Price Control for firmus energy (Supply) Ltd 2023-2026

Draft Determination for Consultation May 2022

THE CONSUMER COUNCIL RESPONSE

CONTENTS

The Consumer Council response to the Utility Regulator Price Control for firmus Energy (Supply) Ltd 2023-2026: Draft Determination for Consultation May 2022.

29th July 2022

1. Executive Summary

1.1 The 2023-2026 Price Control is an opportunity for the Utility Regulator (UR) to continue to safeguard consumers, and promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland. The interests of consumers must be at the heart of the Final Determination; especially after the record gas tariff increases that consumers in Northern Ireland endured in 2021/2022, leaving many households in vulnerable circumstances, having to choose between eating and heating.

1.2 We acknowledge the work carried out by UR and firmus energy (Supply) Ltd (FES) in delivering this price control draft determination. The main points in our response are:

- It is important the Utility Regulator continues to ensure costs are properly allocated to FES' regulated and unregulated businesses, as well as to supply and distribution businesses;
- Where costs are adjusted retrospectively, any up-front allowance should reflect, as closely as possible, what the actual spend will be;
- FES and the Utility Regulator should seek to ensure opportunities for efficiencies are taken in this determination and throughout the lifetime of this control; including by examining best practice in other network areas;
- The existing 2% margin level for FES is sufficient;
- The profit margin should be reviewed and tapered when wholesale prices go up, but operating costs remain the same, to prevent excessive profits being made; and
- We would encourage FES to again commit to donating a percentage of it's profits to a fuel bank initiative each year to help those in energy crisis.

1.3 As a regulated company, firmus energy must ultimately be accountable to its customers. This accountability must be underpinned by transparency in respect of its operational activities, and pricing. Consultation on this draft determination is a welcome step in providing the assurances required to ensure that firmus energy are operating in the interest of Northern Ireland consumers.

2. The Consumer Council

2.1 The Consumer Council is a non-departmental public body (NDPB) established through the General Consumer Council (Northern Ireland) Order 1984. Our principal statutory duty is to promote and safeguard the interests of consumers in Northern Ireland. The Consumer Council has specific statutory duties in relation to energy, postal services, transport, and water and sewerage. These include considering consumer complaints and enquiries, carrying out research, and educating and informing consumers.

2.2 **Consumer Principles**

We use the eight consumer principles shown in Figure 1 as a framework that asks important questions about service design and delivery, consumer impact and how services should look and feel to the consumer, and that helps assess regulatory decisions from a consumer perspective.

Figure 1: The Consumer Council's Eight Consumer Principles

2.3 The consumer principles also establish a common language that all stakeholders (Government, Regulator, Consumer Advisory Body, and the Company) can use to meaningfully and constructively engage with consumers to develop trust and a better understanding of the value for money a company can provide.

2.4 The Consumer Council welcomes the opportunity to respond to the Utility Regulator (UR) Control for firmus Energy (Supply) Ltd 2023-2026: Draft Determination for Consultation, to ensure that the interests and needs of Northern Ireland consumers are represented and protected.

3. Consumer Context

3.1 From the 1st July 2022, the typical annual cost of the regulated gas supply tariff in Ten Towns for a typical credit meter customer is 21% more expensive than a typical credit meter customer in the regulated gas tariff in Greater Belfast [1].

3.2 Household incomes in Northern Ireland are under pressure as a result of high inflation with significant increases to food, fuel and home energy costs.

3.3 Northern Ireland's lowest earning households' biggest outlay is for energy bills. On average 20% of their weekly basic spending is on housing, water, electricity, gas & other fuels[2].

3.4 Northern Ireland's lowest earning households have only £29 of discretionary income to spend per week (£28.86) [2].

3.5 44% of Northern Ireland consumers have £300 or less to spend after essential outgoings each month. This figure is significantly higher for [C2DEs (49%)], those not working (54%), those with an income of <£20,000 (72%), renters (56%) and those who consider themselves significantly limited by a disability (59%)[2].

3.6 In 2022 home energy was cited as the biggest expenditure worry for 30% of consumers, up from 9% in 2021[3].

3.7 Finally, 34% (247,000) of households are classified as being in fuel poverty[3]. A significantly higher level of fuel poverty was recorded in households where gas (47%) is the main source of fuel for heating, this equates to approximately 102,000 households that use gas as their main heating source.

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[1] The Consumer Council calculations using a consumption of 12,000kWh and the unit rates of SSE Airtricity and firmus energy.

[2] Centre for Business and Economics Research, Impact of Covid-19 on household finances in Northern Ireland – Q1 2022, June 2022

'Lowest earning households' definition: Quartiles are income values which divide the population, when ranked by household income, into four equal-sized groups. 'Lowest earning households', also known as Quartile 1, are the bottom 25 per cent of the income distribution.

'Discretionary Income' definition: Discretionary Income = Gross Household Income – Taxes – Cost of basics

[3] The Consumer Council Consumer Insight Survey 2022, March 2022.

[4] The Consumer Council A Review of Fuel Poverty Levels in Northern Ireland Survey 2022, May 2022.

4. Scope and Duration

4.1 FES remains the only domestic supplier in the Ten Towns area and the dominant supplier in the small business market segment, therefore the Consumer Council agrees with UR that the price control should remain for End User Category 1 (EUC1) up to 73,200kWh per annum.

4.2 The Consumer Council agree that a four-year period is the more appropriate duration for the price controls as it balances the resource and cost implications of carrying out a control with the ability to forecast accurately over the medium term. Therefore, UR should apply the control for the period from; 1 January 2023 to 31 December 2026.

5. The Regulated Tariff and Network Costs

5.1 The cost of energy is a primary concern for Northern Ireland consumers, especially those domestic gas customers in the Ten Towns who have had to endure five different tariff increases from 1st April 2021, seeing their average annual bill increase from £440 to £1,504.

5.2 The Consumer Council supports UR's proposal to maintain the k-factor at a minimal level, through the use of regular tariff reviews and a trigger mechanism to monitor the tariff closely, therefore, minimising the impact of the k-factor on the tariff.

5.3 The Consumer Council continues to willingly participate in the formal bi-annual tariff review process, and we fully support the trigger mechanism, which can help mitigate tariff volatility for consumers. However, we are of the opinion that the current 5% trigger should be increased to 10% due to the number of tariff increases (five) experienced in the Ten Towns network since April 2021 until May 2022. By increasing the trigger percentage, this should reduce the number of tariff reviews in the Ten Towns network in the event of periods of volatility which we are currently witnessing. By reducing the number of tariff reviews, gas consumers will have more breathing space between reviews and can therefore more time to adapt to price changes.

5.4 The Consumer Council believe there is a distinct lack of consumer understanding around the reason for the many recent gas price increases. For example, consumers lack knowledge of why a tariff increase is necessary; how the tariff increase is calculated; and why gas suppliers cannot absorb these wholesale energy costs when they are forward purchasing gas, rather than passing these increases onto consumers. This lack of knowledge and misinformation is having a detrimental impact on consumer trust with the gas industry and especially with FES in the Ten Towns Network. We would suggest UR encourages FES to engage more with the local communities they serve and provide further information in respect of pricing so that their customers are better informed in relation to tariff increases.

5.5 Given the record high gas wholesale costs and numerous tariff increases in recent months, we fear many domestic (and EUC1) credit meter gas customers in the Ten Towns network are having to cut back gas consumption and/or do without other essentials to be able to afford other household / business expenditure. These gas customers are being penalised by having to pay a higher rate for their first 2,000 kWh compared to lower rate for each kWh after 2,000 kWh (Around 4p (inc VAT) for domestic tariffs and around 6p for SME Business tariffs). The Consumer Council requests that the UR to review the standing charge element of this two-tiered tariff and review its impact on consumers.

5.6 We recognise network costs are outside the control of FES. Therefore, the Consumer Council supports UR's proposal to set them as a pass-through element of the regulated tariff.

6. Supply Operating Costs

6.1 In this section, where the Consumer Council do not comment about specific cost items, we support UR's proposals.

6.2 The consultation sets out the apportionment costs of FES' regulated business only and does not provide any explanation for the choice or level of those cost drivers. It is essential the Utility Regulator ensure that customers of the regulated business are not cross-subsidising the unregulated business. The same explanation should be provided when apportioning cost drivers between firmus energy's supply and distribution businesses.

Manpower Costs

Salaries

6.3 The Consumer Council notes that the UR's proposal to allow an increase of 0.5 Full Time Equivalents (FTE) in each year of the SPC23 period is based on FES' forecast to increase its number of domestic and Industrial and Commercial (I&C) consumers using less than 73,200 kWh by 30,000 in the next four years.

6.4 The Consumer Council notes that the Draft Determination states that *"The additional FTEs requested for regulatory work, customer service and billing appear commensurate and linear with the expected level of customer growth and therefore we propose allowing the increase in costs that FES has requested".*

6.5 However, the forecast 30,000 additional customers does not appear to be in line with the c. 20,000 customer growth over the past 4 years (see table 1 below). In addition, recent significant tariff increases, and the expectation that gas prices will remain high and volatile for the foreseeable future, are likely to reduce the number of connections normally achieved by FES.

6.6 Therefore, the Consumer Council questions the validity of attaining 30,000 new connections by 2026 and suggest that a figure of 15,000 -20,000 new connections is a more reasonable forecast given that the average new connections from 2018 to 2021 was around 5,100) and this was achieved when gas prices were cheaper and less volatile.

Table 1. FES Annual Domestic and IC1 customer growth

Year	Number of new domestic and IC1 customers
2018	5,050
2019	3,826
2020	5,400
2021	6,112
Total	**20,388**

Source: figures submitted to UR by Firmus to us for the number of connections in each calendar year.

6.7 In addition, 80% the customers of FES' regulated business are on pay as you go tariffs[4]. The ratio is unlikely to change significantly during the SPC23 period. These customers do not receive bills nor require account management. We ask UR to clarify whether it has considered this when proposing the 0.5 annual increase of FTEs.

6.8 On this basis we request that the UR revise downward the proposed manpower increase. Should customer numbers reach the FES forecast, then they should be allowed to retrospectively claim back costs per connection.

6.9 The Consumer Council would welcome UR monitoring and analysis on the costs of training and recruitment to ensure FES delivers good value for money and satisfactory levels of customer service in comparison to other regulated suppliers.

Travel and Subsistence

6.10 We would welcome assurances that firmus energy's Travel and Subsistence costs are allocated fairly and transparently between firmus energy's distribution and supply businesses, and between FES' regulated and unregulated customers.

Operations Costs

IT OPEX and CAPEX

6.11 The Consumer Council notes the significant uplift in information technology allowances for the SPC23 period. Our understanding was allowed to invest in a new billing system to replace FES' IUS system during SPC23 and that the new system would make its operations and billing processes more efficient and cost effective and deliver a better consumer experience. Therefore, we are surprised at the 32% average annual uplift in IT costs across the period.

[4] The Consumer Council calculations using UR's Quarterly Transparency Report Q1 2022.

6.12 In addition, the Consumer Council questions the validity of basing the uplift in IT allowances on customer growth figures. We do so because it is unlikely that IT maintenance costs will rise in direct correlation to customer numbers and, as outlined in paragraphs 6.4 – 6.8 of this response, it is likely that customer growth numbers will be lower than the FES forecast.

Professional and Legal Fees

6.13 We believe UR's approach and rationale to Professional and Legal Fees to be fair in using the forecast for 2022 to be used to set fixed allowance across the four years of SPC23 allowance and disallowing the GDPR related fees.

Advertising, Website and Sales

6.14 We agree with UR's assessment that FES, a monopoly domestic supplier that faces no competition in the Ten Towns market, is not provided with any additional advertising and marketing allowance during SPC23, even if other suppliers enter the domestic market. This is the case with Power NI (PNI) and SSE Airtricity Gas (SSE) who are also denied a marketing allowance in their respective price controls.

Office Costs

6.15 With regards to Office Costs, Firmus Energy operates its regulated supply businesses from the same premises as its distribution and unregulated supply businesses and many costs may be common or jointly incurred. Therefore, it is particularly important that costs are properly identified and allocated to the relevant business. Firmus Energy will have an incentive to favour allocation to its regulated business and it is important that UR continues to oversee the cost allocation.

Rates

6.16 The Consumer Council believes that the rates element of the SPC23 should be the pass-through of the Lands and Property Services (LPS) bill. However, we would expect FES to seek advice from LPS to minimise its rates bill or mitigate any planned increases.

Insurance

6.17 UR has not clarified whether the higher insurance costs due to the impact of COVID-19 covers the regulated and unregulated FES business and if so, how is the cost to be apportioned between the two.

Network Maintenance

6.18 We note 62% annual average uplift in proposed Network Maintenance costs for SPC23 compared to the actual in 2020, 2021 and the LBE for 2022. While we recognise that maintenance requirements are likely to be increasing due to the age of the Network and current inflationary pressures, it is important that FES, FED and the UR provide consumers clarity regarding these increases. We ask UR to explain what has determined these proposed increases in Network Maintenance Costs by firmus energy Distribution Limited and confirm that these allowances are as cost reflective as possible.

Billing Costs

Bad Debt

6.19 We need to balance the need to keep bad debt as low as possible with the recognition that more people could get into debt with ever increasing gas prices. The Consumer Council believes that the methodology to set FES' Bad Debt allowance should be based around the following principles:

- Supporting vulnerable customers;
- Being cost reflective;
- Requiring FES to have processes and systems in place to reduce risk of bad debt;
- Providing an incentive to increase FES' efficiency;
- Reflecting investment in for example the new billing system implementation that may have a positive impact on debt management; and
- Considering the socioeconomic profile of FES' regulated customers.

6.20 With regards to UR's proposals in respect of Bad Debt for SPC23, we note the significant difference (92%) between the allowance in UR's SPC20 (£277K) and FES' actual Bad Debt costs for tariff customers only in 2020, 2021 and the LBE for 2022 (£133K). We ask UR to explain the differential and confirm that the allowance for SPC23 is as cost reflective as possible.

6.21 Based on this evidence, and without an explanation of the reasons for the disparity between the SPC20 allowance and FES' actual costs, the Consumer Council believes that FES' Bad Debt SPC23 allowance should be based on historical data for FES' regulated business. In this case, using the figures for the SPC20 period.

6.22 UR proposes to use a 45:55 ratio to apportion the Debt Costs allowance between FES' regulated and unregulated businesses. This is based on FES' analysis that would show that "larger unregulated I&C customers are less likely to default on payments."

6.23 The Consumer Council's own analysis of gas consumption in Ten Towns by FES customer type shows that regulated bill pay customers only account for around 20% of all the gas that FES sells in Ten Towns. This is shown in Table 2. Given that pay as you go customers cannot fall into debt[5], we ask UR to re-examine the Bad Debt weighting to ensure that it is as cost reflective as possible.

6.24 It would be helpful if Table 4, page 19 in UR's consultation paper showed the Bad Debt figures split between FES' regulated and unregulated businesses for each year of the price control. This will provide more clarity about the actual allowance as well as providing a comparison between both businesses.

[5] With the exception of instances of meter interference.

Table 2. FES Ten Towns Consumption Analysis by market segment extracted from the 2021 Firmus Distribution REMM submissions

	Ten Towns firmus energy Consumption for 2021 (MWh)	% share of overall consumption
Regulated pay as you go (EUC1)	434,542	50%
Regulated bill pay (domestic credit & small I&C EUC1)	169,126	20%
I&C <73,200kWh (EUC2)	143,431	17%
I&C >73,200 kWh (EUC3)	109,552	13%
Total	856,651	100%

Source: The table above was extracted from the Firmus Distribution REMM submissions (excludes the I&C daily metered consumption of 625,879MWh).

Bill Processing and Postage

6.25 The Consumer Council believes that rather than increasing or even staying constant during the price control period, more should be done to encourage customers to move to online and digital methods for receiving customer information and billing, thus reducing communication costs per customer.

Paypoint Costs incl. PAYG Cards

6.26 At present FES pay as you go (PAYG) customers can only top-up at PayPoint outlets. From the perspective of the PAYG users, it would be a positive development to have a greater choice of options to top-up. If the trial and roll out of the new “smarter” gas meter which will allow gas customers to top-up online proves successful in SPC23, we ask UR and FES if they have factored in the possible reduction on the use of PayPoint during this price control period.

Meter Reading

6.27 The Consumer Council would like to know if the rates that are set for meter reading are benchmarked those with SSE Airtricity Gas and suppliers outside Northern Ireland. We ask UR to provide further analysis on this issue in the final determination.

6.28 We note also that FES advises and incentivises its customers to provide their own meter reads through discounts and billing advice[6]. Have these incentives reduced the number of meter readings that FES has had to undertake for its regulated and unregulated businesses, and if so, has UR considered this when setting the SPC23 allowance.

[6] https://www.firmusenergy.co.uk/home/help-advice/network/billing-payments/can-i-manage-my-account-online-to-monitor-my-consumption

7. Gas Costs

Energy Balancing

7.1. The Consumer Council believes it is important that FES is not incentivised to increase potential risk for consumers by leaving large proportions of gas to be purchased within the month, particularly during times of market uncertainty.

7.2. We believe that UR should further consider whether:

- A full 10% premium is required to fund the extra cost of gas purchased in the month.
- Whether full pass through of the premium is required up to 40% of the gas requirement, or whether by more effective demand forecasting FES should be able to forecast actual demand with greater accuracy and therefore have an active incentive to purchase a greater proportion of their gas in advance.

7.3. We ask that UR benchmark both these aspects of the energy balancing cost against SSE Airtricity in the Greater Belfast network and other gas suppliers in GB.

8. Margin

8.1 We agree with UR's assessment that the regulated retail market conditions in Ten Towns have not changed sufficiently during the years of the SPC20 period. However, as the hedging risk to gas purchases falls almost entirely to consumers, the Consumer Council would still question if the 2% margin level is too high a reward for the risk involved for SPC23.

8.2 We believe that the profit margin should be reviewed and tapered to a lower percentage (than 2%) when wholesale prices go up, but operating costs remain the same thus preventing excessive profits being made by FES. This tapered approach would help limit the impact that high energy prices are having on households that are experiencing energy crisis in the Ten Towns network.

8.3 We would also encourage FES to commit to donating a percentage of it's profits to a fuel bank initiative each year to help those households in energy crisis.

9. Reconciliation Costs

Inflation

9.1 The Consumer Council agrees with UR using the Consumer Price Index (CPI) in SPC23 rather than using the Retail Price Index (RPI) as its measure of inflation. Other regulators such as Ofcom, Ofwat and Ofgem have already moved to using the Consumer Price Index (CPI) in their current regulatory reviews.

Rate of Interest

9.2 The Consumer Council support the change from LIBOR (London Inter-Bank Offered Rate) that was used in SPC20 to the Bank of England Base Rate plus 1.5% for SPC23.

9.3 The Consumer Council remains committed to working in partnership with UR and the gas industry to develop natural gas and its accessibility, to promote competition and most importantly, to protect the interests of consumers.

10. Contact Information

To discuss our response in more detail, please contact:

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The Consumer Council consents to this response being published.