Utility Regulator Determination on

Phoenix Supply Price Control, 2012 - 2016

November 2011

1.0 Executive Summary

The following document sets out the Utility Regulator's price control determination for Phoenix Supply Ltd. (PSL)

Requirement for Price Control

PSL has a licence to supply gas. Under the terms of this licence the Utility Regulator has the power to control how much PSL can charge for gas. The price control, as laid out in this document, serves as a substitute where there is no effective competition in order to protect the interests of gas customers. The Utility Regulator has determined that in the market for customers using less than 25,000 therms per annum (typically domestic and small industrial and commercial properties) there is not yet effective competition.

Process

This is the third price control for Phoenix Supply Ltd. The first price control was for the period from 1 January 2007 to 31 December 2008, the second for the period from 1 January 2009 to 31 December 2011.

In June 2011 we published our minded to position for consultation. This laid out the proposals for the price control. This paper can be found at http://www.uregni.gov.uk/news/minded_to_position_on_the_third_price_control_for_phoenix_supply_ltd/

There were four responses to this consultation from
PSL
Consumer Council for Northern Ireland
firmus energy
Power NI

These responses can be found on our website.

Tariff

The tariff charged by PSL is made up of a number of elements. The price control determines how each of these elements will be treated. These elements and their treatment are listed in the table below.

Treatment of costs

Cost Element	Treatment	Section
Transmission	Pass through	8.0 Network Costs
Distribution	Pass through	8.0 Network Costs
Gas Costs	Pass through	7.0 Gas Costs
K factor	Pass through	9.3 K factor
Supply Operating Costs	Determined by price control	6.0 Operating Costs
Margin	Set at 1.5% of allowed revenue	10.0 Margin

The tariff is reviewed on a bi annual basis in April and October to ensure that the tariff charged to customers is reflective of the costs incurred by PSL. Additionally there is a facility to undertake a tariff review at any stage where costs have changed significantly from those forecast.

Scope

The price control will apply to all customers using less than 25,000 therms per annum (typically domestic and small industrial and commercial properties).

Duration

The price control will last for five years effective from 1 January 2012 to 31 December 2016. There will be a review of the price control after three years to ensure that the decisions within the control remain appropriate in the light of changes in the market, the company or the economy.

Outcome

Supply Operating Costs (2010 prices)

PSL submit forecast operating costs which we then review. We set an allowance for each cost, based on an analysis of actual costs over the last number of years, forecast volumes and further information provided by PSL. We consult on our proposals for the price control and consider the responses received and carry out further analysis where required to establish a final determination. The table below shows the PSL submission, the Utility Regulator determination and the variance between the two. The pence per therm represents the cost to each customer for every therm of gas used.

Cost	2012	2013	2014	2015	2016
PSL Submission total costs (‘000)	£6,439	£5,903	£5,826	£5,904	£5,975
PSL Submission pence per therm	10.27	10.39	10.38	10.09	9.80
UR Determination total costs (‘000)	£5,004	£4,772	£4,669	£4,673	£4,742
UR Determination pence per therm	7.98	8.40	8.32	7.99	7.78
Variation	22%	19%	20%	21%	21%

Impact on customers

In terms of operating expenditure as shown in the table above our final determination has reduced costs from PSL’s original submission by an average of over 20%, saving customers on average over £1.1m per annum.

Per customer this equates to a saving of around £9 per annum over the period of the control on operating costs.

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2.0 Introduction

2.1 Aim

The aim of this paper is to set out the Utility Regulator's determined to position on the third price control for Phoenix Supply Ltd (PSL). This price control will take effect from 1st January 2012.

2.2 Introduction

This is the third price control for Phoenix Supply Ltd. The first price control was for the period from 1 January 2007 to 31 December 2008, the second for the period from 1 January 2009 to 31 December 2011.

In June 2011 we published our minded to position for consultation. This laid out the proposals for the price control. This paper can be found at http://www.uregni.gov.uk/news/minded_to_position_on_the_third_price_control_for_phoenix_supply_ltd/

There were four responses to this consultation from
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Consumer Council for Northern Ireland
firmus energy
Power NI

These responses can be found on our website.

2.3 Methodology

In determining the appropriate treatment of costs we have considered the submission received from PSL and subsequent discussions, the actual costs incurred in previous years, our previous determinations, responses to consultations and appropriate benchmarks in the industry.
All prices in this document are in 2010 prices unless stated otherwise.

3.0 Timescale

This price control determination is set to last for five years from January 2012 to December 2016. There will be a review at three years to establish if the price control should be reopened at that point. The review will examine such items as

- Costs
- Volume
- Market share
- Competitive Environment
- Policy position of the Utility Regulator

4.0 Scope

This determination will apply to customers using less than 25,000 therms per annum.

The Utility Regulator has reviewed the margin achieved by PSL in the greater than 25,000 therms market, the behaviour of suppliers and customers in the market and the number of supply companies operating in the market. We consider that customers are benefitting from competition in this market. However, we will continue to monitor this market closely and review this decision if there is evidence that competition is not effective.

5.0 Forecast Gas Volumes

For this determination the Utility Regulator has accepted the submissions from PSL in terms of volumes of gas flowed and numbers of customers. Included in the submissions are assumptions on the impact of competition. PSL assume that by 2012 20% of domestic customers will have switched to an alternative supplier and by 2013 30% will have switched remaining at 30% for the rest of the control period. PSL have also made assumption of the number of new connections which is in the region of 5,000 customers connecting to PSL each year.

In their response to the consultation firmus energy state that
We note that PSL's forecast was 5,000 new connections each year. Firmus energy understands current connection levels are circa 8,000 per year. Therefore we fail to understand how a developing gas market is able to forecast a lower annual connection number than current levels.

We consider that PSL are incentivised to forecast volumes accurately by the correction mechanism (see section 9.4). Additionally the majority of items for which volumes and customer numbers are a cost driver are retrospectively adjusted for the actual figures. These include billing costs such as meter reading, bill printing and postage and bad debt. The apportionment between tariff and non tariff customers is also retrospectively adjusted.

PSL will be allowed to present revised volume assumptions at each tariff review period.

6.0 Operating Costs Expenditure Analysis

6.1 PSL Submission

The following table shows the PSL submission for the five year period of the price control. All figures are in 2010 prices.

Table 1 PSL Submission from 2012 to 2016 (£'000s)

Cost	**2012**	**2013**	**2014**	**2015**	**2016**
Network Maintenance	£323	£322	£322	£323	£325
Manpower	£1,647	£1,667	£1,687	£1,703	£1,721
Fleet Costs	£68	£68	£69	£69	£69
Travel and Subsistence	£20	£20	£20	£20	£20
Rates	£43	£43	£43	£43	£43
Office Costs	£222	£217	£212	£208	£218
Telephone & Postage	£53	£42	£43	£44	£46
Stationery	£48	£48	£47	£49	£50
Advertising, Marketing and PR	£338	£335	£334	£335	£337
Licence Fee	£68	£68	£68	£68	£68
IT	£259	£170	£169	£179	£178
Professional and Legal Fees	£174	£181	£159	£159	£159
Billing	£3,037	£2,588	£2,413	£2,568	£2,603
Entertainment	£16	£16	£16	£16	£17
Insurance	£65	£65	£65	£65	£65
Human Resources	£45	£40	£41	£42	£43
Capex	£13	£13	£118	£13	£13
PSL 12 Submission	**£6,439**	**£5,903**	**£5,826**	**£5,904**	**£5,975**

6.2 Utility Regulator Determination

The following table shows the Utility Regulator's determination on operating costs and capital expenditure for the period of the price control. The detail regarding these decisions can be found in the remainder of this section.

Table 2 Utility Regulator Determination (£'000)

Cost	2012	2013	2014	2015	2016	Reference
Network Maintenance	£289	£249	£197	£147	£147	6.7
Manpower	£1,511	£1,507	£1,520	£1,526	£1,526	6.13
Fleet Costs	£56	£56	£56	£56	£56	6.5
Travel and Subsistence	£15	£15	£15	£15	£15	6.5
Rates	£44	£44	£44	£44	£44	6.5
Office Costs	£222	£217	£212	£208	£218	6.12
Telephone & Postage	£35	£35	£35	£35	£35	6.5
Stationery	£38	£38	£38	£38	£38	6.5
Advertising, Marketing and PR	£119	£119	£119	£119	£119	6.8
Licence Fee	£65	£65	£65	£65	£65	6.5
IT	£172	£170	£171	£180	£178	6.9
Professional and Legal Fees	£138	£148	£133	£123	£123	6.11
Billing	£2,246	£2,052	£2,006	£2,060	£2,121	6.14
Entertainment	£8	£8	£8	£8	£8	6.6
Insurance	£57	£57	£57	£57	£57	6.5
Human Resources	£27	£27	£27	£27	£27	6.5
Capex	£13	£13	£13	£13	£13	6.10
UR Determination	**£5,055**	**£4,820**	**£4,716**	**£4,721**	**£4,789**	
Efficiency Factor	**1%**	**1%**	**1%**	**1%**	**1%**	6.3
Determination	**£5,004**	**£4,772**	**£4,669**	**£4,673**	**£4,742**	

6.3 Efficiency Factor

In our consultation we stated that we were minded to apply an efficiency factor of 2.5% to all operating costs. PSL responded to this with the following arguments.

- Inconsistent with treatment of Power NI
- Regulator has not conducted an assessment of efficiency of PSL business operations
- PSL does not have post privatisation efficiency to be taken out
- Double counting of efficiency on top of cuts to forecast expenditure
- PSL operates competitive tendering
- Competition leading to a small customer base

We consider that the application of an efficiency factor to PSL's operating cost is both necessary and appropriate. This price control is set for five years compared to the two year control for Power NI. It is appropriate to assume that within this time frame the impact of competition and changes in the market will lead to innovation and efficiency.

The basis of this price control has been to examine historical costs and roll those costs forward at an appropriate level. So by applying an efficiency factor we do not make a judgment on whether PSL's existing cost base is efficient, or assume that there are inefficiencies to be removed. We consider whether it is appropriate to roll these costs forward at inflation or whether the changes to the market that this company operates in, and the type of costs incurred will mean that they will be able to identify additional efficiencies over the timeframe of the control.

Furthermore the GB market is some years ahead of the NI market in terms of competition. PSL has the opportunity to capitalise on the experience of firms in this market and the examples of best practice and innovation from this market.

PSL also argue that the efficiency factor should not be applied to retrospective items. They state

To apply an efficiency factor to retrospective items does not give Phoenix Supply an opportunity to meet the efficiency factor applied

Retrospective items are certain costs within the PSL cost base which are driven by volumes or customer numbers. For each of these costs an allowance is set per unit which is multiplied by a forecast number of units. This is then retrospectively adjusted to allow for the actual number of units.

These costs, the units and cost drivers involved are identified below

Table 3 Cost items and their respective drivers

Cost	Unit allowance	Cost Driver
Bad Debt	1% of credit turnover	Credit turnover
Billing Printing and Postage	Cost to print each bill Cost to post each bill	Number of Bills
Meter Reading	Cost to read each meter	Number of meter readings
Transaction charges for prepayment meters	Charge for each transaction	Number of transactions

The unit cost is determined on the same basis as other costs within the price control and in line with all other costs it is appropriate that an efficiency factor is applied to this cost.

PSL consider that the proposed efficiency factor of 2.5% is not appropriate.

We have reviewed the efficiency factor with consideration to

- The latest analysis produced by Ofgem in the electricity distribution price control (DPCR5)
- The figures used in the Phoenix Natural Gas Distribution price control proposals and
- The principles outlined above

On this basis we determine that an efficiency factor of 1% will be applied to the operating costs of PSL. The table below shows the impact of the efficiency factor.

Table 4 Impact of Efficiency Factor

Year	2012	2013	2014	2015	2016
Impact of Efficiency Factor ('000)	£51	£48	£47	£47	£48

6.4 Apportionment of Costs

When apportioning the determined costs between tariff and non tariff customers we have identified the most appropriate cost driver for each cost. Table 2 shows each cost item and the driver we have used to apportion these costs.

Following comment from PSL on the apportionment used we have made the following change.

- Bad Debt – in the minded to position this was the figure for tariff bad debt only. Following the submission of additional information from PSL we have updated the calculation to show total bad debt and apportioned this to tariff and non tariff customers on the basis of credit revenue.
- Sales – in the minded to position we allocated 100% of sales staff to the non tariff sector. Following discussion with PSL we have allocated 50% to tariff and 50% to non tariff on the basis that there are a large number of I&C customers within the tariff sector.

The apportionment of operating costs will be retrospectively adjusted on the basis of actual volumes, customer numbers, number of bills generated, number of meter reads and revenue where appropriate.

Table 5 Cost items and their respective drivers

Cost Item	Cost Driver
Network Maintenance	All tariff
Manpower	Manpower Numbers
Fleet Costs	No. of cars
Travel and Subsistence	Manpower
Rates	Manpower
Office Costs	Manpower
Telephone and Postage	Avg. no. burning customers (supplied)
Stationery	Avg. no. burning customers (supplied)
Advertising, Marketing and PR	Avg. no. burning customers (supplied)
Licence Fee	Load in therms
Information Technology	Avg. no. burning customers (supplied)
Professional and Legal Fees	Load in therms
Entertainment	Manpower numbers
Insurance	Load in therms
Human Resource	Manpower numbers
Capex	Avg. no. burning customers (supplied)
BILLING COSTS	
Bank fees & charges	Load in therms
Gas Cards	All tariff
Qntm, Pypt & Libra Service Charges	All tariff
Billing Transaction Costs	All tariff
Bad Debt Allowance	No. bills generated
Billing Bad Debt	Credit turnover
Billing Printing and Postage	No. bills generated
Billing Meter Reading	No meters read

The following table shows the allocation of total costs between tariff and non tariff (contract) sectors over the period of the control.

Table 6 Apportionment of Operating Costs

Year	2012	2013	2014	2015	2016
Tariff	92.1%	92.0%	91.8%	91.8%	91.9%
Contract	7.9%	8.0%	8.2%	8.2%	8.1%

6.5 Treatment of Operating Costs

In the previous two price controls the Utility Regulator scrutinised each cost line contained within the PSL submission and made a final determination on each cost line based on the costs incurred in previous years, the costs forecast to be incurred and any other relevant information.

In total there are sixteen cost lines within the PSL submission. Of these eight cost lines make up more than 94% of the total cost. The remaining eight cost lines, identified below, are to be rolled forward at an average of the last four years actual costs (2007 to 2010). We are content that this methodology is sound having scrutinised the costs robustly in the previous two price controls. The costs allowed are broadly in line with those allowed in the previous price control. The PSL submission and the Utility Regulator's determination for these costs can be seen in the two tables below.

In respect of Licence fees these will be retrospectively adjusted for the actual amount charged to PSL.

Table 7 PSL Submission of Rolled Forward Costs (£'000s)

	2012	2013	2014	2015	2016
Fleet Costs	£68	£68	£69	£69	£69
Travel and Subsistence	£20	£20	£20	£20	£20
Rates	£43	£43	£43	£43	£43
Telephone & Postage	£53	£42	£43	£44	£46
Stationery	£48	£48	£47	£49	£50
Licence Fee	£68	£68	£68	£68	£68
Insurance	£65	£65	£65	£65	£65
Human Resources	£45	£40	£41	£42	£43
PSL Submission	**£410**	**£394**	**£396**	**£400**	**£404**

Table 8 UR Determination on Rolled Forward Costs (£'000s)

	2012	2013	2014	2015	2016
Fleet Costs	£56	£56	£56	£56	£56
Travel and Subsistence	£15	£15	£15	£15	£15
Rates	£44	£44	£44	£44	£44
Telephone & Postage	£35	£35	£35	£35	£35
Stationery	£38	£38	£38	£38	£38
Licence Fee	£65	£65	£65	£65	£65
Insurance	£57	£57	£57	£57	£57
Human Resources	£27	£27	£27	£27	£27
UR Determination	**£337**	**£337**	**£337**	**£337**	**£337**

6.6 Entertainment Costs

The minded to proposal was to disallow all entertainment costs. PSL have argued that they use these funds to run a number of programmes which
‘engage with staff, raise morale and therefore motivate staff to perform more effectively’
PSL have requested that we
‘permit an allowance of £150 per employee in line with HRMC guidance on non taxable employee benefits’.

After reviewing the PSL comments and in line with the treatment of entertainment costs in the Phoenix Natural Gas Distribution price control we have decided to allow entertainment costs at £8k per annum (£150 per employee). This is also in line with the actual costs incurred by PSL in 2010 – the most recent audited accounts of PSL.

Table 9 Entertainment Costs

	2012	2013	2014	2015	2016
PSL Submission	£16	£16	£16	£16	£17
UR Determination	£8	£8	£8	£8	£8

6.7 Network Maintenance

The minded to proposal for network costs included a reduction in costs related to meter tampering and all other costs were rolled forward at an average of the last three years costs. PSL have raised the following concerns.

In relation to Energy Care PSL argue that these costs should increase as the number of customers on the scheme increases. The energy care scheme is available to elderly and vulnerable customers and relates to the provision of adapters and equipment. We note that numbers on the energy care scheme have been increasing over the last number of years but costs have not increased significantly. Indeed in 2010 costs fell. Therefore we have decided to roll the costs forward at the 2009 level of £35k per annum.

In relation to meter tampering PSL state that
Meter tampering is illegal and exceptionally dangerous and we must be clear that responsibility for this criminal activity rests only with those carrying out this illegal activity’
PSL also list a number of activities they carry out in order to highlight the issue of meter tampering.

While we fully agree that the responsibility for meter tampering lies with those who carry out the activity we consider that PSL must continue to be proactive in identifying and dealing with those who carry out meter tampering. Therefore we have designed the price control to incentivise PSL to reduce the number of meter tampering incidents each year.

The Consumer Council stated in their response
'Meter tampering is an illegal activity that puts at risk all consumers and is paid for by all consumers. The Consumer Council believe that with the enhanced powers in the Energy Bill, PSL has the opportunity to reduce this'

Our determination is to allow 75% of the proposed number of meter tampering for the next year, reducing to 25% over the next three years. PSL must evaluate its policies on meter tampering to reduce the levels of meter tampering and to minimise the cost of handling each incident.

In addition we will grant an allowance of £50k per annum for the next three years. This is a ringfenced amount which PSL must demonstrate they have used to identify, deal with and reduce meter tampering.

We have also allowed an increased amount for meter reading for prepayment meters. We have increased the allowance from 1.3 to 2 reads per annum. This equates to an increase of around £53k per annum. We consider that this will aid PSL in discovering meter tampering following the experience of increasing the keypad meter reading by NIE.

The Utility Regulator is considering undertaking a review of meter tampering across all sectors over the next year. The price control will be retrospectively adjusted to account for the impact of the findings of any such review**.**

Table 10 Network Maintenance Costs (£'000s)

	2012	2013	2014	2015	2016
PSL Submission	£323	£322	£322	£323	£325
UR Determination	£239	£199	£147	£147	£147
Network Maintenance Allowance	£50	£50	£50		

6.8 Advertising Marketing and PR

In our minded to position we proposed disallowing costs relating to competition. We allowed costs for customer literature, advertising production and running costs and market research.

We stated that it is our view that customers should not finance either retaining or attracting other customers to PSL. PSL have stated that
'Other industries fund customer acquisition costs from funds recovered from customers which benefits all customers as greater economies of scale can be generated by having a greater number of customers.'

However PSL have also stated
'The advent of competition is likely to result in Phoenix Supply having a smaller customer base and therefore there is little or no scope for the company to generate further economies of scale'

We consider that customers should not pay more for their service because of the introduction of competition and therefore determine that all costs relating to marketing the company are disallowed.

In the distribution price control an amount of £50k per annum has been recharged from PNG to PSL. This recharged cost relates to the benefit PSL receive from marketing by PNG in terms of branding. This cost has been allowed.

Costs have been allowed for customer literature, advertising production and running costs (relating to customer literature) and market research.

PSL have noted that costs for energy efficiency have not been included. We recognise the importance of providing energy advice to customers and the obligations on PSL to provide this advice. These costs have now also been allowed.

Any impact of the EU Third internal Package (IME3) on the branding of PSL will form part of the reopener review after three years.

Table 11 Advertising and Marketing Costs (£'000s)

	2012	2013	2014	2015	2016
PSL Submission	£338	£335	£334	£335	£337
UR Determination	£119	£119	£119	£119	£119

6.9 Information Technology

We have determined that all IT costs, with the exception of those related to PAYG systems will be allowed. We consider that allowing these costs will aid PSL in continuing to strive towards an efficient business. These costs are in support of all PSL's requirements for running their business including but not limited to billing, customer switching and day to day operational matters.

From September 2011 new system capabilities within PNG meant that all PAYG customers could switch suppliers. PSL have identified changes to be made to their system in relation to PAYG to improve switching.

In their response to the consultation firmus energy have stated that
'…information technology costs re: PAYG switching have been allowed. Firmus energy would like to understand why an incumbent supplier has been allowed these costs.'

We consider that it is correct that PSL be granted appropriate costs to ensure their systems are capable of managing the switching process smoothly. PSL will be required to submit a business plan detailing the planned spend and the benefit to the company to demonstrate that these costs are wholly necessary. A retrospective allowance will be granted on the basis that PSL can demonstrate the system is in place and the appropriate allowance was spent.

Table 12 Information Technology Costs (£'000s)

	2012	2013	2014	2015	2016
PSL Submission	£259	£170	£169	£179	£178
UR Determination	£172	£170	£171	£180	£178

6.10 Capital Expenditure

The following table shows the PSL submission for capital expenditure costs and the Utility Regulator's determination.

Table 13 Capital Expenditure (£'000s)

	2012	**2013**	**2014**	**2015**	**2016**
PSL Submission	£13	£13	£118	£13	£13
UR Determination	£13	£13	£13	£13	£13

In 2014 PSL have included the costs for a billing server, the Utility Regulator will allow these costs. PSL will be required to submit a business plan detailing the planned spend and the benefit to the company to demonstrate that these costs are wholly necessary. A retrospective allowance will be granted on the basis that PSL can demonstrate the system is in place and the appropriate allowance was spent.

6.11 Legal and Professional fees

In relation to legal and professional fees PSL have commented that costs relating to the climate change levy should be allowed on an annual basis as
'the cost represents the annual cost of modifying the climate change levy'.

PSL also requested that costs in respect of wholesale market data be included. These costs were already allowed in our minded to position.

This cost includes an annual figure for legal and professional fees of £123k this is to cover all legal and professional costs arising from the business of Phoenix Supply.

The following table shows the determined costs for legal and professional costs.

Table 14 Legal and Professional Costs (£'000s)

	2012	2013	2014	2015	2016
PSL Submission	£174	£181	£159	£159	£159
UR Determination	£138	£148	£133	£123	£123

6.12 Office Costs

The following table shows the determined costs for office costs.

Table 15 Office Costs (£'000s)

	2012	2013	2014	2015	2016
PSL Submission	£222	£217	£212	£208	£218
UR Determination	£222	£217	£212	£208	£218

6.13 Manpower

The table below shows the PSL submission and the Utility Regulator Determination for manpower costs and numbers.

Table 16 Manpower (£'000s)

PSL Submission

	2011	2012	2013	2014	2015	2016
Number FTE	55.00	56.50	55.50	56.00	56.50	57.50
Total Cost ('000)	£1,612	£1,647	£1,667	£1,687	£1,703	£1,721

UR Determination

	2011	2012	2013	2014	2015	2016
Number FTE	53.0	55.0	54.5	55.0	55.0	55.0
Total Cost ('000)	**£1,600**	**£1,511**	**£1,507**	**£1,520**	**£1,526**	**£1,526**

Our determination has been updated for actual 2010 staffing levels and salaries provided by PSL.

Staffing Numbers

We have determined staffing levels of 55 fte for 2012. Actual levels for 2010 are 36 fte with 10 agency staff. We took as our starting position the determined number of ftes for 2011 of 53ftes.

During 2011 PSL were given a temporary allowance for four additional staff to operate the switching system to its current maximum capacity of 1,550 switches per week. The level of switches and resource were monitored on an ongoing basis and adjusted as required. From 2012 onwards we have allowed an additional two grade nine staff to operate the switching system to this capacity of 1,550. We note that switching levels have consistently been weel below the 1,550 limit and that as a result PSL will be able to use this additional resource to increase efficiency if managed appropriately. No further requests for resource will be considered within existing switching constraints.

Additional staffing levels for credit support have been allowed and adjustments made for falls in customer numbers due to competition.

Salary Levels

In our minded to proposals we commented that on a comparison of grade 9 salaries with call centre salaries from the ASHE report we found gross salaries to be largely in line with the ASHE report.

PSL have disputed this point stating that

'To suggest that these salaries are broadly in line with those contained in the ASHE report in hugely misleading'

We compared PSL grade 9 salaries at £12,405 (2010 level) with those in Scotland at a median of £13,962[1]. This provides a difference of 11.2%. ASHE do not report Northern Ireland salaries by occupation, therefore we consider that Scottish salaries offer the closest comparison. ASHE do however comment that NI salaries are lower than in any other region, further ASHE compare median weekly salaries by region. A comparison of the weekly median salary in Scotland with that in Northern Ireland shows that Scottish salaries are higher by 9.7% (£488.2 to £440.8). We consider that this demonstrates that the call centre salaries are largely in line with those in the ASHE report.

PSL have proposed to increase basic salaries by more than inflation over the next few years in order to attract and retain staff. The Utility Regulator does not see any justification for an above inflation rise in salaries. Instead the Utility Regulator will roll forward the 2011 salary at inflation. The Northern Ireland ASHE report shows that gross salaries in Northern Ireland fell between 2009 and 2010[2]. As with all other costs manpower costs will be reduced by the 1% efficiency factor.

[1] Annual Survey of Hours and Earnings, 2010 Provisional Results http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-200444

[2] Northern Ireland Annual Survey of Hours and Earnings 2010 http://www.detini.gov.uk/ashe_2010_ni_statistics_bulletin.pdf

6.14 Billing Costs

The PSL submission for billing costs includes the following costs.

Table 17 Billing Costs PSL Submission (£'000s)

	2012	2013	2014	2015	2016
Gas Cards	£44	£41	£40	£41	£43
Third Party Debt recovery	£102	£81	£68	£71	£74
Bad Debt	£1,114	£902	£785	£821	£861
Transaction Charges	£285	£262	£255	£266	£276
Transaction Costs	£384	£349	£336	£348	£357
Bill Printing and Postage	£302	£275	£269	£280	£292
Meter Reading	£653	£588	£570	£587	£605
Bank Fees	£154	£90	£90	£154	£95
Total	**£3,037**	**£2,588**	**£2,413**	**£2,568**	**£2,603**

The Utility Regulator has determined the following costs. These costs are detailed below.

Table 18 Billing Costs UR Determination (£'000s)

UR Determination	2012	2013	2014	2015	2016
Gas Cards	£15	£15	£15	£15	£15
Debt management allowance	£100	£100	£100	£100	£100
Bad Debt	£557	£515	£524	£547	£574
Transaction Charges	£285	£262	£255	£266	£276
Transaction Costs	£323	£292	£280	£288	£296
Bill Printing and Postage	£287	£265	£259	£269	£278
Meter Reading	£628	£552	£522	£524	£531
Bank Fees	£51	£51	£51	£51	£51
Total	**£2,246**	**£2,052**	**£2,006**	**£2,060**	**£2,121**

6.14.1 Gas Cards

We consider that £15k per annum is an appropriate level for gas cards. The original card for prepayment meters is provided by PNG and customers are charged for additional cards. This allowance will cover replacement of cards where the customer is not charged, eg faulty cards, vulnerable customers etc.

6.14.2 Bad Debt Costs

The table below shows the PSL submission for bad debt

Table 19 PSL Submission on Bad Debt (£'000s)

	2012	2013	2014	2015	2016
Bad Debt	£1,114	£902	£785	£821	£861
Bad Debt as % of Total Revenue	1.25%	1.07%	0.92%	0.90%	0.89%

In the previous price control we set a bad debt allowance of 1% of credit revenue. This allowance was accepted by PSL. We made a statement of intent to reduce this 1% level in the next price control as we considered the level to be too high. We commented that an improvement in PSL's systems and procedures was required.

In the minded to consultation PSL stated that all information requested by ourselves had been provided. During the drafting of the minded to consultation we met with PSL to discuss bad debt. PSL highlighted difficulties customers are experiencing in paying bills and the company is experiencing in tracing and collecting debt. At this meeting we requested from PSL information on debt management procedures from customer connection onwards. This information has not been received. Additionally we requested metrics from PSL on the number of customers in debt by payment method. PSL have stated that they do not collect this information.

PSL state that bad debt has been in excess of 1% of credit revenue since 2008. Nevertheless the 1% level for 2009 to 2011 was accepted by the company and no improvement has been seen in bad debt levels since this time despite our concerns raised in the previous price control.

By comparing PSL to Centrica we are not attempting to compare overall debt levels but instead the levels of 'doubtful' debt which are more likely to lead to bad debt. There is always a difficulty in benchmarking against other companies, particularly the GB supply companies given the lack of transparency in their information and in the provision and collation of this information.

We do consider the best comparison to be Power NI, the regulated electricity supplier in Northern Ireland. Power NI experience many of the risks and issues identified by PSL. The Power NI allowance has been set at 0.56% of total revenue compared to 0.63% equivalent for PSL.

We made clear during the previous price control that it was our intention to reduce the bad debt allowance and would consider a level around the Power NI figure to be appropriate. However for the current period we have decided to remain at the 1% figure due to

- Current economic climate and the difficulties experienced by customers in paying their bills as highlighted by PSL
- Differences with Power NI notably that gas is not available to every property and therefore tracing customers who have moved house, having left debt behind, is more difficult.

In addition we have made other allowances available to PSL to help them to reduce and deal with bad debt. These include

- £100k allowance per annum in order to establish improved debt prevention and management techniques
- Increased meter readings for direct debit customers from one to four
- Increased meter readings for pay as you go and quantum customers from 1.3 to two in order to reduce levels of meter tampering which subsequently lead to bad debt
- £50k per annum allowance for meter tampering to reduce levels of meter tampering and corresponding bad debt

We therefore determine a bad debt level of 1% of credit revenue. Bad debt levels will also form part of the three year review.

Table 20 Utility Regulator Determination on Bad Debt (£'000s)

	2012	2013	2014	2015	2016
Bad Debt	£557	£515	£524	£547	£574
Bad Debt as % of Credit Revenue	1.00%	1.00%	1.00%	1.00%	1.00%
Bad Debt as % of Total Revenue	0.63%	0.61%	0.61%	0.60%	0.60%

In addition to the bad debt allowance PSL have also requested monies for third party debt recovery agents. PSL have evidenced to us that third party debt recovery yields little results, and the tactics employed by many of these agencies have come into question over the last number of years. The Utility Regulator proposes to grant PSL an allowance for each year of the price control of £100k. We would strongly encourage PSL to seek out best practice and innovative solutions to avoiding debt and dealing with it when it does occur. This allowance is ring fenced solely for debt management and prevention and PSL will have to evidence to the Utility Regulator how this money has been spent and the benefits achieved from it.
We would also encourage PSL to liaise with other organisations who may be able to help customers with their debt and other financial difficulties, and to provide ways of helping customers manage their energy bills now and in the future.

In addition the Utility Regulator has also allowed additional manpower costs for increased credit control staff.

6.14.3 Meter Reading

Our minded to proposal stated that for domestic properties we intended to set the meter reading rate at £0.97 per read in line with the NIE meter reading submission. PSL have argued that for NIE all meters are read quarterly and
'this creates significant efficiencies and therefore results in a lower meter reading rate than natural gas…'

We have determined an increase in meter reads for direct debit properties from one to four reads per year. Additionally as referenced in the Network Maintenance section we have increased meter reads for pay as you go (including quantum) customers from 1.3 to two reads per annum. This will increase the level of meter reading undertaken by PSL by 63% and as a result we would expect to see the cost per meter read decrease.

We will set the meter reading allowance for domestic properties at £1.15 for 2012 reducing to £0.97 by 2016. The 2012 price is calculated from the PSL submission price reduced by the Phoenix Energy Services PES profit element at 11.6% to 1.18. A further assumption has been made to take account of the economies of scale achieved from increasing the number of meter reads. The following table shows the movement in the rate over the period of the control.

The meter reading rate for I&C and special reads have been set at the PES rate less the profit element at 11.6%.

Table 21 Set Rate per Meter Read

Rate per Meter Read	2012	2013	2014	2015	2016
Domestic	1.15	1.10	1.05	1.00	0.97
I&C	2.34	2.34	2.34	2.34	2.34
Special Read	6.10	6.10	6.10	6.10	6.10

The total meter reading cost will be retrospectively adjusted for the actual number of meters read at the rate set above. This rate will be subject to the efficiency factor at 1%.

The number of meter readings per meter type is allowed as shown in the table below

Table 22 Number of Meter Readings

Payment Type	Number of Meter Readings per annum
Standard Credit	4.0
Direct Debit	4.0
PAYG	2.0
Quantum	2.0

In relation to meter reading the consumer council stated that
‘We welcome the inclusion of four meter reads per year for Direct Debit customers. The Consumer Council has argued for this for a number of years as we believe it is essential that customers can actively monitor their gas use and prevent the accumulation of debt.’

The table below shows the Utility Regulator’s Determination for meter reading.

Table 23 Meter Readings (£'000s)

Meter reading	2012	2013	2014	2015	2016
PSL submission	£653	£588	£570	£587	£605
UR determination	£628	£552	£522	£524	£531

The Utility Regulator intends to undertake a review of meter reading services over the next year to establish who should be responsible for meter reading. The impact of this review will be applied retrospectively to this price control.

6.14.4 Printing and Postage

Printing and Postage costs will also be retrospectively adjusted for the actual number of bills received. This is based on an allowed rate per bill for printing and for postage and retrospectively adjusted on the basis of actual number of bills. The allowed rates are shown in the table below.

Table 24 Printing and Postage Costs (£'000s)

Cost description	Unit rate per bill
Processing Costs	0.09
Postage cost	0.33
Stationery Cost – Bill	0.07
Stationery Cost – DD statement	0.12
Stationery Cost – PAYG statement	0.12
Stationery Cost – Tariff Change	0.11

Additional costs in relation to an increase in the number of direct debit statements in line with the increase in meter readings are allowed. Costs for annual statements to pay as you go and quantum customers are also allowed.

Table 25 Printing and Postage Costs (£'000s)

	2012	2013	2014	2015	2016
PSL submission	£302	£275	£269	£280	£292
UR determination	£287	£265	£259	£269	£278

6.14.5 Transaction Costs

Transaction costs are the costs incurred by PSL when a customer tops up their pay as you go or paypoint card. These costs are retrospectively adjusted. The rate per transaction is based on the actual rate charged to PSL then adjusted for the actual number of transactions.

The table below shows the set rate per transaction.

Table 26 Transaction Costs (£'000s)

Transaction Type	Unit rate per transaction
[redacted]	[redacted]

The following table shows our determination for transaction costs.

Table 27 Transaction Costs (£'000s)

	2012	2013	2014	2015	2016
PSL submission	£384	£349	£336	£348	£357
UR determination	£323	£292	£280	£288	£296

Service charges are accepted at the level proposed by PSL and will be retrospectively adjusted based on the actual costs charged.

7.0 Gas Costs

The wholesale cost of gas and the associated costs of purchasing gas make up more than 55% of the final price of gas to customers. This section details the Utility Regulator's determination on each element of gas costs.

7.1 Wholesale Gas Cost

The minded to consultation proposed that wholesale gas costs would be treated as pass through for the duration of the price control. This is in line with the treatment of these costs over the previous price controls. We consider that in the wholesale gas market PSL is a price taker; in that it has no control over the price of wholesale gas. Therefore it is appropriate that wholesale gas costs are treated as pass through.

The Utility Regulator will monitor closely the build up of over and under recoveries and will act to ensure these remain at a low level so as not to distort prices. (see section 6.3)

As part of the pass through arrangement we expect PSL to provide us with the following information.

- On an annual basis the PSL gas purchasing strategy with advice from a third party expert source (as allowed in professional fees).
- On a monthly basis details of gas purchases on an ex ante and ex post basis for both tariff and non tariff customers.
- Full details of any over/under recoveries

In their response to the minded to consultation the consumer council stated that
'It is important that the Price Control is used to provide an incentive to PSL to increase the efficiency of their business and reduce the price to the end user'

CCNI also point to Power NI's licence obligation to purchase electricity efficiently. PSL do not currently have an equivalent licence obligation. We considered the addition of such an obligation to the PSL licence during the previous price control. At this stage we considered that evidence showed that PSL were already acting efficiently in their purchases.

CCNI also commented on the need for an incentive mechanism in the purchasing of wholesale gas which would act as an
"incentive to purchase efficiently and for them [PSL] *to incur a penalty if they fail to do so".*
We consider that PSL is increasingly incentivised to purchase gas efficiently due to increasing competition. Additionally any mechanism which changes the risk levels for PSL would have to be reflected in the margin awarded to PSL we do not consider that for such a mechanism the increased benefits to customers would outweigh the increased costs of an increase in margin.

7.2 National Transmission System Transportation Charges

These are the costs associated with transporting gas through the National Transmission System (NTS) in Great Britain. These charges are set and published by National Grid. These costs are allowed as pass through costs.

7.3 Unaccounted for Gas

The level of unaccounted for gas is allowed as a pass through of the Shrinkage Factor published by Phoenix Natural Gas Ltd.

7.4 Credit Support

PSL have submitted a breakdown of their required credit costs to finance the purchasing and conveyance of gas. These include credit charges to Premier Transmission Ltd, Belfast Gas Transmission Ltd, Phoenix Natural Gas Ltd and Total Gas and Power Ltd. PSL have submitted the cost of credit support to be 1.03ppt , to be treated as pass through for the actual cost of credit support incurred.

The Utility Regulator will use this determination to incentivise PSL to secure the most economic forms of credit support. In the minded to consultation we stated that we would disallow the 8% prepayment cost on the distribution charge paid to PSL's associated company PNGL. This costs accounts for more than half of the total credit costs. PSL have stated that they cover their obligation under the Network Code to provide credit cover by prepaying Distribution charges two months in advance. They have stated that this is charged at a rate of 8% but provided no rationale or evidence for this rate. We have set a rate at 2% for credit cover for distribution charges, in line with the rate charged for letters of credit. Therefore the Utility Regulator allows a cost of credit set for the period of the control at 0.54ppt.

7.5 Energy Balancing

PSL buy a proportion of their gas requirements in advance of the month and the remainder within the month. The energy balancing amount is a figure included within the tariff 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 accurately reflects the impact of the timing of purchasing the gas. PSL have proposed an energy balancing figure of 15% premium on the wholesale cost of gas within the tariff, based on 40% of gas purchased within the month. For the last tariff the actual increased cost of gas within the month, over the amount allowed in the tariff, was on average 10%. Therefore the Utility Regulator determines an energy balancing figure of 10% premium on the wholesale cost of gas within the tariff on 40% of purchases for the month.

8.0 Network Costs

Network costs are the charges for the use of the transmission and distribution systems. In previous price controls these costs have been set as pass through costs. The Utility Regulator has determined that transmission and distribution costs will continue to be treated as pass through.

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. They also include the costs for bringing gas to the distribution network areas. These costs are published on the Premier Transmission website at http://www.premier-transmission.com/. The Utility Regulator reviews and approves these costs.

The costs for the distribution system are those costs associated with moving gas throughout the Greater Belfast Area to homes and businesses. These can be found on the Phoenix Natural Gas website at http://www.phoenixnaturalgas.com/naturalgas/transportation-services/conveyance-charges/. Distribution costs are also subject to price control by the Utility Regulator. The next price control period will be from 1 January 2012 and a determination is due in December 2011.

9.0 Tariff

The tariff is the amount that PSL charges to its customers for gas. This can be set at or below the maximum average price. The table below shows the Utility Regulator's determination on the treatment of those costs which make up the tariff.

Table 28 Treatment of costs

Cost Element	Treatment
Transmission	Pass through
Distribution	Pass through
Gas Costs	Pass through
K factor	Pass through
Supply Operating Costs	Determined by price control
Margin	Determined by price control

9.1 Tariff Process

The tariff is reviewed on a bi annual basis in April and October. The costs detailed above will be analysed against the forecast cost to establish whether a change in the tariff is required. Typically it is movement in the wholesale cost of gas which will lead to a change in the tariff as the other costs are more readily forecast. Any movement in the wholesale cost of gas also has more impact on the tariff as it makes up around 55% of the overall tariff. The tariff process involves the Utility Regulator, PSL, the Department of Enterprise, Trade and Investment and the Consumer Council for Northern Ireland. This process is detailed in Appendix 1.

9.2 Trigger Mechanism

In addition to the bi annual tariff review there will be a trigger mechanism in line with previous price controls. The aim of this trigger mechanism is to initiate a tariff review should the cost of gas vary significantly from the cost forecast within the tariff.

In the previous price control the mechanism triggered a review when the price of gas increased so as to increase the tariff by 5%. The Utility Regulator considers 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.

The trigger mechanism will operate to allow the Utility Regulator to initiate a tariff review should the wholesale cost of gas change, either increase or decrease, so as to change the tariff by 5%. Where a review is initiated by the trigger mechanism the tariff review group will look at not only the wholesale cost of gas but 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 PSL

The Utility Regulator retains the flexibility to initiate a review at any stage it believes in is the interest of customers.

9.3 K factor

The treatment of costs as pass through means that PSL is allowed to recover the actual costs incurred. Where actual costs vary from those forecast PSL can charge any under recoveries or return any over recoveries to customers through the tariff. This amount of over or under recovery is known as the k factor.

In their consultation response Power NI stated that
'Any significant under recovery is unlikely to be made good in future years as it would reduce the competitiveness of the business'

The Utility Regulator intends that the k factor should remain at a minimum level to avoid distorting the PSL tariff and affecting the competitive environment. The bi annual tariff reviews and the trigger mechanism will ensure that the tariff remains close to the actual costs and therefore minimises the k factor.

At each tariff review the Utility Regulator will publish the k factor to allow for transparency.

9.4 Tariff Period

The tariff usually runs for a 12 month period. Historically the cost of gas has been higher for the winter months than the summer. There is evidence that this is changing with the increase of storage and greater availability of LNG leading toward a flatter forward curve. A 12 month tariff encompasses all the seasons and therefore spreads the costs of the more expensive winter gas over the summer months. A shorter tariff period may lead to increased rises and falls in tariff. The tariff process set out in Appendix 1 allows the Utility Regulator to review various time scales for the tariff period including 12, 18 and 24 month periods. This allows the Utility Regulator to assess the impact of changes in the forward curve and smooth the path of prices for customers. Additionally the Utility Regulator can assess the impact of the k factor on the tariff and choose a time period over which the k factor will have minimal impact.

9.5 Structure

The current PSL tariff structure is based on a two tiered tariff, with one amount charged up to a limited number of units and a second amount charged for every unit used above that. Pay as you go customers pay a flat tariff; the same amount for each unit used. PSL calculate the tariff on a weighted average basis, based on the number of customers on each tariff and the average usage per customer type.

We are content that the tariff structure can be based on best estimate of usage based on the previous year's actuals. We require PSL to evidence that the assumptions used to create the tariff structure ensure that the weighted average price is equal to or less than the maximum average tariff.

10.0 Margin

The Utility Regulator proposed in its consultation paper to retain the current margin of 1.5% for the period of this control. We have proposed to set margin at 1.5% of allowable turnover. This is in line with the previous price controls from 2008 which have been accepted by PSL. We consider that the risks to the company have not changed and that the company can finance its activities at this margin.

PSL have stated that a 1.5% margin is not sufficient. This is the lowest margin allowed to a regulated company. They state that risks have increased due to increased competition. As customers switch they will be unable to recover all their costs from customers.

We do not consider, nor does the evidence of switching to date show, that customers will switch in such great numbers as to leave PSL with stranded costs. There is currently only one other supplier active in the domestic market. Experience from GB also shows that a large number of customers will never switch supplier. In addition bi-annual tariff reviews and the trigger mechanism operate to minimise the k factor and reduce the risk of stranded costs to PSL.

PSL argue that their credit arrangements to facilitate access to normal credit terms have increased. However we allow credit costs separately for distribution, transmission and gas costs and these form no part of the margin.

PSL also state in their response that there should be a small company premium included on their margin. The recently published Network Price Controls paper[3] rejects the idea of a small company premium.

In the minded to consultation we stated that the 1.5% margin was based on the figure applied to BG by Ofgem in 2000. We stated that we considered this to be an appropriate benchmark as there is currently less competition in the market in Greater Belfast than in the GB market at that stage and only one other operating supply company. PSL have stated that this figure is not appropriate, they evidence that financing costs and the wholesale gas market have changed fundamentally since 2000. However we do not consider this argument to be relevant as this margin has been accepted by PSL since 2008 and during the last price control from 2009 to 2011.

PSL have stated that they require a margin of a minimum of 5% and cite the example of the GB companies earning margins in excess of 10%[4]. The latest Ofgem figures indicate that gas supply margins are in excess of 10%, however these figures are widely disputed and companies state that their margins are closer to 4%.[5]

[3] Utility Regulator - Proposals for a cross utility approach to network price controls Sept 2011 http://www.uregni.gov.uk/uploads/publications/Proposals_for_a_cross_utility_approach_to_network_price_controls.pdf

[4] Ofgem Supply Market Report October 2010 http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=64&refer=Markets/RetMkts/rmr

[5] Centrica Press release http://www.centrica.com/index.asp?pageid=39&newsid=2256

The 1.5% margin has been in place since 2008 (previously 1.3% in 2007). It takes into account the risks the company is exposed to and the working capital requirements of the company. It is in line with the margin applied to other regulated companies, 1.7% proposed for NIEES, 2% for BGE. The Utility Regulator does not consider that the risks to the company have changed so as to warrant an increase in the margin.

In relation to the variance between the margin set for NIEES and PSL there are increased working pressures on NIEES due to the purchasing regime of the SEM which requires that purchases of wholesale energy are paid for every four days.

11.0 Reconciliation

On an annual basis the Utility Regulator will reconcile the costs allowed in the price control with the actual costs incurred by PSL and determine a reconciliation amount to be returned to customers or received from customers.

This reconciliation will take into account

- Retrospective items
- Maximum average price
- Rate of Interest applicable
- Correction Mechanism

11.1 Retrospective Items

The retrospective items are those items detailed in the operating costs section above which will be adjusted for either actual costs or actual performance.

These costs are

- Licence Fee
- Billing Costs
  - Bad Debt (adjusted for actual credit revenue)
  - Transaction costs (adjusted for actual number of transactions)
  - Meter reading costs (adjusted for actual number of meter reads)
  - Bill printing costs (adjusted for actual number of bills)
- Inflation
- Apportionment of costs

The retrospective mechanism works by setting an allowance for each cost area, multiplied by the cost driver, eg number of bills. This will then be adjusted during the reconciliation to take account of the actual level of the cost driver. Efficiencies will apply to the set cost in retrospective items as with all costs.

In addition there are ringfenced amounts in relation to network costs and bad debt. PSL will have to demonstrate that these costs have been used to improve performance in these areas, either by improving policies and procedures, offering additional services to customers, demonstrating a reduction in the cost area etc.

The following areas will be reviewed during the course of the price control by the Utility Regulator and the price control will be retrospectively adjusted to account for the impact of any such review.

- Meter tampering
- Network Maintenance

There will be a three year review to determine if the price control should be reopened. The impact of IME3, bad debt and network maintenance will form a specific part of this review. However the Utility Regulator reserves the right to investigate all costs, volumes and issues which may affect the price control as highlighted in Section 3.

11.2 Maximum Average Price

The amount of revenue received by PSL will always be reconciled to the maximum average price. Therefore if PSL choose to charge less than the maximum average price any difference in costs will be funded from the margin. Also if PSL charge more than the maximum average price any difference will be returned to the customer. It is important to note that in this situation PSL will be considered to be in breach of their Gas Supply Licence.

The Utility Regulator will review any situation where a difference in actual revenue versus the maximum average price is caused by the tariff structure. This would be caused where PSL have underestimated the amount of gas a customer will consume annually. This can be seen in the example below. In this example the maximum average price is 3.33p/kWh. Using an estimate annual usage of 12,000kWh PSL set their tariff structure at 5p/kWh for the first 2,000kWh and 3p/kWh for every kWh used after that. Following a cold winter the actual usage turns out to be 17,000kWh meaning that PSL only received an average price of 3.24p/kWh.

Table 29 Example of Tariff Structure

Estimated Usage 12,000 kWh	p/kWh	Usage	Cost (£)
Up to 2000 kWh	5.00	2000	100
Over 2000 kWh	3.00	10000	300
Total Usage		12000	400
Maximum Average Price p/kWh		3.33	

Actual Usage 17,000 kWh	p/kWh	Usage	Cost (£)
Up to 2000 kWh	5.00	2000	100
Over 2000 kWh	3.00	15000	450
Total Usage		17000	550
Maximum Average Price p/kWh		3.24	

Where PSL have charged less than the maximum average price the Utility Regulator will require evidence that;

- The tariff structure was based on sound principals
- A fundamental change occurred which affected the underlying assumptions

On this basis the Utility Regulator may allow PSL to recoup the variance between actual revenue and the maximum average price.

11.3 Rate of Interest applicable

Any reconciled amounts, whether to be returned to or collected from the customer will be rolled forward at an interest of LIBOR plus 1.5%. This rate will also apply to any gas costs which have been over or under recovered. This rate of interest is set to reflect the cost to PSL of financing the under recovery or the benefit to them of holding any over recovery. It is different to the rate set in the correction mechanism below, which is set at a penal rate to incentivise PSL to forecast volumes accurately.

11.4 Correction Mechanism

In a calendar year any allowed expenditure (with the exception of gas costs) not incurred or exceeded because of inaccurate forecasts of volume etc. will be addressed at the end of the year through a correction mechanism. For any over recoveries PSL incur we propose to continue to use the two-tier mechanism determined in the previous price control. This methodology is similar to that used by Ofgem in the 2007 Distribution Price Control. The two tier mechanism is as follows:

- If PSL over recovers by more than 3 per cent, they suffer an interest rate of 3 per cent higher than the base rate;
- If PSL over recovers by less than 3 per cent, they suffer an interest rate of 1.5 per cent higher than the base rate;
- If PSL under recovers by less than 3 per cent, they may recover interest at a rate of 1.5 per cent higher than base rate; and
- If PSL under recovers by more than 3 per cent, they may recover interest at base rate.

The base rate used is the rate set by the Bank of England and will be taken as the July figure.

The Utility Regulator will allow PSL to submit updated volumes at the beginning of each tariff period.

12.0 Outcome

The following tables show the PSL submission compared to the UR determination in terms of the operating cost per therm.

Table 30 Outcome based on PSL Submission

	2012	**2013**	**2014**	**2015**	**2016**
PSL Submission (£'000)	6,439	5,903	5,826	5,904	5,975
Allocation	92.1%	92.0%	91.8%	91.8%	91.9%
Tariff Costs (£'000)	5,932	5,429	5,346	5,421	5,491
Operating Cost per therm	10.27	10.39	10.38	10.09	9.80

Table 31 Outcome based on Utility Regulator Determination

	2012	2013	2014	2015	2016
UR Determination (£'000)	5,004	4,772	4,669	4,673	4,742
Allocation	92.1%	92.0%	91.8%	91.8%	91.9%
Tariff Costs (£'000)	4,610	4,388	4,284	4,291	4,357
Operating Cost per therm	7.98	8.40	8.32	7.99	7.78

Appendix 1

PSL Tariff Review Process

Introduction

The aim of this document is to create a process for future Phoenix Supply Ltd (PSL) tariff reviews. The tariff review process is a consultative one which involves PSL, Utility Regulator (UR), Department of Energy, Trade and Investment (DETI) and Consumer Council for Northern Ireland (CCNI). All parties bring their expertise and opinion in relation to the needs of PSL, the needs of the consumer and the wider impact on the economy. It is important, therefore, that all parties are aware of and in agreement with a formal process. PSL set a tariff in April each year, followed by a tariff review in October. There have also been occasions where the cost of gas has changed significantly so as to make a review at other times of the year necessary. This process will provide a robust procedure to ensure that all parties are consulted in a timely, prescribed and comprehensive manner for both anticipated and unanticipated tariff reviews. A tariff review is the process of analysis and discussion of the PSL tariff to consider if a change to the tariff is needed, and to decide the magnitude and timing of any change.

Requirement for process

According to the terms of the Phoenix Supply licence[6] PSL must apply to the Utility Regulator for consent to a maximum average price which it can charge for gas supply over a 12 month period. Within the PSL price control (PC02) is also a trigger mechanism which allows PSL or the Utility Regulator to undertake a further tariff review.

> *'A review of gas tariffs will take place if Phoenix can demonstrate that the weighted average cost of gas (WACOG) has diverged from forecast sufficiently to cause a rise in the annual maximum average tariff of more than 5%. The WACOG is calculated as the weighted average price of gas for the year based on the forward price of gas and any purchases already made by PSL. As a result of the review the Utility Regulator will allow an adjustment to the maximum tariff to take into account the movement in gas prices. If events are such that the Utility Regulator believes a review, whether to increase or decrease the tariff, would be in customers' interest then we would retain the flexibility to initiate such a review.'*[7]

Over the next few months the Utility Regulator will be consulting on the next PSL price control. The trigger mechanism will form part of this consultation, in particular if the 5% threshold is appropriate.

[6] Condition 2.4.1, 'Control over Charges in the absence of competition'. Licence for the Supply of Gas in Northern Ireland, granted to Phoenix Supply Limited, by the Northern Ireland Authority for Energy Regulation, 19 December 2006.

[7] Utility Regulator Decision on Phoenix Supply Price Control, 2009 – 2011. February 2009

Elements of the tariff

The following table shows the makeup of the PSL tariff and the treatment of these items.

Element of Tariff	Treatment of Cost
Transmission	Pass through - analysed as part of tariff review
Distribution	Pass through - analysed as part of tariff review
Gas Costs	Pass through – weighted average taken on prescribed five days
Over/under recovery	Analysed as part of tariff review
Supply Operating Costs	Set in price control
Margin	Set in price control

Process

The tariff announcement date must be 30 calendar days plus five working days before the effective date of the new tariff. The process will start seven weeks before the intended tariff announcement date for formalised reviews. Where the trigger mechanism is activated the tariff review process will start. To start the process PSL and the Utility Regulator will agree the analysis of the tariff. This analysis will be based on the principals set out in the price control, including elements such as gas costs, over/under recovery, transmission and distribution costs. PSL will provide analysis for the tariff over the timescales requested by the Utility Regulator. These will vary depending on the timing of the review and the rationale for the review. The Utility Regulator considers it essential to be flexible in this analysis so as to best show the impact of the forward gas curve on the tariff and the impact of over/under recovery.

The weighted average cost of gas (WACOG) in the final tariff will be calculated based on

- gas already purchased by PSL
- volumes still to be purchased at a price taken at an average of five working days on the forward curve.

The five working days will commence seven working days before the tariff announcement date. For example for a new tariff on 1 April 2012 the tariff announcement date will be 23 February and the five working days will be 13 to 17 February 2012.

February 2012

Sun	Mon	Tue	Wed	Thu	Fri	Sat
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	12
26	27	28	29			19
						26

The Utility Regulator considers that flexibility is essential when considering the data set to use for setting the tariff. Where the market is highly volatile the Utility Regulator may consider it appropriate to use a different set of dates or change the basis for setting the tariff.

Meetings

During the process there will be at least one meeting for all parties. The Utility Regulator will present the result of the analysis of the tariff. The parties will discuss the consultation paper, comment on preferred options, agree the way forward and arrange subsequent meeting(s) in line with dates for the final tariff decision. The parties will also discuss media issues, timings of announcements and related issues. These meetings will be minuted with a record of the meeting forwarded to all parties.

Timing of Tariff Reviews

All other things being equal there will be a tariff review in

- February (for an April tariff change)
- August (for an October tariff change)
- Any occasion where trigger mechanism is activated

The Utility Regulator retains the flexibility to initiate a review where it considers it to be necessary.

If, as a result of analysis, PSL and the Utility Regulator propose that there should be no change to the tariff the process will still be followed. All parties will meet to discuss the results of the analysis and to discuss the media and related issues associated with the announcement.

Once the tariff decision has been announced the Utility Regulator will publish a review of the tariff decision, including comparisons with other suppliers and regions.

Tariff Review Process

1. **Analysis**

   12 weeks before a new tariff date PSL to provide Utility Regulator with
   - Draft consultation paper
   - Detailed tariff analysis for timescales requested by Utility Regulator
   - Over/under recovery analysis
   - Analysis of transmission and distribution charges

   The Utility Regulator will inform all parties that this information has been received from PSL

2. **Meeting with Utility Regulator and PSL**

   Within one week of analysis being received Utility Regulator and PSL meet to agree analysis and consultation paper. Final analysis will use gas figures for five workings days commencing seven working days before the tariff announcement date. These dates will remain flexible particularly where the market is volatile.

3. **PSL Tariff Analysis Consultation Paper**

   10 weeks before a new tariff date PSL to circulate consultation paper to all parties with information on
   - Elements of tariff
   - Analysis
   - Over/under recovery
   - PSL preferred option

4. **Meeting with PSL, CCNI, DETI and Utility Regulator**

   Within one week of receipt of paper all parties to meet to discuss consultation paper, comment on preferred options, agree way forward and arrange subsequent meeting in line with dates for final tariff decision. This meeting will be minuted with record of the meeting forwarded to all parties.

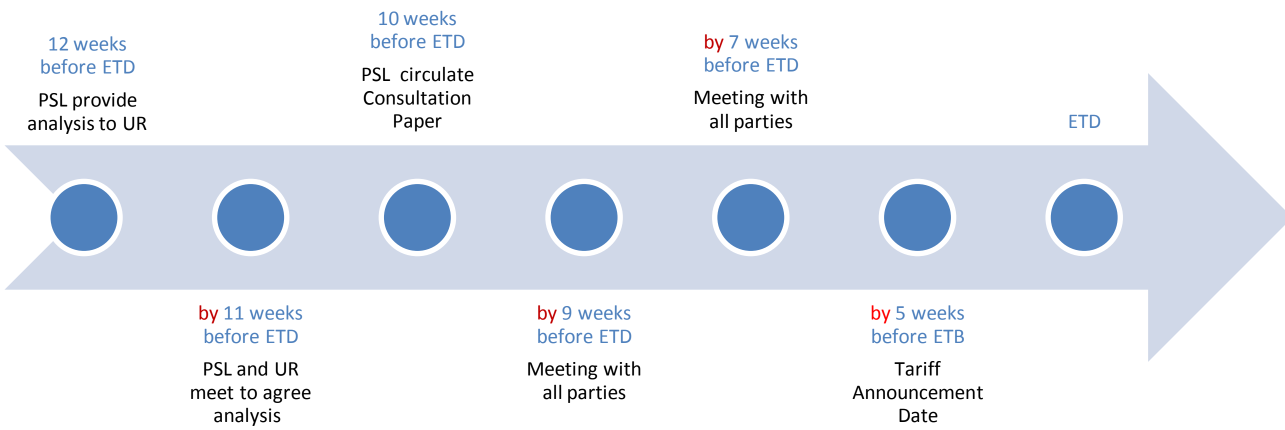
5. **Meeting with PSL, CCNI, DETI and Utility Regulator**

   At least seven weeks before the new tariff date all parties meet to agree tariff, timings of press releases and statements from all relevant parties.

6. **Announcement Date**

   Announcement date will be 35 days before the effective tariff date.

Below is a timeline showing the process. (ETD is effective tariff date)



Below is a worked example of the process where the new tariff date is 1 April 2011.