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The Exchange
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15 May 2009

Dear Stuart

FUEL VARIATION TARIFF (FVT) A BACKGROUND NOTE AND CONSULTATION PAPER

Thank you for the opportunity to respond on the structural elements of FVT.

Attached in Annex A is our summary response to each of the specific questions posed by this consultation. We also draw out below two of our key concerns with respect FVT, namely:

- it is far too early to countenance rolling back regulation for any FVT customers; and
- the level of discount applied to FVT customers needs to be reduced.

<u>Rolling back regulation</u>

The FVT segment is relatively new, having been introduced in October 2007 and designed to encourage the development of competition through greater transparency and cost reflective tariff structures.

The Commission hoped its introduction would encourage new entrants into the NDM sector[1], and indeed we are now starting to see the early signs of competition starting to develop. However, it is still a long way from being sustainable - according the

[1] Competition in Gas Supply, Decision Paper, CER/07/126, page 3

Commission's Gas Retail Information Report 2008[2], Bord Gáis Energy Supply (BGES) still accounts for 93% of customers in this sector by number and volume.

Sustainable competition requires evidence of active competition for all business customers, and for FVT customers we are clearly not there yet. It will take time for this to develop and it is far too early to review the effectiveness of the scheme.

We would like to emphasise the importance of FVT as a key customer segment in the establishment of competition in the business gas market. As such, it is important to maintain some level of regulatory consistency to allow a stable competitive platform to develop. We therefore advise against any reform measures that might undo the limited progress that has been made, albeit further refinement would help to spearhead further growth in this sector. We therefore comment below on one particular aspect that warrants the Commission's further attention.

Secondary Capacity Discount

We do not agree it is appropriate to cross subsidise FVT customers via a discount, simply because of secondary capacity sales flowing from the NDM '1 in 50' peak day capacity requirement on BGES. This confers on the incumbent commercial advantages on a scale not available to other market participants and encourages inefficient capacity procurement practices.

Put simply, BGES is effectively hedged against any downside, i.e. unsold over purchase of capacity in the NDM sector is covered by the 'K' Factor, whereas it also benefits from the upside of over purchase, which can be used (and is used) to offset charges elsewhere. This is not just inefficient (creates perverse incentives not to optimise capacity procurement), but also affects the development of the newly evolving FVT competitive market. .

We suggest this represents good grounds to reduce the amount of discount applied to the FVT sector, which in turn would encourage a more efficient capacity purchasing approach to keep down prices for all customers. We therefore recommend the discount should be suitably constrained (on a reducing percentage basis over time) to encourage efficient capacity management practices.

In conclusion, it is too early to countenance a rolling back of regulation for this sector, and the current 10% secondary capacity discount needs to be reduced, if not removed altogether for FVT customers.

[2] Gas Retail Report, CER 08/244, page 13 (dated 28 November 2008)

Please do not hesitate to contact us if we can provide any further input to your considerations.

Yours sincerely,

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ANNEX A

RESPONSE TO CONSULTATION QUESTIONS

Question 1: Fixed Charge

Do you agree with the components of the Fixed Charge? Is this charge transparent?

Viridian response: *creating a degree of regulatory and market stability is important for the development of competition, and so we do not particularly advocate any change at this juncture with respect the Fixed Charge components. However, any steps that can be taken to improve transparency are always welcome, e.g. a greater degree of granularity in the values that are applied.*

Question 2: Capacity Discount

Do you agree with the current level of the Capacity Discount? What do you feel the appropriate level should be? Give reason why.

Viridian response: *we welcomed the Commission' decision[3] in February 2009, not to increase the level of discount on the grounds that such changes in the level of the discount could have significant implications for the development of competition.*

Further, we do not agree it is appropriate to cross subsidise FVT customers via a discount, simply because of secondary capacity sales flowing from the NDM '1 in 50' peak day capacity requirement on BGES. This confers on the incumbent commercial advantages on a scale not available to other market participants and encourages inefficient capacity procurement practices.

We do not agree it is appropriate to cross subsidise FVT customers via a discount, simply because of secondary capacity sales flowing from the NDM '1 in 50' peak day capacity requirement on BGES. This confers on the incumbent commercial advantages on a scale not available to other market participants.

[3] Decision on Bord Gáis Energy Supply Fuel Variation Tariff Charges, 1 March 2009 – 30 September 2009 (dated 18 Feb 2009).

BGES is effectively hedged against any downside, i.e. unsold over purchase of capacity in the NDM sector is covered by the 'K' Factor, whereas it also benefits from the upside of over purchase, which can be used (and is used) to offset charges elsewhere. This is not just inefficient (creates perverse incentives not to optimise capacity procurement), but also affects the development of the newly evolving FVT competitive market.

We suggest this represents good grounds to reduce the amount of discount applied to the FVT sector, which in turn would encourage a more efficient capacity purchasing approach to keep down prices for all customers. We therefore recommend the discount should be suitably constrained (on a reducing percentage basis over time) to encourage efficient capacity management practices.

Finally, we note the Commission's previous proposal to advance an increase in the level of the discount to 14% was done so in light of more accurate information being available. Given that future decisions may well rest on the efficacy of this information, it would be helpful for consultees to have access to this data.

Question 3: 2 Day Booking Window

Do you agree with the 2 day booking window? Do you feel it should be longer/shorter? Give reasons why.

Viridian response: *the gas commodity cost reflects the monthly unit cost of wholesale gas and this needs to be as accurate as possible for FVT customers. The greater the 'window' during which the booking can take place, the greater the risk for BGES and for its customers.*

It therefore makes good sense to ensure the offer price and the booking window are as closely aligned as is possible - the 2 day window seems to strike this balance. However, if the Commission where minded to allow additional flexibility (and therefore risk) this should be limited to a backward view only, e.g. moving from D -2 to D -4, where D is the effective date of supply - the allowed margin might also be increased to counter the increased risk. To do otherwise would be to allow customers to transfer some of the procurement risk from themselves to BGES, by allowing customers to unduly delay their decision before deciding to commit (or not!).

Question 4: Understanding the End Goal of FVT

What is your understanding of the goal of the FVT? When do you think is would be appropriate for the Commission to step back from regulating this sector?

Does the FVT deliver the intended degree of value to customers in the FVT sector?

Viridian response: *as we have outlined in our cover letter, FVT was introduced in October 2007 just 19 months ago to help foster competition. The grounds for its introduction are as valid now as they were then. It would be very unfortunate if the limited progress that has been made to date were to be subsequently undone. At this stage, we therefore recommend a further review take place in 18-24 months time. This should provide a degree of market stability to help foster competition.*

Question 5: Supply Margin

Should the supply margin be removed from the Fixed Charge (the other components of which are primarily transport related) and should it be grouped instead with other charges? If so give reasons why?

Should the supply margin be grouped with the Gas Commodity Charge?

Viridian response: *providing the transparency principle is upheld, we are relatively relaxed where the Supply Margin is grouped. That said, we can see no justification for change especially as the market has only just become used to how the charges are presently structured (and where they are grouped). Keeping the groupings the same does at least ensure continuity and helps with future reviews.*

Question 6: CHP Opt Out

Should CHP customers be given the option to opt out of the FVT in favour of choosing an unregulated contract? If so give reasons why.

Should minimum criteria be developed to determine a CHP site's ability to opt out of the FVT regime include a minimum level of efficiency for the CHP plant and /or a ratio off CHP to site energy requirements?

Viridian response: *no, there is no justification for fragmenting this sector, it will detract from the ability of independent suppliers to make competitive headway, and any dilution will adversely affect competition.*

Even to introduce qualifying criteria for CH customers would entail making this unnecessarily complex to operate and lessen overall transparency. It will increase the cost to serve and reduce opportunities for independent suppliers to develop and deliver deals that are attractive to a range of differing customer types, including CHP.