Conclusion of the Utility Regulator's Review of the firmus energy (Supply) Ltd Maximum Average Price in the Ten Towns area

December 2021

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

Protecting customers is at the heart of the Utility Regulator's role and ensuring that customers pay the correct price for gas from the price regulated supplier firmus energy Supply Ltd (FES) is a core part of our work.

We commenced a review of the maximum average price with FES in October 2021. We have scrutinised the submission provided by FES to ensure that the maximum average price approved is not more than the sum of the costs allowed under the price control determination. This ensures that customers pay no more than the costs of purchasing and supplying gas plus a pre-determined allowance for the operating costs of the business and an agreed profit margin.

The maximum average price for FES' domestic and small business customers in the Ten Towns area will increase from 156.07 pence per therm to 215.66. This equates to an increase of 38.18% to the bills of domestic and small business customers.

Audience

Customers and customer groups, industry and statutory bodies.

Consumer impact

FES' customers in the Ten Towns area will see an average increase of 38.18% in their annual bill. This change will affect all domestic customers and small business customers using less than 2,500 therms per annum, and will take effect from 3 December 2021.

The impact of the tariff change on a domestic credit customer with average consumption of 12,000 kWh per annum will be an increase of approximately £267 per annum (including VAT) on their gas bill.

1. Context

1.1 On 7 October 2021 the Utility Regulator—in consultation with firmus energy (Supply) Limited (FES), the Department for the Economy (DfE) and the Consumer Council Northern Ireland (CCNI)—began a review of the FES maximum average price for domestic customers and small business customers using less than 2,500 therms per annum. The current maximum average price has been effective from 1 October 2021 and covers approximately 57,000 domestic and small business customers[1] within the Ten Towns area.

1.2 The Utility Regulator carries out formal reviews of the FES maximum average price on a bi-annual basis (in advance of April and October). The Utility Regulator can also initiate a further review at any stage should the wholesale cost of gas change significantly such that it would result in an increase or decrease of at least 5% to the maximum average price. On an ongoing basis we analyse the cost of wholesale gas on the forward curve, along with the forward purchases that FES has made to date.

1.3 This review was initiated to establish the new maximum average price to become effective from 3 December 2021 due to a FES request to do so given the significant changes in the wholesale cost of gas. The review is a formal process agreed by the UR, FES, DfE and the CCNI.

1.4 FES uses the maximum average price to set the actual tariffs that are charged to customers. The tariffs are calculated on a weighted average basis, based on average usage and the number of customers using each tariff. FES cannot charge more than the maximum average price overall.

1.5 From 3 December 2021, the maximum average price for domestic and small business customers will be 215.66 pence per therm (p/therm); increasing from 156.07 p/therm in the October 2021 tariff. The new maximum average price has been modelled and forecast over a period of 12 months. However, it will be kept under constant review and adjusted within that time period if required. We will complete another formal review in advance of 1 April 2022 and will continue to monitor gas prices to identify if an additional review is required.

1.6 The unit rates of tariffs for FES's customers in the Ten Towns area will increase by 38.18% from 3 December 2021. These unit rates are detailed in Table 3 of this paper.

[1] q2-2021-qremm.pdf (uregni.gov.uk)

2. Background

2.1 In Northern Ireland, there are three distinct distribution areas for natural gas. These are the Greater Belfast area, the Ten Towns area and the West area. Phoenix Natural Gas Limited (PNGL) own and operate the distribution network in the Greater Belfast area, firmus energy (Distribution) Limited own and operate the distribution network in the Ten Towns area, while Scotia Gas Networks (SGN) own and operate the distribution network in the West area.

2.2 FES holds a licence to supply gas to customers in the Ten Towns area. This licence was granted to FES with a period of exclusivity for supplying gas to customers within this area, meaning that FES was the only company allowed to supply gas within the Ten Towns during this period.

2.3 From 1 April 2015, the supply market in the Ten Towns area opened to competition from new entrant suppliers in all customer sectors. However FES are currently the only supplier for domestic consumers in this market. FES currently supply around 57,000 domestic and small business customers (referred to as "tariff" customers) in this area.

2.4 Under the terms of FES's licence to supply gas, the Utility Regulator ("the Authority") has the power to control the maximum amount that FES can charge for gas. These controls apply when customers are not protected by competition. The FES licence states:

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 Premises shall not exceed the maximum price calculated in accordance with Condition 2.4.2*"[2].

2.5 The Utility Regulator has established a price control determination which sets out FES's allowed costs. The price control determination sets out how each of the cost elements which make up the maximum average price will be treated.

Elements of Maximum Average Price

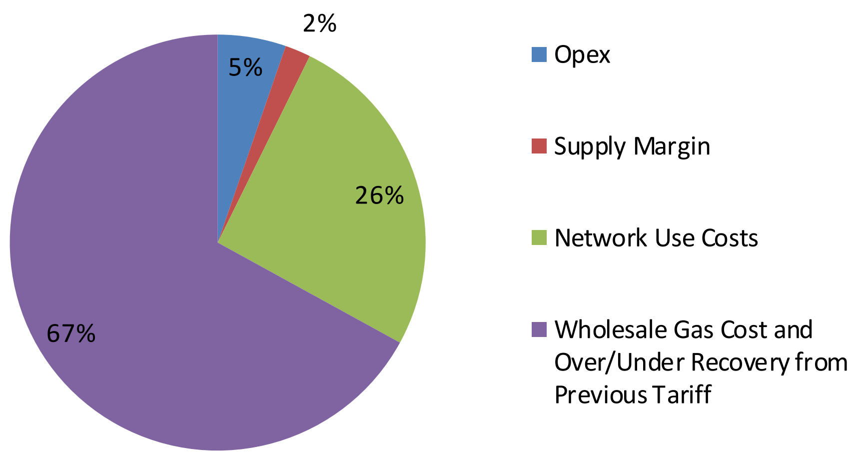
2.6 The maximum average price is made up of a number of costs:

[2] 2020-10-01 firmus energy (Supply) Ltd - Supply Licence TenTowns.pdf (uregni.gov.uk)

- Operating costs and supply margin;
- Network costs; and
- Wholesale cost of gas.

2.7 The breakdown is shown in Figure 1 below.

Figure 1 – Makeup of the maximum average price from 3 December 2021



2.8 The Utility Regulator has taken an active role in scrutinising the costs within each of the elements of the maximum average price of FES's submission. FES uses the maximum average price to set the actual tariffs that are charged to customers, and FES cannot charge more than the maximum average price overall.

Operating Costs and Supply Margin

2.9 Operating costs are the costs necessary for FES to run its supply business for tariff customers. For example the costs of billing, meter reading, customer service, offices, salaries and IT systems etc. The operating costs were determined under the price control carried out by the Utility Regulator.

2.10 The margin refers to the amount of profit FES is allowed to make. The margin was determined within the price control and was set at 2% of allowable turnover from tariff customers.

2.11 In September 2019 we published the final determination for the firmus energy supply price control[3] which indicates the total amount of revenue that

[3] Price Control for firmus energy (Supply) Ltd
Final Determination 2020-2022 27th September 2019: https://www.uregni.gov.uk/news-centre/final-price-control-determination-firmus-energy-supply-ltd-ten-towns-gas-area

the Licensee can recover, in any relevant year, in respect of their gas supply business.

2.12 The price control determination runs from 1 January 2020 to 31 December 2022.

Network Costs

2.13 Network costs cover the charges for the use of the Northern Ireland transmission and distribution systems. These charges are reviewed and approved by the Utility Regulator as part of the network price controls.

2.14 The FES price control determined that the transmission and distribution system charges will be treated as pass through charges which means that the customer pays no more or less than the actual cost of the network charges.

2.15 The costs for the transmission system are those costs involved in bringing gas from Scotland to Northern Ireland, via the Scotland to Northern Ireland Pipeline, and all the transmission pipelines within Northern Ireland. These costs are published on the Gas Market Operator NI and National Grid websites

2.16 The costs for the distribution system are those costs associated with moving gas throughout the Ten Towns area to homes and businesses. On the 15th September 2016 the final determination on the price control for Northern Ireland's gas distribution networks for 2017-2022 (GD17), and associated licence modifications for consultation, were published. GD17 is the distribution price control for Phoenix Natural Gas Limited (PNGL), firmus energy (Distribution) Limited and SGN Natural Gas Limited which runs from 1 January 2017[4]. The distribution price control determines the amounts that firmus energy Distribution can charge for suppliers to use the Ten Towns network. These can be found on the feDL website.

Wholesale Gas Costs

2.17 As determined within the FES price control, the gas cost element of the maximum average price incorporates the wholesale cost of gas as well as charges for transporting gas through Great Britain and costs for securing credit cover associated with purchasing wholesale gas.

2.18 The FES price control determines that gas costs are treated as pass through

[4] https://www.uregni.gov.uk/news-centre/gas-distribution-networks-price-control-gd17-period-2017-2022-published

which means that the customer pays no more or less than the actual cost of gas. Therefore where wholesale gas costs decrease or increase over those set in the tariff, the resulting savings or additional costs are passed on to the customer.

2.19 FES has a gas purchasing strategy in place which means that it purchases a percentage of its forecast volumes in advance on an ongoing basis. This is known as hedging and limits the exposure to more short term fluctuations in wholesale gas prices, and therefore aims to create more stability in the gas price for final customers. It is important to note that FES' hedging strategy will be specific to it, and due to the specific timing of forward gas purchases the price paid will be different from other suppliers who will purchase different volumes at different time periods (and hence at different prices as the gas market moves on a daily basis). Hence, the overall wholesale cost of FES will likely always differ somewhat from that of other gas suppliers even though they are purchasing from the same gas market.

2.20 At the time of review, the overall cost of gas for the maximum average price is estimated based on a combination of actual forward gas purchases that have already been secured, along with forecast volumes of gas required, and the forecast wholesale cost of that gas which has yet to be bought (based on the gas price forward curve). Buying gas in advance (hedging) can help to reduce any over/under recoveries building up as the price of the hedged gas in the maximum average price is known when the price is set.

Over/Under Recovery from Previous Tariff Periods

2.21 Wholesale gas costs make up a large component of the final maximum average price and as these costs can be volatile there will always be a difference between the outturn cost of the wholesale gas that has yet to be purchased compared to the forecast costs that were included when the maximum average price was set.

2.22 Where the wholesale gas costs out turn less than was forecast in the maximum average price, FES will 'over recover'. This means that they recovered more money from customers than they spent on gas costs and they will subsequently refund the over recovered difference to customers in the following tariff period.

2.23 Alternatively, where the wholesale gas costs turn out higher than forecast in the maximum average price, FES will 'under recover'. This means they spent more on gas costs than they recovered from customers and they will therefore be able to recharge the under recovered difference to customers in the following tariff period. This ensures that customers only pay for the actual cost of gas.

2.24 Therefore, each maximum average price includes an amount of over or under recovery which was accumulated during the previous tariff periods.

2.25 Both FES and the Utility Regulator strive to keep the over/under recovered amount as low as possible in order to avoid distortion of the maximum average price. This is carried out through ongoing monitoring and tariff changes being put through when over or under recoveries are accumulating to such an extent that they would adversely affect the tariff.

3. Why is the Maximum Average Price for FES increasing?

3.1 The maximum average price for FES' tariff customers in the Ten Towns area will increase to 215.66 p/therm from 3 December 2021. Both Table 1 and Figure 2 below show the movement in the regulated maximum average price from April 2015 (the first FES regulated tariff) to date.

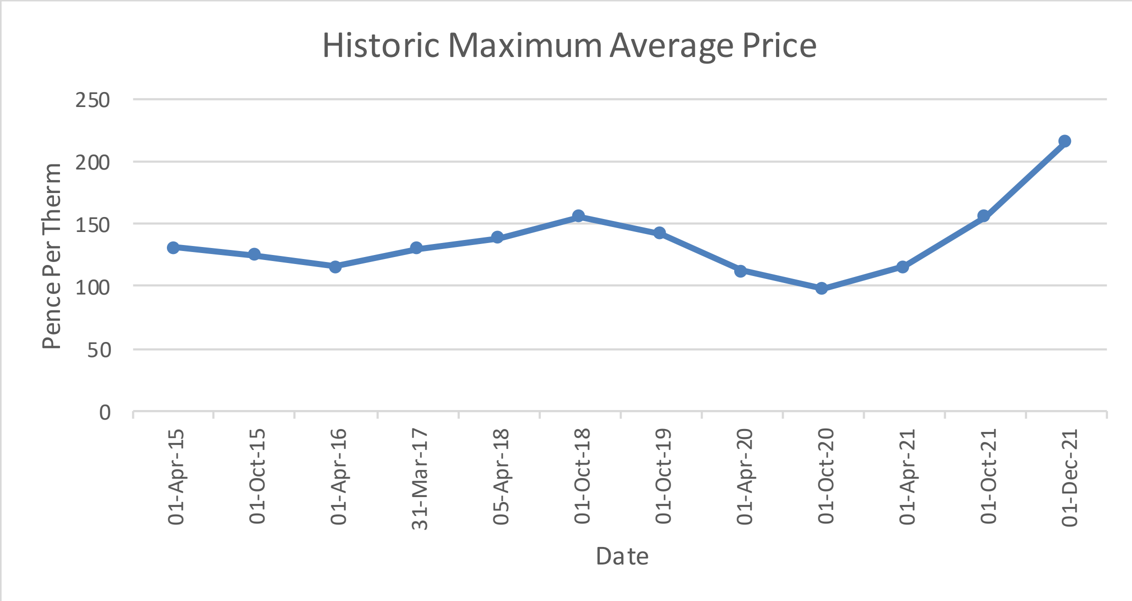
Table 1 - Historic maximum average price

Effective from date	Approved Maximum Average Price (p/therm)
01-Apr-15	130.85
01-Oct-15	125.16[5]
01-Apr-16	115.51
31-Mar-17	130.27[6]
05-Apr-18	139.10
01-Oct-18	155.80
01-Oct-19	142.14
01-Apr-20	112.07
01-Oct-20	98.08
01-Apr-21	115.48
01-Oct-21	156.07
01-Dec-21	215.66

[5] *This figure has been restated to take into account updated volume forecasts. At 01-Oct-15 the approved Maximum Average Price was 124.44 p/therm*

[6] *This figure has been recalculated to take account the removal of EUC2 customers from the regulated tariff. Previously the approved Maximum Average Price was 129.57 p/therm.*

Figure 2 - Historic maximum average price



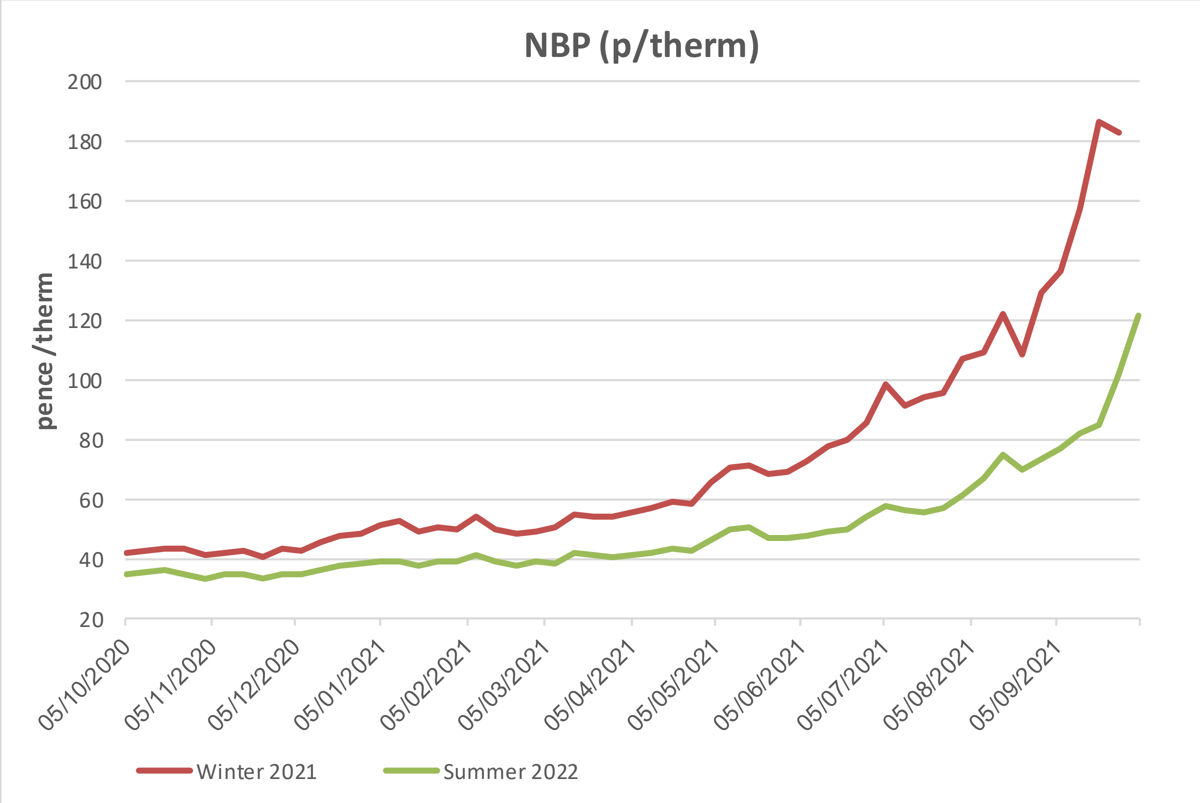
3.2 The overall increase in the FES maximum average price is primarily due to:

- the increase in the cost of wholesale gas; and
- the increase in the under recovery position.

Increase in Forecast Cost of Wholesale Gas

3.3 There have been unprecedented increases in the forward wholesale gas markets (which have been trading at all time high prices). This has been caused by a shortage in supply meaning significant price increases due to a number of factors which are broadly similar to those seen at the last tariff review and have continued to impact upon wholesale prices but in a more severe way. There has been a reduction in the supply from Russia and Norway to Europe as well as gas storage supplies already depleted from the 2020 winter not being replenished as quickly as usual due to high summer gas prices. The High price of carbon has also encouraged the use of gas fired power plants instead of coal around Europe again contributing to the higher demand for gas. In addition to this, the demand for Liquefied Natural Gas (LNG) in both Asia and in Brazil (due to issues with running hydro power) has diverted its supply away from Europe.

Figure 3 – Movement in forward curve of wholesale gas cost



Source: Intercontinental Exchange

3.4 This rise in firmus' commodity costs is the largest driver of the forthcoming firmus tariff increase of 38.18%. As can be seen in Table 2, firmus' wholesale gas costs increased from 82.24 p/therm in the current tariff to 130.53 p/therm in the 3 December 2021 tariff. It is important to note that an element of the gas price included within the maximum average price for the 3 December 2021 tariff is a forecast cost and the actual outturn prices may be higher or lower. This element is the cost of the gas that has not already been bought (hedged) to date.

Table 2 – Wholesale Costs within Maximum Average Price

Elements within Maximum Average Price	October 2021 (p/therm)	December 2021 (p/therm)
Wholesale Gas Cost	82.24	130.53
(Over)/Under Recovery	1.59	13.99
Total Wholesale Gas Cost and Over/Under Recovery from Previous Tariff Periods	83.83	144.52

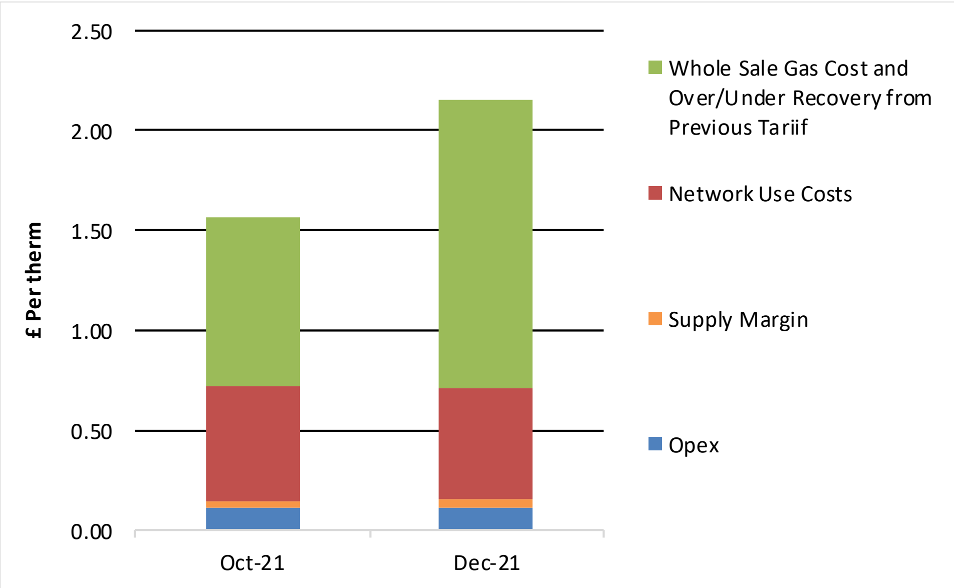
3.5 The maximum average price coming into effect from 3 December 2021 also includes an under recovery of 13.99 p/therm from the existing tariff period. This is primarily due to the increasing gas commodity costs in 2021, which resulted in firmus paying more for gas that had not already been hedged since the tariff was set in October 2021. It is important to highlight that this under recovery has moved substantially from an under recovery of 1.59 p/therm in the current tariff.

3.6 As shown in Table 2 above, overall the combined cost of wholesale gas and over/under recovery has increased from 83.83 p/therm in the 1 October 2021 tariff to 144.52 p/therm in the 3 December 2021 tariff.

4. Breakdown of Maximum Average Price

4.1 The graph shown in Figure 4 below compares the breakdown of the December 2021 maximum average price with a breakdown of the previous maximum average price set at October 2021. As explained previously, the increase in the maximum average price is overwhelmingly due to the significant increase is the cost of wholesale gas and the increase in the under recovery.

Figure 4 – Breakdown of December 2021 maximum average price compared with previous maximum average price



Impact on Tariff

4.2 As already stated, FES uses the maximum average price to set the actual tariffs charged to customers. The tariffs are calculated on a weighted average basis, based on average usage and the number of customers on each tariff. FES cannot charge more than the maximum average price overall. From 3 December 2021, the unit rates of tariffs for FES's customers in the Ten Town area will increase by around 38.18%.

4.3 The new unit rates for tariff customers are shown in Table 3 below. Table 4 shows the percentage increase for each individual unit rate of the domestic and small business tariffs.

Table 3 – FES's tariff unit rates from 3 December 2021 (shown in p/kWh including VAT)

FES gas supply tariffs Ten Towns	Domestic Credit (inc. 5% VAT)	Domestic PAYG (inc. 5% VAT)	Small Business (inc. 20% VAT)
Up to 2,000 kWh	11.079	7.678	11.328
Over 2,000 kWh	7.468	-	7.523
Over 73,200 kWh	-	-	-
Direct Debit discount	£22	-	-

Table 4 – Percentage increase in FES's tariff unit rates from 3 December 2021

FES gas supply tariffs Ten Towns	Domestic Credit	Domestic PAYG	Small Business
Up to 2,000 kWh	38.18%	38.18%	38.18%
Over 2,000 kWh	38.18%	-	38.18%
Over 73,200 kWh	-	-	-

4.4 FES's typical domestic credit (non-prepayment) bill will increase to £968 per annum[7] from 3 December 2021. This equates to an increase of around £267 per year compared with the existing tariff.

Comparison with GB and Ireland

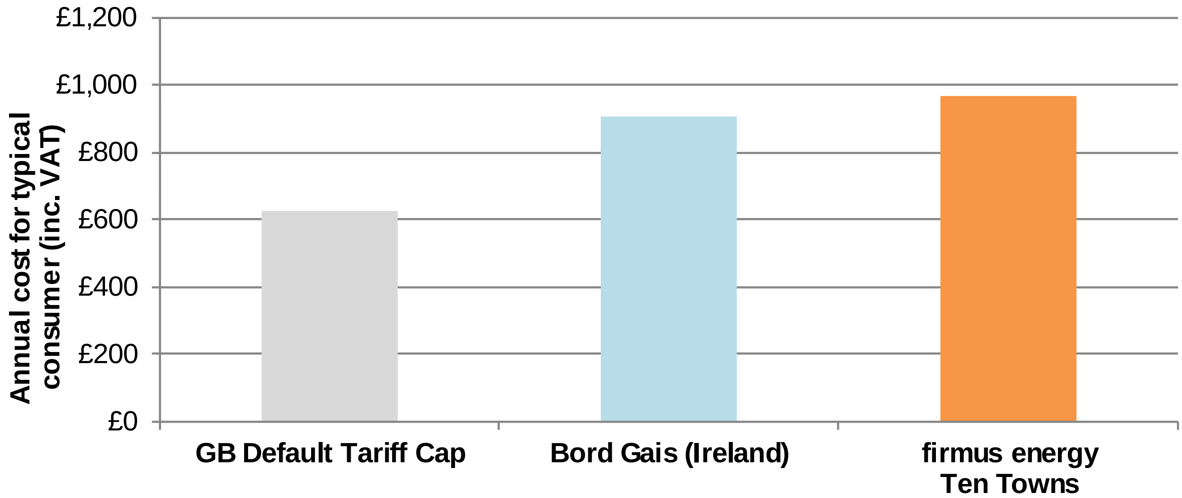
4.5 Figure 5 below shows the typical FES domestic standard credit tariff from 3 December 2021, compared with Bord Gais[8] in Ireland and the Default Tariff Cap[9] level in GB. The average annual bill amounts in this graph have been calculated based on actual tariff unit rates (including VAT) and are based on average annual consumption of 12,000kWh.

4.6 Figure 5 illustrates that the FES tariff for an average domestic standard credit customer in the Ten Towns area will be 54.58% above the Default Tariff Cap level in GB and 6.68% above the Bord Gais standard tariff in Ireland. **It is important to note however that the GB Default Tariff Cap is**

[7] Based off a typical consumption of 12,000 kWh per annum. Including VAT. Excluding discounts.
[8] Our Tariffs & Prices | Bord Gáis Energy (bordgaisenergy.ie) Correct as of 3 December 2021.
[9] Default tariff cap level: 1 October 2021 to 31 March 2022 | Ofgem Average across all regions. Correct as of 3 December 2021.

expected to increase significantly.[10]

Figure 5 - Comparison of average annual domestic bills (based on standard domestic credit customers with estimated usage 12,000kWh per annum including VAT)



Conclusion

4.7 The Utility Regulator has reviewed the maximum average price submission provided by FES and reviewed the forecasts against its own market analysis. The Utility Regulator is satisfied that it is appropriate and justified to set a maximum average price of 215.66 p/therm for tariff customers in the Ten Towns for one year. This represents an average increase of circa 38.18% in the actual tariff unit rates that FES uses to charge domestic and small business customers in the Ten Towns area.

4.8 The Utility Regulator continues to retain the flexibility to initiate a review of gas prices at any stage if it is considered to be in the interest of customers.

[10] https://www.bbc.co.uk/news/business-58840537

https://www.ofgem.gov.uk/publications/rising-wholesale-energy-prices-and-implications-regulatory-framework?utm_source=twitter&utm_medium=ofgem&utm_term=&utm_content=JBletter&utm_campaign=Risingprices