



SPC20: Price Control for SSE Airtricity Gas Supply (NI) Ltd

Consultation
03 July 2019



About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.



Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.



Our vision

To ensure value and sustainability in energy and water.



Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.



Abstract

This consultation paper sets out the Utility Regulator's (UR) approach to the supply price control for SSE Airtricity Gas Supply (NI) Ltd in Greater Belfast and West, due to come into effect on 1 April 2020 and run until 31 March 2023. This is the second of a series of documents which the UR will publish relating to the price control under this SPC20 project.

This consultation follows our Information Note on Supply Price Controls published in November 2018. This paper outlines the proposed decisions in relation to the main areas within the control: structure and form; scope and coverage of regulated tariffs; duration of control; operating costs levels and allocations; and allowed margin.

Audience

Consumers and consumer groups; industry; and statutory bodies.

Consumer impact

This paper sets out the UR's proposed decisions for the gas supply price control from 2020 onwards. The price control will establish the permitted costs and profit margin for the duration of the control period. Subsequent regulated tariffs will have to operate within these limits.

The price control decisions will therefore impact on the bills of price regulated customers, ensuring that customers only pay for the cost of the gas they receive and a fair profit margin.



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Glossary

Name	Definition
CAPEX	Capital Expenditure
CCNI	Consumer Council for Northern Ireland
CMA	Competition and Markets Authority
DfE	Department for the Economy
EUC	End User Category
Firmus	firmus energy (Supply) Ltd
FTE	Full Time Employee
GB	Great Britain
HMRC	Her Majesty's Revenue & Customs
IT	Information Technology
I&C	Industrial and Commercial
LBE	Latest best estimates
NI	Northern Ireland
OPEX	Operating Expenditure
PAYG	Pay As Your Go (Pre-payment meter)
PSL	Phoenix Supply Limited
Power NI	Power NI Energy Ltd
Q	Quarter
REMM	Retail Energy Market Monitoring
RPI	Retail Price Index
SGN	SGN Natural Gas Limited
SNIP	Scotland-Northern Ireland Pipeline
SPC17	Supply Price Control 2017-2020
SPC20	Supply Price Control 2020-2023
SSE Airtricity	SSE Airtricity Gas Supply (NI) Ltd
UR	Utility Regulator

1. Introduction

- 1.1 The principal objective of the Utility Regulator (UR) in relation to gas is “to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland” while having regard to “the need to ensure a high level of protection of consumers of gas”.
- 1.2 To help meet this objective we retain price controls on dominant, former monopoly, gas suppliers. This consultation sets out our proposed decisions for the price control for SSE Airtricity Gas Supply (NI) Ltd (SSE Airtricity) in the Greater Belfast and West areas.
- 1.3 The control will apply from 1 April 2020 for SSE Airtricity until 31 March 2023.
- 1.4 This document sets out the proposed decisions and principles that will form the basis for the price control and provides background information on the gas markets in Northern Ireland.
- 1.5 This consultation follows the UR Information Note on Supply Price Controls published in November 2018¹ which set out our high level proposals for the price controls. A separate consultation for Firmus’ supply price control was published in June 2019.
- 1.6 We consider that our approach has been consistent with the principles of better regulation² which the Utility Regulator continues to apply: transparent, consistent, proportionate, accountable and targeted.
- 1.7 All costs presented are in October 2018 prices. These prices will be adjusted within the tariff for inflation as discussed in section 9.5.
- 1.8 As SSE Airtricity changed their accounting period from 1 January to 1 April for the current price control (SPC17), any references to a year within this document relate to the period 1 April – 31 March.

¹ UR Information Note on Supply Price controls: <https://www.uregni.gov.uk/sites/uregni/files/media-files/Gas%20retail%20supply%20price%20controls%20011118.pdf>

² Department for Business Innovation & Skills, *Principles for Economic Regulation*, April 2011: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principles-for-economic-regulation.pdf

2. Background

- 2.1 In Northern Ireland there are three separate distribution areas for natural gas. These are the Greater Belfast area, the Ten Towns area and the West area. The Greater Belfast area is served by Phoenix Natural Gas Ltd (PNGL) and the price-regulated supplier is SSE Airtricity. The Ten Towns area is served by Firmus Energy (Distribution) Ltd and the price-regulated supplier is Firmus Energy (Supply) Ltd (Firmus). The West area is served by SGN Natural Gas Ltd (SGN) and the price-regulated supplier is SSE Airtricity.
- 2.2 The Greater Belfast market includes Belfast, Newtownabbey, Carrickfergus, Larne, Carryduff, Newtownards, North Down and East Down. There are approximately 215,000 connections to the network (comprising of 204,208 domestic and 11,132 I&C connections) in this area³. Currently there are five active suppliers in the market. Only two of these companies supply to domestic customers; SSE Airtricity and Firmus.
- 2.3 The West market includes Coalisland, Cookstown, Dungannon, Magherafelt, Omagh, Enniskillen, Strabane and Derrylin. There are approximately 400 connections to the network (comprising of 380 domestic and 18 I&C connections in this area³. There are now 3 active suppliers in the West area, namely SSE Airtricity Gas NI as the commissioning domestic supplier, with Electric Ireland and Flogas active only in the I&C market.
- 2.4 The current SSE Airtricity price control applies for the period from 1 April 2018 to 31 March 2020, in line with their accounting period.
- 2.5 SSE Airtricity is a subsidiary of SSE plc a UK-listed energy company with operations and investments across the UK and Ireland. SSE is involved in the generation, transmission, distribution and supply of electricity, the production, storage, distribution and supply of gas and in the provision of energy-related services.

³ UR Quarterly Transparency Report (Q1 2019): https://www.uregni.gov.uk/sites/uregni/files/media-files/Transparency%20Report%20Q1%202019_0.pdf

3. Scope and Duration

Scope

- 3.1 The SPC17 Final Determination stated that the control would apply to one distinct End User Category 1 (EUC1) – all domestic customers and those businesses using less than 2,500 therms (73,200 kWh);
- 3.2 Due to the continued dominance of SSE Airtricity in the EUC1 category (64% of connections, almost 4 times that of the nearest competitor Flogas⁴), for SPC20 we propose to retain the scope of the control at domestic and low-consumption business customers using up to 2,500 therms (73,200kWh) per annum.

Duration

- 3.3 In the November 2018 Information Paper we stated that we considered a three year period to be the most appropriate duration for the price controls as it balances the resource implications of carrying out a control with the ability to forecast accurately over the medium term.
- 3.4 Therefore, it is our proposal to apply the control for a period of three years; from 1 April 2020 to 31 March 2023, in line with SSE Airtricity's financial year.

⁴ UR Quarterly Transparency Report (Q1 2019): https://www.uregni.gov.uk/sites/uregni/files/media-files/Transparency%20Report%20Q1%202019_0.pdf

4. The Regulated Tariff

- 4.1 The gas supply licence confers on the UR the power to control charges if deemed necessary:

2.4.1 Control over Charges

“The Licensee shall take all reasonable steps to secure that in any Relevant Year the average price per unit of gas supplied by it to Regulated Premises⁵ shall not exceed the maximum price calculated”

- 4.2 A price control is the mechanism that the UR uses to determine the costs which make up the maximum average price per therm that a price regulated gas supply company can charge.
- 4.3 In granting consent we review the maximum average price to ensure that it is constructed in line with the provisions within the price control.
- 4.4 This price control sets out the treatment of each cost element which makes up the maximum average price. These are:
- Network Costs
 - Wholesale Gas Costs
 - Supply Operating Costs
 - Margin

K Factor

- 4.5 In addition to the costs outlined above the maximum average price will also include a k factor adjustment.
- 4.6 Within this consultation we have proposed that some costs should be treated as retrospective costs. Some of the retrospective costs will be pass through costs, meaning that the company is allowed to recover the actual levels of costs incurred; whereas other retrospective costs will be subject to a retrospective adjustment to calculate the level of allowed cost based on pre-determined factors.
- 4.7 The costs which we have proposed in this price control to treat as

⁵ Regulated Premises means premises supplied by the Licensee in the Ten Towns Area at which the normal annual consumption of gas is reasonably expected not to exceed 73,200 kilowatt hours.

retrospective costs are listed in the table below along with our proposal for the determination basis of each cost.

Retrospective cost line	Determination Basis
Network costs	Pass through cost <i>(see Section 5 of this consultation paper)</i>
Wholesale gas costs	Pass through cost <i>(see Section 7 of this consultation paper)</i>
Prepayment transaction costs <i>(within Billing costs)</i>	Retrospective adjustment <i>(see Section 6.60 of this consultation paper)</i>
Bad debt <i>(within Billing costs)</i>	Retrospective adjustment <i>(see Section 6.42 of this consultation paper)</i>
Meter reading costs <i>(within Billing costs)</i>	Retrospective adjustment <i>(see Section 6.61 of this consultation paper)</i>
Customer information processing & postage <i>(within Billing costs)</i>	Retrospective adjustment <i>(see Section 6.54 of this consultation paper)</i>
Safety inspections and meter exchanges <i>(within Operations Costs)</i>	Retrospective adjustment <i>(see Section 6.41 of this consultation paper)</i>

- 4.8 Within the tariff we will include a forecast for these retrospective costs based on historical performance and latest best estimates. Each year a reconciliation is carried out to calculate the actual allowed costs based on pass through cost, or the retrospective adjustment as appropriate.
- 4.9 The k factor is the difference—whether positive or negative—between all of the pass through and retrospectively adjusted actual costs incurred, and what was forecast for them. This difference will then be taken off or added to the next tariff revenue requirement respectively at the next tariff change.
- 4.10 It is our intention to maintain the k factor at a minimum level through the use of regular tariff reviews and a trigger mechanism to monitor the tariff closely and thus minimise the impact of the k factor on the tariff.
- 4.11 At each tariff change the UR will publish the k factor to allow for transparency.

Tariff Review

- 4.12 A tariff review is the process of analysis and discussion of the tariff to consider if a change to the tariff is needed, and to decide the magnitude and timing of any change.
- 4.13 We review the gas tariffs on a bi-annual basis. In addition we will be able to initiate a tariff review under the trigger mechanism as discussed below. We consider that regular reviews minimise the impact of k factor on the tariff and can help mitigate tariff volatility for consumers.
- 4.14 We have established a process in consultation with the SSE Airtricity, the Consumer Council NI (CCNI), and the Department for the Economy (DfE) which sets out the timescales and information required in setting the tariff.
- 4.15 The tariff review process is a consultative one where all parties bring their expertise and opinion in relation to the needs of the gas supplier, the needs of the consumer, and the wider impact on the economy. Therefore, it is important that all parties are aware of and in agreement with the formal process.
- 4.16 This process provides a robust procedure, which is in line with the requirements of the licence to ensure that all parties are consulted in a timely, prescribed, and comprehensive manner for both anticipated and unanticipated tariff reviews.

Trigger Mechanism

- 4.17 In addition to the bi-annual tariff reviews we establish a trigger mechanism within the price control. The aim of this trigger mechanism is to initiate a tariff review should the cost of wholesale gas purchased by the gas supplier vary significantly from the cost forecast within the tariff.
- 4.18 The trigger mechanism will operate to allow the UR to initiate a tariff review should the tariff costs change between review periods, either increase or decrease, so as to change the tariff by 5%.
- 4.19 We consider the 5% level to be an appropriate level, any level under this and volatility in the wholesale market could necessitate a number of tariff reviews in a year. Tariff reviews can be costly and complex for the company.
- 4.20 Where a review is initiated by the trigger mechanism, the tariff review group will look at a number of factors including:
- Volatility in the wholesale gas market

- Time since last tariff review
- Level of k factor
- Amount of gas purchased by the supplier

4.21 The UR also retains the flexibility to initiate a review at any stage it considers is in the interest of customers.

Tariff Structure

- 4.22 The domestic credit tariff for SSE Airtricity is made up of two charges; a higher charge for the first 2,000 kWh used per annum and a second charge for any usage above 2,000 kWh per annum⁶.
- 4.23 Pay as You Go (PAYG) customers pay a flat tariff for each unit used.
- 4.24 Industrial and commercial customers using less than 73,200 kWh (2,500 therms) are charged a two tiered tariff; with different charges for usage up to 2,000 kWh per annum, and between 2,001 kWh and 73,200 kWh per annum⁷.
- 4.25 At each tariff review we will require the supplier to demonstrate the assumptions used to create the tariff structure in order to ensure that the average weighted price charged to customers is equal to or less than the maximum average tariff.

⁶ SSE Airtricity Domestic tariffs: <https://www.airtricitygasni.com/at-home/help-and-advice/tariffs-and-payment-options/>

⁷ SSE Airtricity I&C tariffs: <https://www.airtricitygasni.com/in-business/help-and-advice/tariffs/>

5. Network Costs

- 5.1 Network costs are the charges incurred by SSE Airtricity for their use of the NI gas transmission and distribution systems. These charges are reviewed and approved by the UR.
- 5.2 The costs for the transmission system are those costs involved in bringing gas from Scotland to NI, via the Scotland to NI Pipeline (SNIP), and all the transmission pipelines within NI. These costs are published on the Gas Market Operator for NI (GMO NI) website⁸.
- 5.3 The costs for the distribution system are those costs associated with moving gas throughout the distribution networks area to homes and businesses. These can be found on the Phoenix Natural Gas website⁹ for the Greater Belfast area and on the SGN Natural Gas website¹⁰ for the West area.
- 5.4 Distribution costs are also subject to price control by the UR. The current price control, GD17, runs from the period of 1 January 2017 for to 31 December 2022.
- 5.5 Within the previous controls for SSE Airtricity, the network costs have been treated as pass through costs. This means that the customer pays for the actual cost of the network charges that SSE Airtricity incur, and no more than that.
- 5.6 We propose that network costs remain as pass through costs as these are costs which are outside the control of the supplier.

⁸ GMO NI charges: <http://gmo-ni.com/tariffs/explanatory-notes>

⁹ Phoenix Natural Gas network charges: <https://www.phoenixnaturalgas.com/about-us/about-phoenix/network-information/network-charges>

¹⁰ SGN Natural Gas charging statements: <https://sgnnaturalgas.co.uk/index.php/publications/>

6. Supply Operating Costs

- 6.1 Supply operating costs are those costs which relate to the day to day operating of the SSE Airtricity gas supply business; and include among other things salaries, IT costs, metering costs, rent and rates, consultancy/legal fees and bad debt.
- 6.2 In November 2018 the UR provided SSE Airtricity with an initial information request for the operating costs wholly incurred by the gas supply business in the provision of gas to customers within the all gas distribution areas: Greater Belfast, West, and Ten Towns. This included the total operating costs for serving both price controlled and non-price controlled customers using more than 73,200 kWh per annum.
- 6.3 The submission requested historical actual costs, Latest Best Estimates (LBE) of current costs (2018), and a forecast of costs for 2019 and the three years of the price control period 2020-2022. We stated that we would welcome any evidence to support the figures given in the submission. Additionally, the information request was clear that the burden of proof rests with SSE Airtricity to justify the cost base set out in the submission.
- 6.4 The costs shown throughout this paper are the total SSE Airtricity gas supply business costs (i.e. including SSE Airtricity's unregulated gas supply business in all three distribution areas). The apportionment allocation of costs determines the appropriate level of costs to the tariff sector (i.e. the price regulated sector of SSE Airtricity). This ensures there is no cross-subsidisation between the tariff and non-tariff businesses. In order to calculate the apportionment, each cost line is apportioned on the basis of the most appropriate cost driver and these apportionments summed to provide the overall percentage. A list of the apportionment cost drivers can be found in Annex 1.
- 6.5 In January 2019 the supplier presented its initial submission to the UR.
- 6.6 Over the past five months we have engaged with SSE Airtricity to understand this submission through meetings and additional information requests. We have analysed the forecast cost figures against historical costs and previous determinations and benchmarked information against other companies where appropriate. We have also engaged consultants to review specific elements of the submissions (e.g. IT required spend).
- 6.7 As a result we present below our proposals for the price controls for SSE Airtricity. These proposals are shown against the previous year's actuals and future years requested costs of the supplier.
- 6.8 In the submission SSE Airtricity presented its costs broken down into detailed costs lines. We present here the costs summarised into three main cost categories; **Manpower**, **Operations**, and **Billing**. It is not our intention to provide a line-by-line budget for the supplier to spend, but rather to provide an

efficient overall allowance, derived from a reasonable assessment of the various cost requirements, for it to spend running the price regulated supply business.

- 6.9 In setting out how we have reached our proposed allowances we will refer to the submissions and detailed cost lines and discuss in more detail those areas where our proposals vary significantly from the SSE Airtricity's submissions.
- 6.10 Table 1 below shows the total (price regulated and non-price regulated) costs for the SSE Airtricity's entire supply business. We have excluded IT CAPEX as this is presently being assessed by external consultants. This will complete during the consultation period but it cannot be allowed to delay publication of the consultation paper any further.

Table 1: SPC20 submission and consultation proposals

Tariff Costs (£ 000)	Actuals/LBE			Initial Submission			Consultation Proposal		
	2017	2018	2019	2020	2021	2022	2020	2021	2022
	(Actual)	(LBE)	(Forecast)						
Manpower	2,100	2,368	2,542	2,945	2,987	2,931	2,700	2,699	2,604
Operating Costs (exc. IT CAPEX)	1,260	1,133	1,165	1,841	1,730	1,737	1,596	1,465	1,453
Billing Costs	1,801	2,105	2,264	2,480	2,578	2,725	2,246	2,284	2,366
Total Costs	5,161	5,606	5,970	7,266	7,295	7,393	6,542	6,449	6,423

- 6.11 The following section discusses each of these three main cost headings above in greater detail to explain the basis for the consultation proposals.

Manpower

Table 2: Manpower costs

Manpower costs (£000)	Actuals/LBE			Initial Submission			Consultation Proposal		
	2017	2018	2019	2020	2021	2022	2020	2021	2022
	(Actual)	(LBE)	(Forecast)						
Salaries	1,544	1,756	1,920	2,304	2,342	2,288	2,081	2,080	1,990
Staff Engagement	9	11	10	12	12	11	11	11	10
Travel and Subsistence	45	43	44	50	49	47	47	47	44
Training	27	40	45	51	50	47	44	44	42
Recharges	475	517	523	528	534	539	517	517	517
Total	2,100	2,368	2,542	2,945	2,987	2,931	2,700	2,699	2,604

Salaries

- 6.12 Salaries make up the vast majority (93%) of the manpower cost submission along with some other smaller items of manpower cost. In their submission for manpower costs SSE Airtricity are requesting additional headcount from an actual level of 67 employees in 2018 to 78.5 in 2020, to support customer growth and business change.
- 6.13 In total they have requested 11.5 FTEs, of which they say 8.5 FTEs are a result of customer growth. In addition to these 11.5 FTE's requested, a further allowance equivalent to 3 FTEs was requested to provide cover for the cost of Long Term Sickness and Maternity cover.
- 6.14 SSE Airtricity have also requested a regrade of salary levels for their lower grades, citing a buoyant employment market in Belfast where they believe similar roles offer higher salaries which leads to increased staff attrition.
- 6.15 We have carried out analysis of their salary grades versus 'The Real Living Wage' and propose to allow the levels forecast for 2019 to become the base for SPC20 with no further increases as SPC20 already benefits from annual inflationary increases (see section 9.5).
- 6.16 SSE Airtricity was given an allowance in the current control to ensure that by the end of 2019 all employees be on or above the real living wage and it was the responsibility of SSE Airtricity to ensure this happened. Furthermore RPI increases have exceeded the increases to the real living wage in recent years which itself takes account of inflation.

- 6.17 In terms of the number of additional FTEs requested, we believe these to be excessive and when benchmarked against the other regulated supply companies we believe that an increase of 6 FTE in 2020 is sufficient, reducing by 4 FTE in the third year of the new control in anticipation of resource efficiencies due to the implementation of the new IT system.
- 6.18 Having benchmarked SSE Airtricity against Firmus Energy and Power NI, we consider the 15.5 FTE requested in SSE Airtricity's submission to be excessive and propose 6 FTE to bring the overall FTE per 1000 customers to a similar (but still higher) level to the benchmarks. These calculations include the recharged staff who are employed in other SSE group businesses.
- 6.19 We propose to allow the following additional six staff:
- **+1.5 Customer Service Advisor** to maintain the current level per 1000 customers, which is in line with Firmus levels;
 - **+1.5 FTE Credit Control** to maintain current level per 1000 customers, and also assist with new Theft CoP compliance;
 - **+1 FTE Back Office Analyst** in line with customer growth.
 - **+0.5 FTE Quality Monitor** to manage customer service regulatory compliance issues
 - **+1 FTE Business Assurance Analyst** to allow for increased regulatory training and reporting to enhance regulatory compliance (this appointment must be in year one of the control and verification sent to the UR that the recruitment has happened);
 - **+0.5 FTE Vulnerable Customer Specialist** to ensure regulatory compliance against Codes of Practice;
- 6.20 Four of the additional employees are roles in areas where customer growth has a direct impact on resource requirements. The other two roles however are in recognition of the established regulatory requirements in relation to the protection of consumers and the need this business has for some resource to concentrate on improvement in this area.

Other Manpower Costs

- 6.21 Staff Engagement - We propose to accept SSE Airtricity's submission as it is in line with HMRC recommendations and SPC17.
- 6.22 Training - We propose to set this cost at the LBE rate per FTE for the duration of the price control.
- 6.23 Travel and subsistence (including Fleet Costs) – We propose to allow the proposed rate per FTE as there is a decrease in spend due to more training activity in Belfast rather than Dublin.
- 6.24 Recharges – SSE Airtricity requested an annual increase of 1% above inflation, which we propose to disallow as allowances are already inflated annually by RPI as with other salaries. SPC20 recharges will be set at the

level incurred in 2018.

Operation Costs

6.25 Table 2: Operation Costs

Operation costs (£000)	Actuals/LBE			Initial Submission			Consultation Proposal		
	2017	2018	2019	2020	2021	2022	2020	2021	2022
	(Actual)	(LBE)	(Forecast)						
Office Costs (including stationery, telephone and postage)	349	360	367	377	384	390	377	384	390
Rates	36	45	46	48	49	51	48	49	51
Professional and Legal Fees	125	140	140	143	143	142	143	143	142
Insurance	31	32	30	27	27	27	27	27	27
IT (exc. CAPEX)	616	827	648	830	682	653	830	682	653
CAPEX (non-IT)	19	20	21	23	23	22	22	22	21
Licence Fee	2	2	2	2	2	2	2	2	2
Network Maintenance (including safety inspections)	120	117	133	143	154	166	86	94	104
Customer Engagements	24	25	30	248	266	286	61	63	65
Total	1,323	1,568	1,416	1,841	1,730	1,737	1,596	1,465	1,453

IT

- 6.26 In SPC17 SSE Airtricity was provided a CAPEX allowance to upgrade its existing Hi-Affinity billing system which is no longer fit for purpose. This project was originally planned for implementation during SPC17 however the current provider has been subject to a takeover and the proposed upgrades are no longer efficient or the best option for the long term interests of customers. The original SPC17 project costs will be deducted from any new IT project to implement a new billing system which is presently in the scoping stages.
- 6.27 We are still liaising with SSE Airtricity regarding the IT CAPEX for this new billing system. This will complete during the consultation period but it cannot be allowed to delay publication of the consultation paper any further.
- 6.28 Within the IT (exc. CAPEX) cost line shown above, SSE Airtricity's IT recharges represent their allocation of parent company costs in relation to infrastructure, software and general hardware maintenance. These have increased from the prior submission (SPC17) as many related group costs

were not yet identified following transition to group IT from PNG. They supported many IT services under a Service Level Agreement until SSE Airtricity relocated to their own office and IT infrastructure. We therefore propose to allow these costs.

- 6.29 The CAPEX request for a new IT billing system mentioned above is a significant cost line. Given the technical nature of these requests we engaged Gemserv to perform an assessment of, and provide an opinion on, the IT costs submitted by the supplier to ensure that they costs are efficiently incurred and the unregulated business is apportioned their fair share of costs. This analysis is ongoing, hence IT CAPEX is not in the table above, but should be concluded during the consultation period.
- 6.30 We also propose to include the IT OPEX for the new system that has been requested at this stage. However Gemserv will carry out an analysis of this IT OPEX alongside the IT CAPEX for the new billing system, and this figure may change.
- 6.31 In addition, in both its SPC17 and SPC20 submissions SSE Airtricity apportioned costs for IT OPEX and IT CAPEX between the regulated and unregulated businesses by customer numbers. However, we propose that these costs be apportioned by customer bills for SPC20, as this closer reflects actual use of these system by customers.

Customer Engagement

- 6.32 SSE Airtricity have requested an allowance to support customer engagement to increase awareness of their services and obligations around energy theft, vulnerability (and awareness of energy care register), energy efficiency and back-billing. SSE Airtricity are proposing a frequency of two postal communications on average per year to customers.
- 6.33 Customer Engagement and Information is important to help ensure customers are aware of the services available. However we do not believe an increase of over £200k per annum is in the best interests of consumers.
- 6.34 We propose to allow the cost of print for one additional communication per year which can be added to the existing mailing (bills/PAYG statements/tariff changes/EE Directive etc.). This extra communication will be approved by UR and must not contain references to other SSE Airtricity services such as Energy Services.

Other Operations Costs

- 6.35 Office Costs (including stationery, telephone and postage) – SSE Airtricity's submission is in line with previous annual increases which we propose to allow.
- 6.36 Rates – SSE Airtricity have applied a nominal 3% uplift above inflation (as per the last price control) and have proposed rates to be a pass-through cost. We propose to allow these costs as submitted.
- 6.37 Professional and Legal Fees - Legal and company secretarial charges are fixed service charges, Payroll recharges are allocated by headcount and tax recharges have been agreed at 18/19 costs subject to inflation. We propose to accept SSE Airtricity's submission as the costs are at the current level.
- 6.38 Insurance – SSE Airtricity's submission is forecast to decrease for the 2020-2023 price control period. Insurance and interest charges have decreased slightly and we propose to allow these costs.
- 6.39 CAPEX (non-IT) - We propose to allow the amount of £300 per FTE for the duration of SPC20. For SPC17 we benchmarked CAPEX information provided against other suppliers and propose to continue to allow this cost.
- 6.40 Licence Fee – We propose to allow the costs for licence fees.
- 6.41 Network Maintenance (including safety inspections) – Following assessment by the UR, SSE Airtricity resubmitted these costs as their original submission included costs in excess of licence obligations. We propose to accept SSE Airtricity's re-submission as the unit rates for maintenance items and safety inspections are set by the network company and the volumes are retrospectively adjusted.

Billing Costs

Table 3: Billing Costs

Billing costs (£000)	Actuals/LBE			Initial Submission			Consultation Proposal		
	2017	2018	2019	2020	2021	2022	2020	2021	2022
	(Actual)	(LBE)	(Forecast)						
Bad debt (Tariff only)	173	168	265	300	312	325	193	201	209
Paypoint & credit check costs	446	471	489	505	521	538	505	521	538
Bank and Interest Charges	156	250	261	274	287	301	274	232	185
Meter reading	690	723	732	783	797	855	783	797	855
Customer information processing and postage	306	444	475	580	617	657	453	491	530
Tracing costs	29	30	32	33	35	37	33	35	37
Text alerts	3	3	4	6	8	12	6	8	12
Total	1,801	2,089	2,257	2,480	2,578	2,725	2,246	2,284	2,366

Bad Debt

Table 5: Bad Debt

Bad Debt	Year	Initial Submission		Consultation Proposal	
		£000	%	£000	%
Actual	2015	399	0.95	420	1.00
Actual	2016	205	0.60	340	1.00
Actual	2017	388	0.49	707	0.90
LBE	2018	177	0.45	352	0.90
Forecast (SPC17 - yr 3)	2019	275	0.64	385	0.90
Forecast (SPC20 - yr 1)	2020	309	0.70	193	0.45
Forecast (SPC20 - yr 2)	2021	322	0.70	201	0.45
Forecast (SPC20 - yr 3)	2022	334	0.70	209	0.45

6.42 The existing SSE Airtricity price control includes a bad debt allowance of 0.9% of tariff credit revenue. This was much higher than Firmus as the previous

owner Phoenix Supply Ltd (PSL) had a poor record with debt.

- 6.43 For SPC20, SSE Airtricity are requesting a bad debt rate of 0.7% of Credit Tariff Revenue which is below their current 0.9% rate. They believe this level will offer a degree of protection to them against the market changes and risks to recovery that they are currently experiencing.
- 6.44 SSE Airtricity state that there are a variety of reasons for their forecast increases including a new suite of customer communication with a softer approach than previous.
- 6.45 SSE Airtricity's current price control includes a bad debt allowance of 0.9% of tariff credit revenue. Significant improvements have been made to their processes which has delivered substantial outperformance of the current target.
- 6.46 As evidenced in Table 5 the actual levels achieved are well below the current allowances and we therefore propose a rate of 0.45% which is the current LBE level, in line with the approach of previous controls. This is comparable to the level set for Firmus.

Bank & Interest charges

Table 6: Bank & Interest Charges

Bank Costs (£ 000)	Actuals/LBE			Initial Submission			Consultation Proposal		
	2017 (Actual)	2018 (LBE)	2019 (Forecast)	2020	2021	2022	2020	2021	2022
Total Bank Costs	156	250	261	274	287	301	274	232	185

- 6.47 Since the last price control determination there have been significant changes to bank charges and card fees for SSE Airtricity which they claim have been wholly outside the control of the business. They have experienced an increase in banking charges of approximately 80% to date during the current Price Control.
- 6.48 SSE Airtricity state that bank charges have increased for a number of reasons including merchant fee rate increases, customer growth and online payments and changes in payment arrangements due to EU Payment Services Directive 2 which came into effect on January 2018 preventing charges from being passed through to customers paying by credit card. By far the main reason for the increase in bank charges is the increase in the costs of card payments.
- 6.49 Increases in card collection costs have risen significantly however we believe

SSE Airtricity have failed to take steps to minimise these costs. For example, their website offers card payments overtly on their homepage and their call centre hold message advises customers of the website card payment option rather than more cost effective collection methods such as Direct Debit or Paypoint card.

- 6.50 SSE Airtricity submitted additional information which indicates that over a third of all payment transactions for credit customers who are not on direct debit are card payments, which benchmarks very poorly versus Power NI and Firmus.
- 6.51 For card payment costs we propose a glide path, diminishing across the three years of the control which will allow SSE Airtricity to take steps to encourage customers to use more efficient payment methods. We will listen carefully to any further arguments SSE might have relating to why their percentage of credit account transactions paid by card is exceptionally higher than other regulated suppliers.
- 6.52 SSE Airtricity requested that bank charges should be set as a retrospectively adjusted item. We do not propose to allow this change as it gives SSE Airtricity no incentive to attempt to achieve the same percentage of card transactions (as a percentage of non-‘Direct Debit’ credit transactions) as the benchmarks.
- 6.53 The other cost items that make up the total bank charges we intend to allow as they move in line with customer growth.

Customer Information/Bill Printing and Postage

Table 7: Customer Information Bill Processing and Postage

Customer Information Processing & Postage (£000)	Actuals/LBE			Initial Submission			Consultation Proposal		
	2017	2018	2019	2020	2021	2022	2020	2021	2022
	(Actual)	(LBE)	(Forecast)						
Stationary & Postage (£000)	257	420	451	439	477	516	429	467	506
Mailing House Retainer (£000)	24	24	24	141	141	141	24	24	24
Cost per customer	£2.05	£2.81	£2.87	£3.35	£3.41	£3.48	£2.62	£2.71	£2.81

- 6.54 Bill processing is a cost that is subject to retrospective adjustment relating to allowance for billing statements, tariff review letters, bad debt letters, welcome packs for new customers and any licensed obligations that require writing to

tariff customers. The rates for printing and postage of these are set by the UR for the control period and the allowances adjusted for the volumes of letters sent.

- 6.55 In its submission SSE Airtricity detailed the expected mailing requirements for SPC20 and then based its forecasts on increasing this cost with customer growth. Rates for print and postage vary slightly across the SPC20 period.
- 6.56 Following the introduction of their new IT system SSE have requested an increase in the Mailing House Retainer of 487% as detailed in Table 7.
- 6.57 Stationary and postage rate increases are in line with previous trends and we propose to allow these costs.
- 6.58 The Mailing House Retainer cost increases submitted by SSE Airtricity are excessive and we do not believe that a new IT system should have a significant negative impact on this cost line. We therefore propose to allow this cost line at the same level as the current price control.
- 6.59 The welcome pack issued to new customers and tariff sheets which are issued to all tariff customers following a tariff change contain an advertisement for SSE Energy Services (an unregulated company). We propose a reduction of £10k per annum to reflect the benefit to SSE Energy Services.

Other Billing Costs

- 6.60 Paypoint Costs & Credit Check Costs - We propose to accept the SSE Airtricity submission as the rates are agreed and numbers are retrospectively adjusted.
- 6.61 Meter reading - We propose to accept the SSE Airtricity submission as the rates are set and numbers are retrospectively adjusted.
- 6.62 Tracing Costs - We propose to accept the SSE Airtricity submission as the rates are in line with customer growth.
- 6.63 Text Alerts - We propose to accept the SSE Airtricity submission as cost increases will have minimal impact on the tariff. We believe increased utilisation will benefit customers by improving communications.

7. Gas Costs

- 7.1 Gas Costs relate to the cost of wholesale gas as well as the costs for transporting gas through Great Britain (GB) to the SNIP. These transportation costs are published by National Grid¹¹. Previous controls have determined that these costs are pass through which means that SSE Airtricity is allowed to recover the actual cost of gas. Therefore, where wholesale gas costs increase or decrease, the difference in costs is passed on to customers.
- 7.2 In the Information Paper, we proposed to allow wholesale gas costs and the related transportation costs as pass through costs. Wholesale gas costs will be allowed as pass through at the level purchased at the National Balancing Point (NBP).

Energy Balancing

- 7.3 In reviewing the gas costs we consider it appropriate to set an additional allowance for energy balancing. The energy balancing amount is a figure included within the tariffs to account for the cost of buying gas within the month as opposed to on the forward curve. The actual wholesale cost of the gas remains pass through, this figure is to ensure the tariff reflects the impact of the timing of purchasing the gas. SSE Airtricity will hedge the majority of their purchases before the month but some gas will remain to be purchased within the month to match the actual consumption profile.
- 7.4 We will set the energy balancing figure in the tariff as follows:
- Where SSE Airtricity has 40% or less of their gas requirements for the month remaining to be secured, there will be a 10% premium applied to the remaining gas to be purchased.
 - Where SSE Airtricity has more than 40% of their gas requirements for the month remaining to be secured, there will be a 10% premium on 40% of the total purchases for the month.
- 7.5 This is in line with the energy balancing figures currently within the SSE Airtricity tariff.

¹¹ National Transmission System (NTS) charges: <http://www2.nationalgrid.com/uk/Industry-information/System-charges/Gas-transmission/Current-charges/>

Credit Support

- 7.6 SSE Airtricity submitted details of credit arrangements in place to cover transmission, distribution, and gas costs and other relevant costs. Currently credit cover costs are allowed at an agreed pence per KWh.
- 7.7 The submission for the supplier's credit costs are reasonable when benchmarked to other suppliers in the energy supply industry. We therefore propose to allow this level of credit cover.

8. Margin

- 8.1 During SPC17, we conducted a complete review of margin in line with the methodology used for the previous Power NI supply price control using a notional supply business capital base and the cost of capital to calculate an appropriate margin.
- 8.2 The SPC17 Final Determination approved a margin of 2% of allowable turnover. This was determined to strike an appropriate balance between the calculations of the CMA, UR external consultants and both SSE Airtricity and Firmus and their advisors, whilst at the same time taking account of other benchmarks in the energy industry.
- 8.3 We do not believe that market conditions have changed sufficiently to warrant any amendment to this level of margin. SSE Airtricity retains a dominant position in supply to price regulated customers (and is the monopoly supplier to domestic customers in West) in the Greater Belfast area and has associated market power. This is one of the principal reasons for the continuance of the price control, and SSE Airtricity still has more market share and fewer competitors than Power NI had when the 2.2% was set for that supplier.
- 8.4 Given all the above and after due consideration, we are satisfied that the calibration of the margin still reflects the appropriate benchmarks. We informed SSE Airtricity that the UR has no specific intentions to modify this or put in place an alternative level of allowed margin.
- 8.5 SSE Airtricity responded with a paper welcoming the previous increase in margin from 1.5% to 2%, but recommending the consideration of a higher level of 2.5% which they claim will encourage entry of new competitors into the market.

9. Reconciliation

- 9.1 This section sets out how the price control will be reconciled to actual allowed costs on an annual basis.

Reconciliation

- 9.2 On an annual basis we will reconcile the forecast costs that are allowed in the price control with the actual allowed costs (i.e. the retrospectively adjusted allowed costs) to determine a reconciliation amount. This amount will then form part of the k factor.

- 9.3 The reconciliation will take into account:

- Billing costs which are retrospectively adjusted
- Ring-fenced allowances (if any)
- Inflation
- Rate of interest applicable
- Possible Other items (to be confirmed)

- 9.4 In addition to the information required to complete this reconciliation, we will also require from SSE Airtricity annual cost reporting to show their actual costs on a line-by-line basis reconciled with regulatory accounts.

Inflation

- 9.5 All costs presented in this paper are in October 2018 prices. These costs will be adjusted to account for inflation where appropriate. Inflation will be treated as a pass through. The costs used to make up the tariff at each tariff period will be adjusted to reflect the current price base. For reconciliation purposes the inflation figure will be the average figure for the year being reconciled. The inflation index used will be Retail Price Index (RPI).

Rate of Interest

- 9.6 We propose that any reconciled amounts, whether under or over recovered, will be rolled forward at an interest rate of LIBOR plus 1.5%. The proposed rate of interest reflects the cost to the suppliers of financing the under recovery or the benefits to them of holding any over recovery.

10. Responding to the consultation

- 10.1 As a public body and non-ministerial government department, the UR is bound by the Freedom of Information Act which came into effect on 1 January 2005. According to the remit of the Freedom of Information Act, it is possible that certain recorded information contained in responses can be put into the public domain.
- 10.2 Therefore, it is possible that all responses made to consultations will be discoverable under Freedom of Information Act, even if respondents asked the UR to treat responses as “confidential”.
- 10.3 It is therefore important that respondents note these developments and in particular, when marking responses as “confidential” or asking the UR to treat responses as confidential should specify why they consider the information in question to be confidential. Confidentiality disclaimers created automatically by your company’s email system will not normally be treated as sufficient in terms of a confidentiality request.
- 10.4 This is an open consultation. We have not posed any specific questions in this paper. Instead we invite stakeholders to express a view on any particular aspect of the paper.
- 10.5 Responses should be received by 4pm on 30 August 2019 and should be addressed to:

Colin Magee
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Queens House
14 Queen Street
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BT1 6ED
Colin.Magee@uregni.gov.uk

Annex 1

Apportionment Cost Drivers

Cost	Driver
Manpower	FTEs
Staff Engagement	FTEs
Training	FTEs
Recharges	FTEs
Travel and Subsistence	FTEs
Office Costs including stationery, telephone and postage	FTEs
Rates	FTEs
Professional and Legal Fees	Customer number
Insurance	FTEs
IT OPEX	Customer bills
IT CAPEX	Customer bills
Licence Fee	Load in therms
Network Maintenance including safety inspections	SSE Airtricity Energy Care Scheme customers ¹²
Customer Engagements	Customer number
Bad debt	Credit Revenue ¹²
Paypoint costs & Credit Check Costs	PAYG customers ¹²
Bank and Interest Charges	Load in therms
Meter reading	Customer numbers ¹²
Customer Information Bill Processing and Postage	Customer numbers ¹²
Tracing Costs	Customer numbers
Text Alerts	Tariff only

¹² This is how this cost line is apportioned for this consultation. This cost is then retrospectively adjusted to actual numbers.