Conclusion of the Utility Regulator's Review of the Phoenix Supply Ltd Maximum Average Price

February 2012

Approval by the Utility Regulator of the Phoenix Supply Ltd. Maximum Average Price

Summary

On 9 January 2012 the Utility Regulator, in conjunction with Phoenix Supply Ltd (PSL), DETI and the Consumer Council began a review of the Phoenix Supply maximum average price for customers using less than 25,000 therms per annum. The current maximum average price was effective from 1 May 2011 until 31 March 2012; therefore a review was required to establish the new maximum average price to become effective from 1 April 2012.

Background

PSL has a licence to supply gas. Under the terms of this licence the Utility Regulator ("the Authority") has the power to control the maximum amount that PSL can charge for gas; these controls apply when customers are not protected by competition.

> *'the Licensee shall take all reasonable steps to secure that in any period of 12 months the average price per therm of gas supplied to such consumers shall not exceed a maximum price to which the Authority has consented'*

The Utility Regulator establishes a price control determination to control PSL costs. A price control determination will set out how each of the costs will be treated in the maximum average price.

PSL can choose to set a price which is below the maximum average price. To date they have always charged the maximum average price.

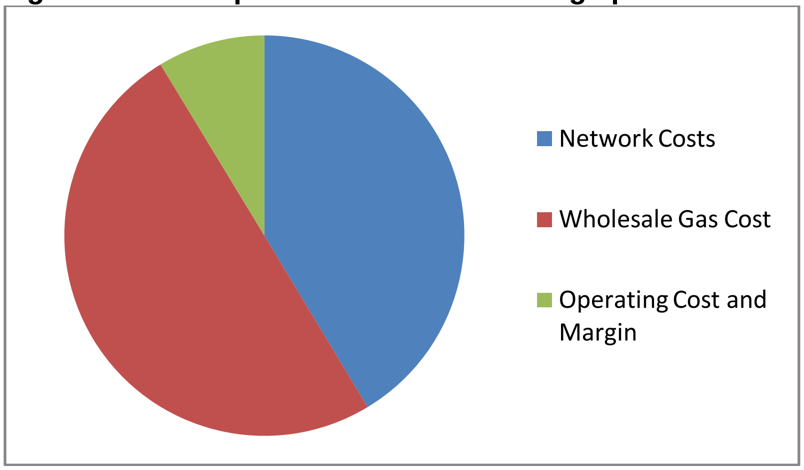
Elements of Maximum Average Price

The maximum average price is made up of a number of costs.

- The wholesale cost of gas
- Network use costs
- The operating expenditure of the supply business and supply margin

The breakdown is shown in figure 1 below.

Figure 1 - Makeup of the maximum average price



Network Costs

Network costs are the charges for the use of the transmission and distribution systems. These charges are reviewed and approved by the Utility Regulator.

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 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/.

Operating Costs and Margin

Operating costs refer to those costs necessary for PSL to run its supply business to tariff customers. For example the costs of billing, meter reading, staff etc. The margin refers to the amount of profit PSL is allowed to make. The margin is currently set at 1.5% of turnover from tariff customers. Both of these elements are determined by the price control carried out by the Utility Regulator. The most recent price control runs from 1 January 2012 to 31 December 2016 and this can be found on our website at http://www.uregni.gov.uk/uploads/publications/PSL_PC03_Determined_to_Position.pdf.

Gas Costs

The wholesale cost of gas is the largest element of the tariff comprising 50% of the total price from April 2012. The price control determines that gas costs are treated as pass through which means that the customer pays for the actual cost of gas. Therefore the savings from recent decreases in the wholesale cost of gas have been passed through to customers in the tariff effective from April 2012.

Where wholesale gas costs turn out to be higher than those set in the tariff the company will be able to recharge the difference to customers and where wholesale gas costs are below those set in the tariff the company will refund the difference to customers through the tariff. This element of recovery is known as the k factor. The tariff effective from April 2012 includes an amount of £6m which PSL have over recovered previously and is now being returned to customers.

The PSL tariff is reviewed biannually in April and October and the price control also contains provision to review the tariff if the price of gas changes significantly.

Table 1 below shows the movement in the PSL tariff from May 2008 to date.

Table 1 - Historic PSL tariff

Effective from date	1 May 2008	1 October 2008	8 January 2009	1 October 2009	1 May 2011	1 April 2012
Approved Tariff (per therm)	£1.2800	£1.5258	£1.1892	£0.9632	£1.3397	£1.2264
% Change	28.0%	19.2%	-22.1%	-19.0%	39.1%	-8.5%

Figure 2 below compares the breakdown of the April 2012 tariff with the breakdown of the previous tariff and demonstrates that network costs and operating costs remain largely the same. The changing wholesale gas costs however make a significant difference to the tariff.

Figure 2 – Breakdown of April 2012 tariff compared with breakdown of previous tariffs

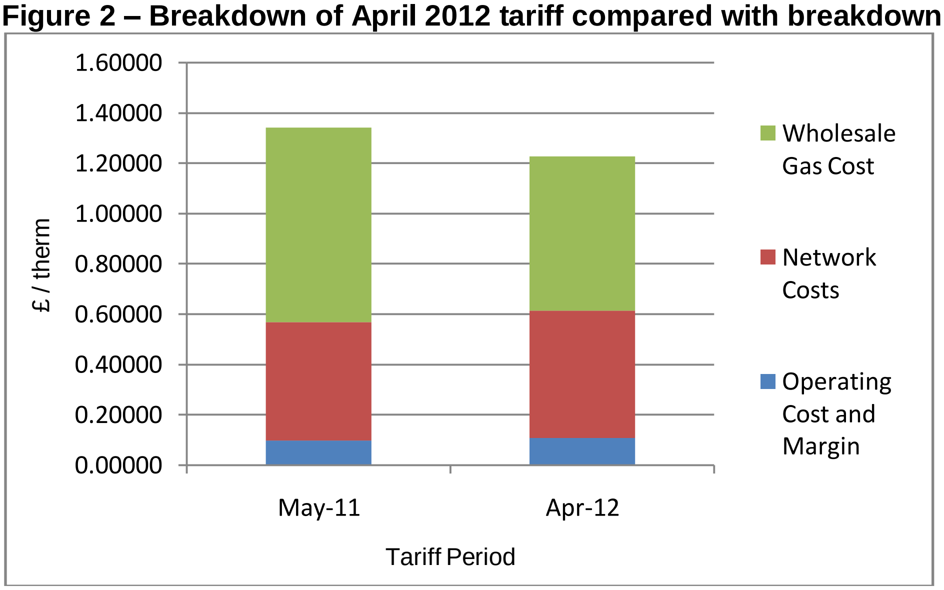
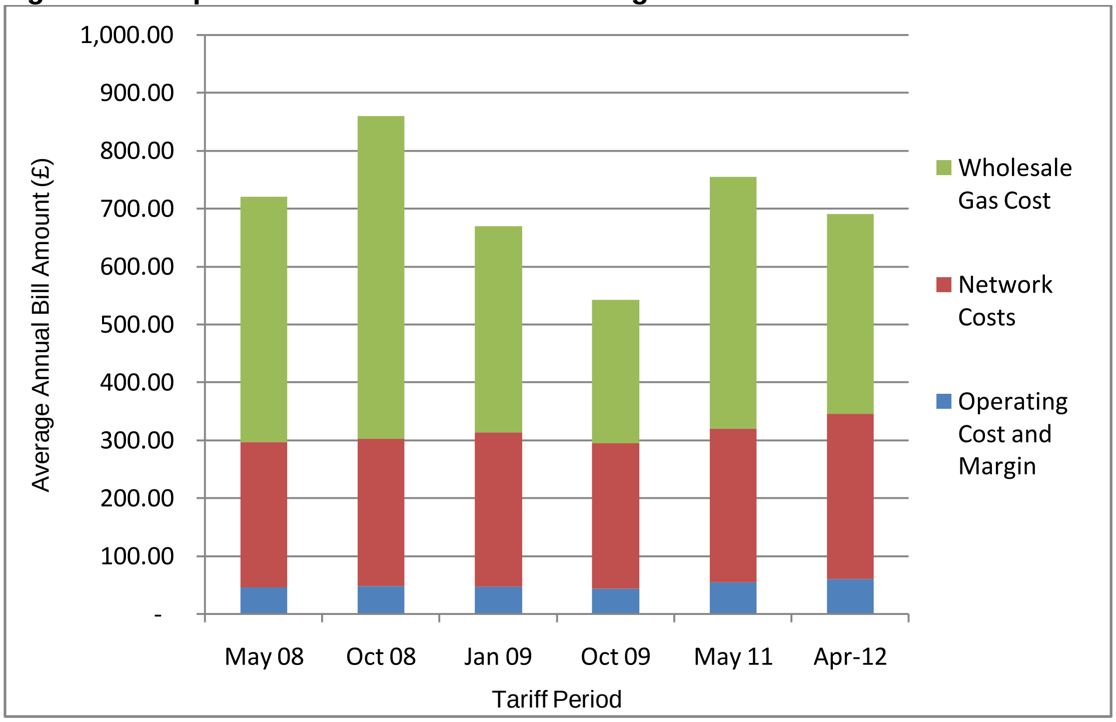


Figure 3 below shows the breakdown in the average annual bill for PSL consumers over the past four years and illustrates again the variation caused by changes in the wholesale price of gas. The average annual bill amounts have been calculated based on average annual consumption of 16,500kWh[1].

Figure 3 - Graph to show breakdown of average annual bill



Why are PSL Tariffs Decreasing?

The decrease in PSL tariffs is driven by a decrease in wholesale gas costs. Prices on the forward curve for Winter 2012 have softened with respect to the prices in the current tariff, prompting the decrease.

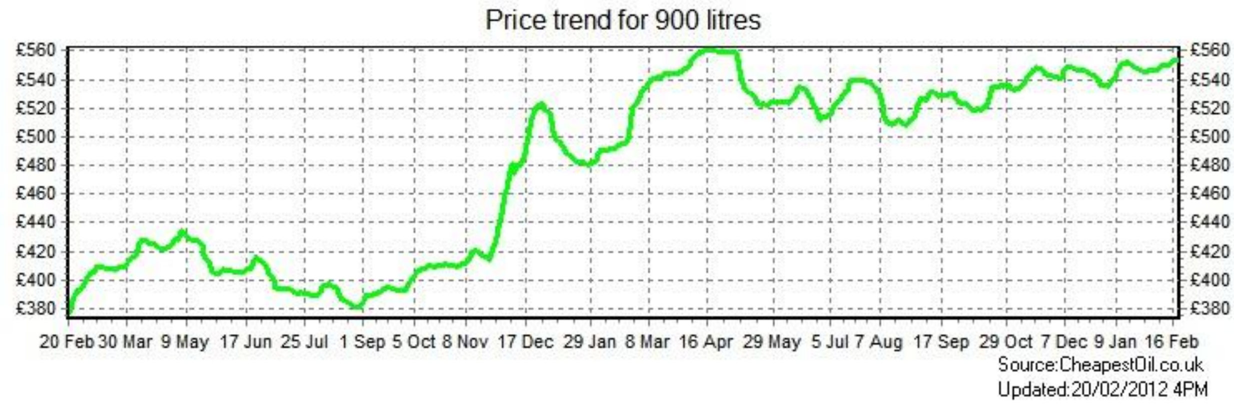
Bord Gais produce a monthly Energy Index. This index is a seasonally adjusted measure of prices in the wholesale energy market. The index tracks movements in oil and gas in addition to other fuels and illustrates the movements in these markets. The energy index can be found at http://www.bordgaisenergy.ie/energyindex/ .

Comparison with Oil

Oil prices have maintained their high levels over the last year. This graph in Figure 4 shows the trend in the average price for 900 litres of oil over a two year period from April 2010 to date.

[1] 16,500 annual usage estimate is based on the figure published by Ofgem in their *Decision Letter: Revision of typical domestic consumption values* document published on 5 November 2010. This can be found at http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=14&refer=Markets/RetMkts/Compl/Consumption

Figure 4 – Price of 900l Home Heating Oil from February 2010 to date



Comparison with GB and RoI

Figure 5, below, shows the average annual bill for a domestic credit customer in PSL compared to the Big 6[2] companies in GB, Bord Gais in Ireland and firmus energy in the Greater Belfast Area. This comparison is based on the standard domestic credit tariffs[3] of each company from 1 April 2012 and takes account of any tariff changes which have been published to date.

Figure 5 - Comparison of average annual bill (based on estimated usage 16,500kWh[4] pa)

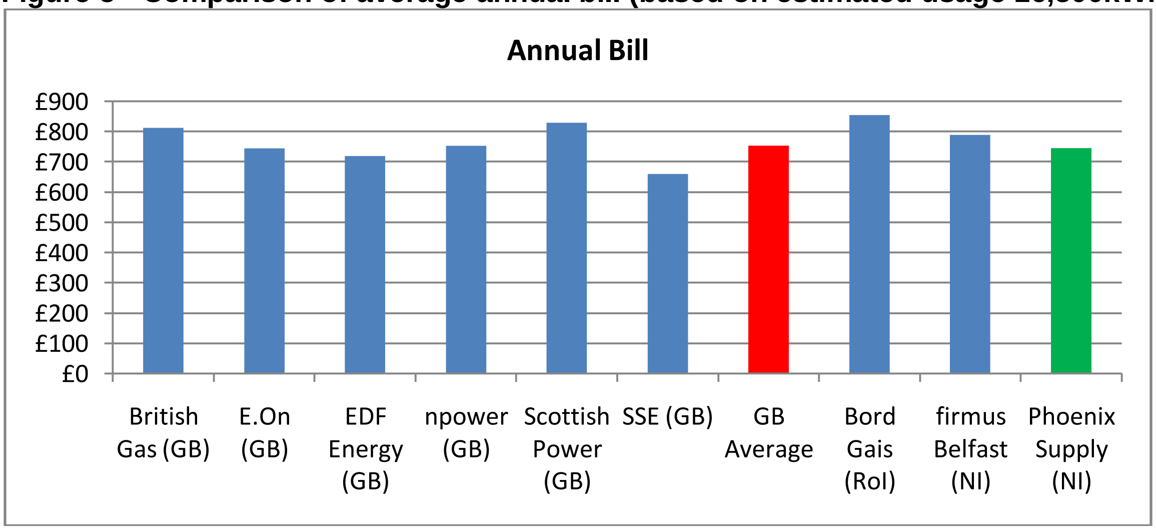


Figure 5 illustrates that the PSL tariff for an average domestic credit customer will be just below the GB average standard tariff, but it will be around 10% lower than the Bord Gais tariff in RoI.

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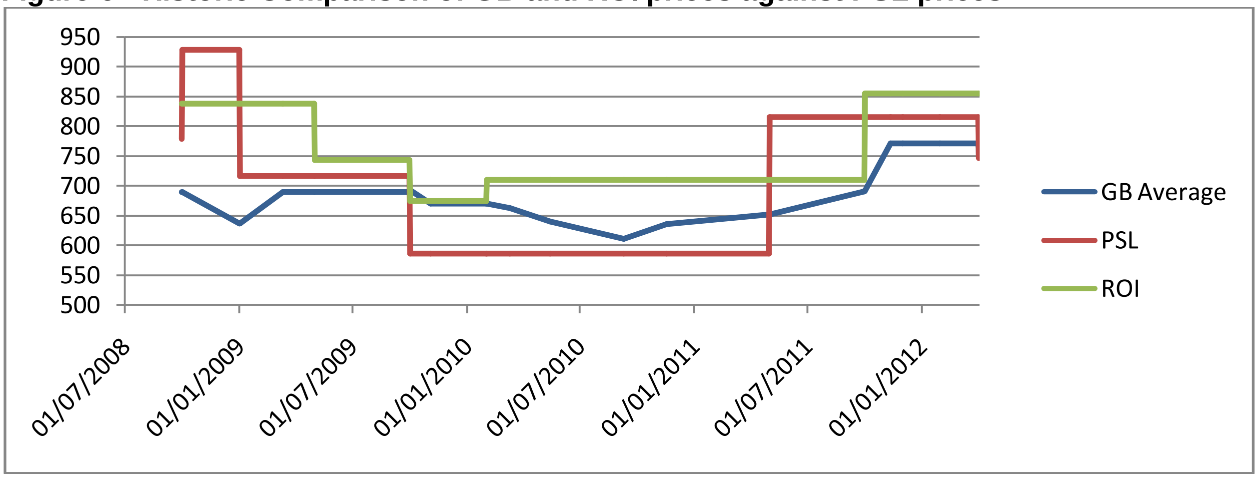
[2] Big 6 companies are British Gas, Scottish and Southern Electric, Scottish Power, npower, EDF and E.on

[3] The tariffs used for comparison purposes are the standard tariff rates for domestic credit customers excluding any discounts available for payment by direct debit, viewing bills online etc.

[4] 16,500kWh annual usage estimate is based on the figure published by Ofgem in their *Decision Letter: Revision of typical domestic consumption values* document published on 5 November 2010. This can be found at http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=14&refer=Markets/RetMkts/Compl/Consumption

Figure 6 illustrates the historic comparison of PSL prices against the average standard tariffs in GB and ROI. It shows that PSL prices have been higher than the average standard tariff in GB for the last 11 months, however from April 2012 the PSL tariff will be just under the standard average tariff in GB.

Figure 6 - Historic Comparison of GB and ROI prices against PSL prices



Three of the Big 6 suppliers in GB have announced tariff decreases of between 4.5% and 5% to take effect between February and March 2012. These decreases are reflected in the graph in Figure 6.

Outcome

The Utility Regulator has reviewed the Maximum Average Price Review submission provided by PSL and reviewed the PSL forecasts against its own market analysis. The Utility Regulator is satisfied that this decrease is justified and therefore approves the tariff of £1.2264 per therm effective on 1 April 2012. This represents a decrease of 8.5% over the previous tariff effective on 1 May 2011 of £1.3397 per therm.

However, the Utility Regulator retains the flexibility to have a review of gas prices at any stage if it is considered to be in the interest of customers.