regulated tariffs would be more appropriate' for markets in New Zealand and Australia. Northern Ireland already has a proven effective regulatory model and we would

reiterate our earlier comment that competition must bring true benefits and not be delivered at any cost.

- The paper raises concerns that markets in Finland are settling to 'oligopoly'. Is this not a possibility for the Northern Ireland market given the size of the market and the number and type of industry players it currently has and may hope to attract in the future? Furthermore the paper goes on to comment that in the absence of vigorous wholesale competition, supply is likely to be oligopolistic. In reality, how much vigorous wholesale competition can be expected in Northern Ireland?

We also observed that there is a need for the Regulatory Authorities to monitor SEM daily ensuring competition is not distorted by anti-competitive behaviour or structures. It could be asked whether a system that requires daily monitoring by the Regulatory Authorities can be considered robust and effective.

In relation to prepayment meters we also note that the paper comments that 'such meters are not costlier for suppliers'. We would point out that this is not the case in the gas market. Currently PNG levy a customer charge on Suppliers for prepayment meters.

PNG Response to Consultation Questions

Consultation question 1

Respondents are asked to comment on the impact of this paper with regard to equality of opportunity and good relations (paragraphs 9 to12).

PNG Response: PNG agrees with UReg's comments in paragraph 12 that the need to identify any equality impacts is not appropriate for this consultation but we also agree that as this process develops it is essential that an equality impact assessment is undertaken.

Consultation question 2

General comments are invited on our overall approach to analysing the cost, benefits and options relating to supply competition.

PNG Response: As detailed in our opening comments, PNG believes that the development of energy retail competition must bring real and measurable benefits to the Northern Ireland consumer and should not be delivered at any cost.

Consultation question 3

To what extent is segmentation of the retail sector inevitable and indeed healthy? What kinds of segmentation (or inequality of outcome) would respondents see as undesirable, and at what level might regulatory intervention be justified?

PNG Response: The research carried out by UReg indicates that segmentation of the retail market is inevitable given the attitude of the different age and socio-economic groups towards competition. The extent of this segmentation will be very much dependant on the level of competition that emerges and in particular the number and type of suppliers looking to enter the retail market. To date new Suppliers have targeted the industrial and commercial market sectors.

Consultation question 4

The paper suggests that the Utility Regulator should monitor with particular care levels of competition for rural customers, pre-payment customers and those not on the gas network. Also that we should monitor closely whether current meter-reading obligations are sufficient. Comments on these priorities are invited. Do respondents wish to suggest other areas that require particular attention from us?

PNG Response: PNG would support UReg's suggestion to monitor levels of competition for rural customers and pre-payment customers and in particular the monitoring of competition among those customers not on the gas network. PNG have often raised concerns about the lack of transparency in pricing for this fuel source and practices which the oil industry continue to engage in which are to the detriment of consumers.

We also believe that expansion of the natural gas network to other areas in Northern Ireland will provide consumers with choice and allow for competition to develop between the different fuel sectors. It is our understanding that the Department for Enterprise, Trade and Investment is currently assessing opportunities for extending natural gas to new areas, something which PNG would be fully supportive of.

In relation to other areas that require particular attention, we would reiterate that an urgent review by UReg of PNG's proposals submitted in November 2008 for the development of an automated customer switching process and the system for switching Pay As You Go customers is required.

Consultation question 5

Comments are sought on our proposed approach to continued regulation of tariffs in the coming years (paragraphs 75 to 78).

No comment.