SPC23: Price Control for SSE Airtricity Gas Supply (NI) Ltd

Draft Determination for consultation

June 2022

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 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 2023 and run until 31 March 2027. This is the second of a series of documents which the UR will publish relating to the price control under this SPC23 project.

This consultation follows our Information Note on Supply Price Controls published in November 2021. 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 2023 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
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)
Power NI	Power NI Energy Ltd
Q	Quarter
QREMM	Quarterly 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
SPC23	Supply Price Control 2023-2027
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 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 gas network areas.

1.3 The control will apply from 1 April 2023 for SSE Airtricity until 31 March 2027.

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 2021[1] which set out our high level proposals for the price controls. A separate consultation for Firmus Energy's supply price control was published in May 2022.

1.6 We consider that our approach has been consistent with the principles of better regulation[2] which the Utility Regulator continues to apply: transparent, consistent, proportionate, accountable, and targeted.

1.7 All costs presented are in October 2021 prices. These prices will be adjusted within the tariff for inflation as discussed in section 9.5.

1.8 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/news-centre/gas-retail-supply-price-controls-2023-information-note

[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 242,000 connections to the network (comprising of 229,953 domestic and 11,664 I&C connections) in this area[3]. 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 2,500 connections to the network (comprising of 2,477 domestic and 69 I&C connections in this area[3]. There are now 3 active suppliers in the West area, namely SSE Airtricity Gas NI as the commissioning domestic supplier, with Firmus and Flogas active only in the I&C market.

2.4 The current SSE Airtricity price control applies for the period from 1 April 2020 to 31 March 2023, 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] Quarterly Retail Energy Market Monitoring Report: Quarter - https://www.uregni.gov.uk/files/uregni/documents/2022-06/Q1%202022%20QREMM%20%28FINAL%29v2.pdf

3. Scope and Duration

Scope

3.1 The SPC20 Final Determination stated that the control would apply to one distinct End User Category - EUC1; which is all domestic customers and those businesses using less than 2,500 therms (73,200 kWh).

3.2 FES are the only supplier competing with SSE Airtricity in the domestic market in Greater Belfast; and SSE Airtricity hold 80% domestic market share[4]. In addition, the latest quarterly transparency report published by the UR shows that SSE Airtricity currently also hold 62% market share in the small I&C market in Belfast.

3.3 There are currently no competing suppliers in the domestic market in the West area, and therefore SSE Airtricity hold 100% market share in that area.

3.4 Due to the continued dominance of SSE Airtricity in the EUC1 category, for SPC23 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

3.5 In the November 2021 Information Paper we stated that we considered a four 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.

3.6 Therefore, it is our proposal to apply the control for a period of four years; from 1 April 2023 to 31 March 2027, in line with SSE Airtricity's financial year.

[4] Quarterly Retail Energy Market Monitoring Report: Quarter - https://www.uregni.gov.uk/files/uregni/documents/2022-06/Q1%202022%20QREMM%20%28FINAL%29v2.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 Premises*[5] *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; and
- 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 retrospective costs are listed in the table below along with our proposal for

[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.

the determination basis of each cost.

Retrospective cost line	Determination Basis
Network costs	Pass through cost *(see Section 5 of this consultation paper)*
Wholesale gas costs	Pass through cost *(see Section 7 of this consultation paper)*
Safety inspections and meter exchanges *(within Operations Costs)*	Retrospective adjustment *(see Section 6.41 of this consultation paper)*
Bad debt *(within Billing costs)*	Retrospective adjustment *(see Section 6.43 of this consultation paper)*
Customer information processing & postage *(within Billing costs)*	Retrospective adjustment *(see Section 6.52 of this consultation paper)*
Prepayment transaction costs *(within Billing costs)*	Retrospective adjustment *(see Section 6.49 of this consultation paper)*
Meter reading costs *(within Billing costs)*	Retrospective adjustment *(see Section 6.51 of this consultation paper)*

4.8 Within the tariff we will include a forecast for these retrospective costs based on historical performance and Latest Best Estimates (LBE). 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 SSE regulated 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 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 pro-rated higher charge for the first 2,000 kWh used per annum and a second charge for any usage above 2,000 kWh per annum.

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 annum.

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.

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) website[6].

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 website[7] for the Greater Belfast area and on the SGN Natural Gas website[8] 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.

[6] GMO NI charges: https://gmo-ni.com/tariffs
[7] Phoenix Natural Gas network charges: https://www.phoenixnaturalgas.com/about-us/about-phoenix/network-information/network-charges
[8] 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 2021 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 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, an LBE of current costs (2021), and a forecast of costs for 2022 and the four years of the price control period 2023-2027. 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 sides of the business. 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 February 2022 the supplier presented its initial submission to the UR.

6.6 Over the past four 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.

6.7 As a result we present below our operating cost 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.

Table 1: SPC23 submission and consultation proposals

Operating Expenditure Totals	Actuals/LBE			Initial Submission				Consultation Proposals			
	2020/21 (Actual)	2021/22 (LBE)	2022/23 Forecast	2023/24	2024/25	2025/26	2026/27	2023/24	2024/25	2025/26	2026/27
Manpower Costs	2,902	3,482	3,920	4,347	4,397	4,445	4,503	3,969	3,969	3,969	3,919
Operations Costs	1,406	1,361	1,474	3,779	3,542	3,530	3,513	3,447	3,350	3,328	3,299
Billing Costs	2,483	2,937	4,392	4,431	4,708	5,007	5,380	4,014	4,276	4,579	4,950
Other	0	0	101	101	101	101	101	0	0	0	0
Total Costs	**6,791**	**7,779**	**9,886**	**12,657**	**12,747**	**13,082**	**13,497**	**11,430**	**11,595**	**11,876**	**12,168**

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	Actuals/LBE			Initial Submission				Consultation Proposals			
	2020/21 (Actual)	2021/22 (LBE)	2022/23 Forecast	2023/24	2024/25	2025/26	2026/27	2023/24	2024/25	2025/26	2026/27
Salaries	2,197	2,339	3,402	3,547	3,583	3,616	3,660	3,179	3,179	3,179	3,129
Staff Engagement	7	11	14	14	14	15	15	13	13	13	13
Training	29	50	43	46	44	46	45	41	41	41	41
Labour Recharge	619	668	683	696	710	724	738	696	696	696	696
Travel and subsistence	50	35	43	44	44	45	45	40	40	40	40
Total Costs	**2,902**	**3,104**	**4,185**	**4,347**	**4,397**	**4,445**	**4,503**	**3,969**	**3,969**	**3,969**	**3,919**

Salaries

6.12 During the SPC20 period, SSE Airtricity undertook considerable recruitment beyond its set allowance in an effort to address some operational and performance issues that arose within the business. The SPC20 allowance for FY22 was set at 72.8 FTEs, but as at 31 March the supplier had 104.3 FTEs employed (meaning the supplier itself was funding an additional 31.5 FTEs).

6.13 One issue needing addressed was the operational performance of the supplier’s call centre. Following a period of heavy recruitment, the supplier had 30 FTEs employed at the call centre by the end of FY22, exceeding their allowance of 18.5 FTEs. We continued to monitor call centre performance metrics, and with this bolstering of CS agents levels the call centre returned to a reasonable level of performance. During this time the supplier also added 5 FTEs in other customer service related roles (team leader, complaints, etc.), again at its own cost.

6.14 SSE Airtricity has also recruited an additional 16.5 FTEs beyond its allowances in many of its other departments in order to help with its general operations; which it says has come under pressure due to an increase in customers, customer contacts, and compliance audits and ensuring compliance processes are embedded into highly manual business processes.

6.15 Beyond the recruitment it has already undertaken, in its SPC23 submission the supplier asks for a further net increase of 14 FTEs (+16 FTEs, but with 2 FTEs being removed in the final year of SPC23); taking its FTE count from 104.3 as at FY22 to 118.8 by FY27. These further increases are:

- 3.5 CS agents;

- 1 CS trainer; and
- 14 spread relatively evenly across other departments

6.16 The supplier has also proposed a 1% above inflation increase for each year of the control to "attract and retain staff in a competitive recruitment market".

6.17 There are also a number of staff who are employed by SSE Group, whose salary costs are partially recharged to SSE Airtricity depending on how much of their work is for the supplier. These costs are forecast to increase 2% above inflation increase each year of the control.

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6.18 SSE Airtricity underwent considerable recruitment above its allowances in SPC20, taking its FTE count to 104.3. Given the operational and performance issues experienced by the supplier during this period, as well as the fact that this additional manpower was funded by the supplier, we propose to accept that these increases were indeed necessary and should be supported under SPC23.

6.19 In terms of the requests for further increases:

- 3.5 CS agents – UR modelling suggests that the current level of 30 FTEs is sufficient for the call centre to function at an acceptable level. This also benchmarks well with other relevant suppliers. Therefore, we propose to not accept the request for an additional 3 FTEs.
- 1 CS trainer - We propose to accept the recruitment of a CS trainer. Given the service issues the call centre has experienced as well as the high level of attrition, providing 1 additional FTE dedicated to training could help support and develop new CS agents.
- 14 other FTEs – The supplier has not provided sufficient evidence to suggest any additional FTEs are required to support their operations. The supplier did not identify gaps or constraints, but rather relied on a new methodology that assesses forecasted customer numbers and forecast calls. We feel such a broad approach is unsuitable in this circumstance and we must assess how each department functions individually, both at present and through the duration of the control. Given the additional FTEs recruited during SPC20, we feel each department is staffed to a suitable level, and SSE Airtricity has not provided sufficient evidence to demonstrate a business need. Therefore, we propose to not accept the request for an additional 14 FTEs.

6.20 Therefore, we propose to provide an allowance for 105.3 FTEs (decreasing to 103.3 in FY26).

6.21 We do not propose accepting the blanket 1% above inflation salary increases for salaries, in line with our treatment of other relevant price controls. We view inflationary adjustments to be sufficient for attracting and retaining staff.

Other Manpower Costs

6.22 Staff Engagement - We propose to accept the submission as it is in line with SPC20.

6.23 Training - We propose to maintain at the FY22 forecast level, as there is a broadly similar staffing level thereafter.

6.24 Travel and subsistence (including Fleet Costs) – We propose to maintain at the FY22 forecast level, as there is a broadly similar staffing level thereafter.

6.25 Recharges – We do not propose accepting the blanket above inflation salary increase for all SSE recharge salaries. Therefore we propose to maintain the recharges allowance at the FY22 forecast level.

Operation Costs

Table 2: Operation Costs

Operation Costs	Actuals/LBE			Initial Submission				Consultation Proposals			
	2020/21 (Actual)	2021/22 (LBE)	2022/23 Forecast	2023/24	2024/25	2025/26	2026/27	2023/24	2024/25	2025/26	2026/27
Office Costs	353	376	396	411	432	450	467	403	416	427	436
Rates	29	47	49	50	52	53	55	50	52	53	55
Professional and Legal Fees	243	155	193	181	184	188	192	178	178	178	178
Insurance	29	29	29	30	30	31	31	30	30	31	31
Information Technology	566	549	553	1,670	1,543	1,492	1,437	1,555	1,428	1,377	1,322
CAPEX	27	37	47	1,061	1,061	1,061	1,061	1,006	1,006	1,006	1,006
Licence Fee	2	2	2	2	2	2	2	2	2	2	2
Network Maintenance	93	101	139	151	161	172	182	151	161	172	182
Customer Engagements	64	65	68	222	77	81	86	72	77	81	86
Total Costs	**1,406**	**1,361**	**1,476**	**3,779**	**3,542**	**3,530**	**3,513**	**3,447**	**3,350**	**3,328**	**3,299**

IT and IT CAPEX

6.26 In SPC17 SSE Airtricity was provided a CAPEX allowance to upgrade its existing Hi-Affinity billing system which was deemed no longer fit for purpose. Following delays, it was decided that the original SPC17 project costs were to be deducted from the forthcoming billing system update.

6.27 During the SPC20 review, the supplier was in the process of procuring its new billing system. This system was expected to implemented during the price control period, and with board approval it was determined that the CAPEX allowance would be allowed for under the Et process following completion of the procurement process and subsequent review by external consultants.

6.28 In January 2021, our external consultants completed their review of the procurement stating that "*SSE has carried out a rigorous procurement process and has put forward the best offer*", and that "*Gemserv considers the total sum […] to be satisfactory as a fixed regulatory allowance for SSE to procure and deliver the new Gentrack customer and billing management system*". On Operating Costs, the consultant also felt they should be considered for inclusion in the price control.

6.29 Later in January 2021, the UR wrote to the supplier providing approval for cost recovery up to the total amount for Capital Expenditure, as was outlined in the report 'Gemserv Report on the Proposed Update to the SSEA Gas NI

Billing System' dated 11 January 2021. Regarding OPEX, the letter stated that "*The amounts for Operating Expenditure will also be allowed as per the contractual arrangements outlined in the assurance consultant's report. We do not anticipate these amounts will increase, nor will approval of any increase be allowed, but SSE Airtricity must inform the UR should there be any reduction to these costs following final negotiations*."

6.30 Delays in the project have resulted in SSE Airtricity requesting that the project cost be put through SPC23, rather than Et.

6.31 However, following our consultant's review of the costs and our letter of approval, the OPEX in the finalised contract included an additional £460k. This was said to reflect the final contract negotiation with Gentrack to meet SSE's liability cover (£15m for GDPR/Data loss breach) to meet level of risk, i.e. 10% of Turnover and meeting SSE's SLA and service level requirements.

6.32 In addition, as indicated in paragraph 6.26, SSE Airtricity was provided a CAPEX allowance to upgrade the billing system under SPC17, and it was agreed that any unspent allowance was to be deducted from the final IT upgrade costs. When the UR queried this, the supplier stated that £219k of this amount was spent on various IT projects unrelated to the billing system upgrades (e.g. such as CAPEX related to Work from Home hardware).

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6.33 The UR provided SSE Airtricity with approval for cost recovery in its letter in 2021, and we do not now propose contesting that.

6.34 However, the additional £460k of OPEX is not something the UR or its consultants ever had an opportunity to review or approve. In our approval letter we stated increases were not expected nor would they be allowed. Therefore, we propose to exclude this cost from SPC23.

6.35 We also do not accept £219k of the SPC17 allowance being spent on various unrelated CAPEX projects. The UR stated during the two previous SPC reviews that whilst this project has straddled two price controls, this allowance was a ring-fenced amount and that any unspent allowance would be subtracted from the projects final costs. Therefore, we view this as an overspend on the suppliers part, and we propose that it be subtracted from the IT CAPEX allowance.

Other Operations Costs

6.36 <u>Office Costs (including stationery, telephone and postage)</u> – We propose a slight reduction to office costs to reflect the lower than requested FTE number. This is primarily focused on those costs affected by FTE number, such a stationary and telephone costs.

6.37 Rates – SSE Airtricity have applied a nominal 3% uplift above inflation (as per the last price control). We propose to allow these costs as submitted.

6.38 Professional and Legal Fees – We accept SSE Airtricity's Year 1 forecast to be reasonable. However, we propose to maintain it at that level for the duration as spend will not rise significantly with customer growth.

6.39 Insurance – SSE Airtricity have applied a reasonable 2% uplift. We propose to allow these costs as submitted.

6.40 Licence Fee – We propose to accept the submission as the forecasts are reasonable.

6.41 Network Maintenance (including safety inspections) –We propose to accept the submission as the unit rates for maintenance items and safety inspections are set by the network company and the volumes are retrospectively adjusted.

6.42 Customer Engagements – When its new billing system goes live, SSE Airtricity has proposed contacting all customers outlining the new digital services available and suggest that customers shift away from paper to digital communication. An allowance for one letter per customer is included in the proposals for SPC23 at a cost of £0.75 per customer (which would equate to ~£150k total). We do not view this as value for money, and propose to not accept that cost. We propose to allow the remaining costs as submitted.

Billing Costs

Table 3: Billing Costs

Billing Costs	Actuals/LBE			Initial Submission				Consultation Proposals			
	2020/21 (Actual)	2021/22 (LBE)	2022/23 Forecast	2023/24	2024/25	2025/26	2026/27	2023/24	2024/25	2025/26	2026/27
Bad debt (Tariff only)	242	420	1,137	1,092	1,132	1,159	1,183	691	724	757	790
Paypoint costs & credit check costs	480	512	752	790	827	864	901	790	827	864	901
Bank and Interest Charges	186	133	236	248	260	271	283	248	260	271	283
Meter reading	729	817	971	1,050	1,146	1,282	1,484	1,050	1,146	1,282	1,484
Customer Information	582	739	942	866	932	999	1,068	866	932	999	1,068
Letter of Credit	236	284	306	326	342	357	373	326	342	357	373
Tracing costs	24	23	28	35	36	38	39	35	36	38	39
Text alerts	5	9	20	26	34	37	49	10	10	11	11
Bad Debt Management	0	0	0	0	0	0	0	0	0	0	0
Bill Processing	0	0	0	0	0	0	0	0	0	0	0
Total Costs	**2,483**	**2,937**	**4,392**	**4,431**	**4,708**	**5,007**	**5,380**	**4,014**	**4,276**	**4,579**	**4,950**

Bad Debt

6.43 In SPC20, SSE Airtricity was provided a bad debt allowance of 0.47% of tariff credit turnover (i.e. non-prepayment customer turnover). The supplier states that during SPC20, external factors such as increased cost of gas and customer behaviour has led to a higher than expected level of both live and closed (written off) debt.

6.44 The supplier states that these external factors are set to continue into SPC23, and that it requires the existing actual write-off provision for bad debt to increase to 0.65% of tariff credit turnover. In addition, due to the increased level of debt experienced in 2020 and 2021 resulting from the same external factors, the supplier also asks for an additional 0.32% provision for ‘aged live debt’ for existing customers.

6.45 Overall, the supplier is asking for 0.97% of tariff credit turnover as a bad debt allowance

Draft Determination

6.46 From analysis of the supplier’s financial accounts and responses to numerous UR Information Requests, we can confirm that actual bad debt experienced by SSE Airtricity indeed increased during SPC20.

6.47 However, we do not propose providing the supplier with a separate live debt allowance as it has requested. In effect such an allowance could be providing two allowances for the same debt.

6.48 Neither the UR nor suppliers can reliably forecast how the economic factors that drive bad debt may change over the course of SPC23. All we have available to us is data on how the supplier has actually performed in recent years. Therefore, we propose averaging the supplier's actual written off bad debt for the last 3 years (FY20-22) and providing that as a percentage of tariff credit turnover for an allowance for SPC23. This methodology will provide the supplier with a 0.6% Bad Debt allowance.

Other Billing Costs

6.49 Paypoint Costs & Credit Check Costs - We propose to accept the submission as these rates are agreed and numbers are retrospectively adjusted.

6.50 Bank and Interest Charges – We propose to accept the submission as the forecasts are reasonable.

6.51 Meter reading - We propose to accept the submission as the rates are set and numbers are retrospectively adjusted.

6.52 Customer Information Processing and Postage - We propose to accept the submission as these rates are agreed and numbers are retrospectively adjusted.

6.53 Letter of Credit - We propose to accept the submission as the forecasts are reasonable.

6.54 Tracing Costs - We propose to accept the submission as the rates are in line with customer growth.

6.55 Text Alerts – We propose to use FY21 LBE as a baseline, and increase the allowance for each year of the control in line with customer growth.

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 Grid[9]. 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. We will discuss the parameters of the energy balancing element of the tariff with SSE Airtricity during the consultation period.

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

9 National Transmission System (NTS) charges: https://www.nationalgrid.com/gas-transmission/charging/transmission-system-charges

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, the UR—along with external consultants—carried out a complete review of margin. For this we used the framework of analysis developed during the 2013 Power NI price control review to understand what an appropriate margin would need to be in order for the two gas companies to be in a position to earn a profit equivalent to the amount of financial capital in a supply business multiplied by the cost of that capital (i.e. a capital base x cost of capital calculation).

8.2 In the case of the capital base, we assessed the size of requirements of the following: fixed assets, customer acquisition costs, collateral and security deposits, working capital, and standby risk capital.

8.3 In terms of cost of capital, we applied the methods that regulators typically use when calculating the weighted costs of capital (WACCs) of regulated companies more generally. This entails, in particular, the use of the capital asset pricing model (CAPM) to estimate the cost of equity.

8.4 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 FES and SSE Airtricity and their advisors, whilst at the same time taking account of other benchmarks in the energy industry. Both companies accepted the same margin in SPC20 given little underlying change to market conditions.

8.5 In GB, the margin set in the Standard Variable Tariff ~3% (Margin is a fixed percentage of 1.9% of turnover; and added headroom set as fixed percentage of costs—excluding network costs—at 1.46%).

8.6 The regulated gas tariffs in NI also importantly include a ‘K-Factor’ to address under / over recoveries within the tariff. This serves as an important cost / risk mitigation mechanism, therefore reducing the need for added risk premiums within the margin.

8.7 We do not believe that market conditions have changed sufficiently to warrant any amendment to this level of margin agreed in SPC20. SSE Airtricity still retain a dominant position in supply to price regulated customers, as well as cost pass through of volatile wholesale costs; plus the freedom to change tariffs at any time of the year in order to collect under recoveries and future increased forecast costs. Therefore, we propose no change to the allowed margin.

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 2021 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 Consumer Prices Index Including Owner Occupiers' Housing Costs (CPIH).

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 Bank of England Base Rate plus 1.5%. The Bank of England Base Rate will replace LIBOR which was previously used. 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 Your response may be made public by the Utility Regulator. If you do not want all or part of your response or name made public, please state this clearly in the response by marking your response as ‘CONFIDENTIAL’.

10.2 Therefore if you want other information that you provide to be treated as confidential, please be aware that, under the Freedom of Information Act 2000, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential.

10.3 Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 and the Data Protection Act 2018.

10.4 As stated in the GDPR Privacy Statement for consumers and stakeholders, any personal data contained within your response will be deleted once the matter being consulted on has been concluded though the substance of the response may be retained.

10.5 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.

10.6 Responses should be received by 4pm on 31 August and should be addressed to:

Colin Magee
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Queens House
14 Queen Street
Belfast
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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
Customer Engagements	Customer number
Bad debt	Credit Revenue[10]
Paypoint costs & Credit Check Costs	PAYG customers[10]
Bank and Interest Charges	Load in therms
Meter reading	Customer numbers[10]
Customer Information Bill Processing and Postage	Customer numbers[10]
Tracing Costs	Customer numbers
Text Alerts	Tariff only

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