



**Conclusion of the  
Utility Regulator's Review of the  
Airtricity Gas Supply (NI) Ltd  
Maximum Average Price**

**February 2013**

## Approval by the Utility Regulator of the Airtricity Gas Supply (NI) Ltd Maximum Average Price

### Summary

On 7 January 2013 the Utility Regulator, in conjunction with Airtricity Gas Supply (NI) Ltd (**Airtricity**), DETI and the Consumer Council began a review of the Airtricity maximum average price for customers using less than 25,000 therms per annum. The current maximum average price has been effective from 1 April 2012 and will remain effective until 31 March 2013. Therefore a review was required to establish the new maximum average price to become effective from 1 April 2013.

The maximum average price for tariff customers will increase to £1.3326 per therm from 1 April 2013 until 31 March 2013. This represents an increase of 8.7%.

### Background

In June 2012, Airtricity Energy Supply (Northern Ireland) Ltd agreed to purchase the entire issued share capital of Phoenix Supply Ltd. Phoenix Supply Ltd was subsequently renamed Airtricity Gas Supply (NI) Ltd (**"Airtricity"**).

Under the terms of Airtricity's licence to supply gas, the Utility Regulator (**"the Authority"** or **"UR"**) has the power to control the maximum amount that Airtricity can charge for gas. These controls apply when customers are not protected by competition. Airtricity can however choose to set a price which is below the maximum average price.

*'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' (Condition 2.4)<sup>1</sup>*

The Utility Regulator has established a price control determination which sets out Airtricity's allowed costs. The price control determination sets out how each of the costs will be treated in the maximum average price.

The Airtricity 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.

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<sup>1</sup> Airtricity Gas Supply (NI) Ltd Licence for the supply of gas:  
[http://www.uregni.gov.uk/uploads/publications/2012-09-28\\_Airtricity\\_Gas\\_Supply\\_\(NI\)\\_Ltd\\_\(PSL\)licence\\_supply\\_of\\_gas\\_in\\_NI\\_\(Mod28-09-2012\).pdf](http://www.uregni.gov.uk/uploads/publications/2012-09-28_Airtricity_Gas_Supply_(NI)_Ltd_(PSL)licence_supply_of_gas_in_NI_(Mod28-09-2012).pdf)

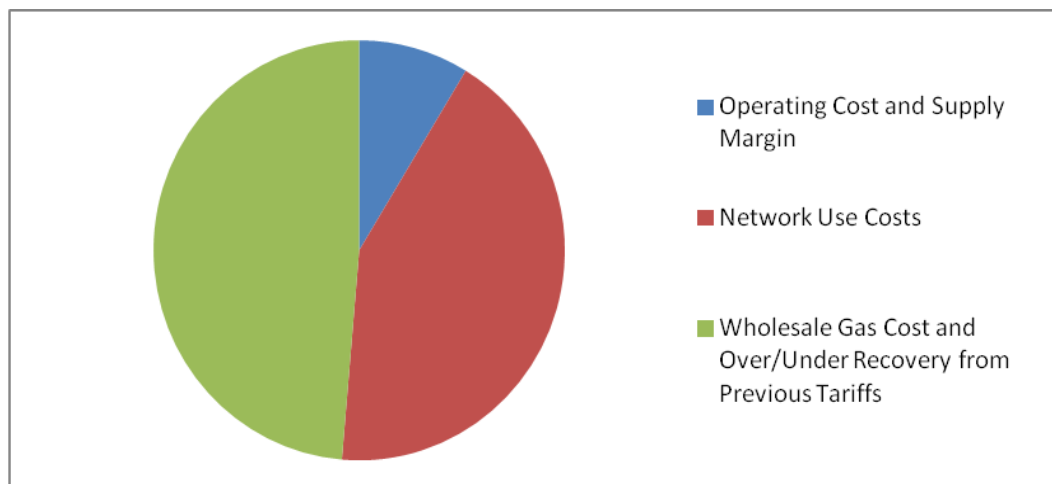
## Elements of Maximum Average Price

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

- Operating costs and supply margin
- Network use costs
- Wholesale cost of gas and over/under recovery from previous tariffs

The breakdown is shown in figure 1 below.

**Figure 1 - Makeup of the maximum average price**



## Operating Costs and Margin

Operating costs are the costs necessary for Airtricity 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 Airtricity 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 and are subject to reconciliation against actual costs. 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](http://www.uregni.gov.uk/uploads/publications/PSL_PC03_Determined_to_Position.pdf).

## Network Use 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 price control determines that the transmission and distribution system charges are treated as pass through which means that the customer pays for the actual cost of the network charges.

The costs for the transmission system are those costs involved in bringing gas from Scotland to Northern Ireland, via the Scotland to Northern Ireland Pipeline and all the transmission pipelines within Northern Ireland. These costs are published on the 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/help-and-advice/networks/charges/>.

## **Gas Costs and Over/Under Recovery from Previous Tariffs**

This is the largest element of the tariff comprising just under 50% of the total tariff price. 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 where wholesale gas costs decrease or increase, the resulting savings or additional costs are passed on to the customer.

At the time of tariff setting, the overall cost of gas for the tariff is estimated based on a combination of actual gas purchases that have already been secured, along with forecast volumes of gas required, and the cost of gas from the forward curve.

Where the wholesale gas costs turn out to be less than what was forecast in the tariff, Airtricity will 'over-recover' and will subsequently refund the over-recovered difference to customers in the following tariff periods. Or, where the wholesale gas costs turn out to be higher than forecast in the tariff, Airtricity will 'under-recover' and will therefore be able to recharge the under-recovered difference to customers in the following tariff periods. Each tariff includes an amount of over or under recovery which was accumulated during previous tariff periods.

## **Why are Airtricity Tariffs Increasing?**

The maximum average price for tariff customers will increase by 8.7% from 1 April 2013. Table 1 below shows the movement in the regulated tariff from May 2008 to date.

**Table 1 - Historic tariff**

Effective from date	1 May 2008	1 Oct 2008	8 Jan 2009	1 Oct 2009	1 May 2011	1 April 2012	1 April 2013
Approved Tariff (per therm)	£1.2800	£1.5258	£1.1892	£0.9632	£1.3397	£1.2264	£133.26
% Change	+28.0%	+19.2%	-22.1%	-19.0%	+39.1%	-8.5%	+8.7%

The increase in the Airtricity tariffs are being driven by two main elements, namely the distribution network charges and the over recovery being returned to customers in this tariff as explained below.

The increase in gas distribution charges represents about half of the increase. This reflects the impact of the Competition Commission's determination<sup>2</sup> on the Phoenix Natural Gas price control and the impact of inflation.

Another factor in the tariff increase is the reduced amount of over recovery applied to this year's tariff. In the April 2012 tariff, the over recovery amount (which represents money which Airtricity has over recovered and is returning to consumers through a reduction in the tariff) was significantly higher than the over recovery applied to the new tariff from 1 April 2013. Both Airtricity and the Utility Regulator strive to keep the over/under recovered amount as low as possible in order to reduce volatility in the tariff.

## **Over Recovery**

The total amount included in this determination is an over recovery of £3,623,982. This is made up of the reconciliation of over recovery from 2007 until 2010, plus an estimate of the reconciliation of over recovery that occurred during 2011. The Utility Regulator has been trying to resolve this over recovery amount for a number of years but has had some difficulties in clarifying the information required to perform the calculations.

While Airtricity accept that it has over recovered since 2007 it has queried whether interest should be applied on over recoveries on gas costs between 2007 and 2011. If interest was not applied to the gas costs the reconciliation amount would be reduced by £814,761. We have reviewed the queries presented by Airtricity but are satisfied that gas costs should have interest applied.

Firstly applying interest to under and over recoveries is standard economic and regulatory practice. There is a cost to the company of not recovering costs in the year they are incurred and it is absolutely appropriate that the company is reimbursed for these costs through the application of an interest rate. Conversely there is a benefit to the company from over recovering costs in any year and likewise it is perfectly appropriate to apply an interest rate to these costs. We are not aware of any economic argument why this should not be applied. We apply similar measures to other regulated companies without controversy.

Secondly as part of discussions with Phoenix Supply Limited (PSL) during our 2007-2008 determination, UR made it clear that interest would apply to gas costs (as PSL had requested) and this was explicitly confirmed in correspondence with PSL. Therefore it is clear that it was the intention of UR to apply interest on gas costs over recovery since the 2007/08 determination and PSL were aware of this from that time.

In addition the 2009 determination states:

*"any over or under recovery resulting from the treatment of gas costs will be rolled*

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<sup>2</sup> Competition Commission's price determination on PNGL12:  
[http://www.uregni.gov.uk/publications/competition\\_commission\\_final\\_pngl\\_price\\_determination](http://www.uregni.gov.uk/publications/competition_commission_final_pngl_price_determination)

*forward at LIBOR plus 1.5%”*

UR has made it clear to PSL over the years that interest would apply to gas cost reconciliations and this was reinforced in written correspondence in 2012. We do not have visibility of the discussions and information exchange on this issue between Phoenix Energy Holdings Limited (PEHL) and Airtricity at the time of acquisition. However, this is a matter between Airtricity and PEHL and should have no impact on consumer prices.

In summary, for the reasons set out above interest does apply to gas costs and we are applying a reconciliation amount of -£3,623,982 to the tariff in line with standard regulatory practice and the stated UR position since 2008.

### Breakdown of Tariff

The graph shown in Figure 2 below compares the breakdown of the April 2013 tariff with the breakdown of the previous tariff and demonstrates that operating costs remain largely the same. The network costs component has increased, and the wholesale gas costs element of the tariff has increased as the over recovered amount being returned to customers in this tariff is less than the over recovered amount that was returned to customers in the previous tariff.

**Figure 2 – Breakdown of April 2013 tariff compared with a breakdown of the previous tariff**

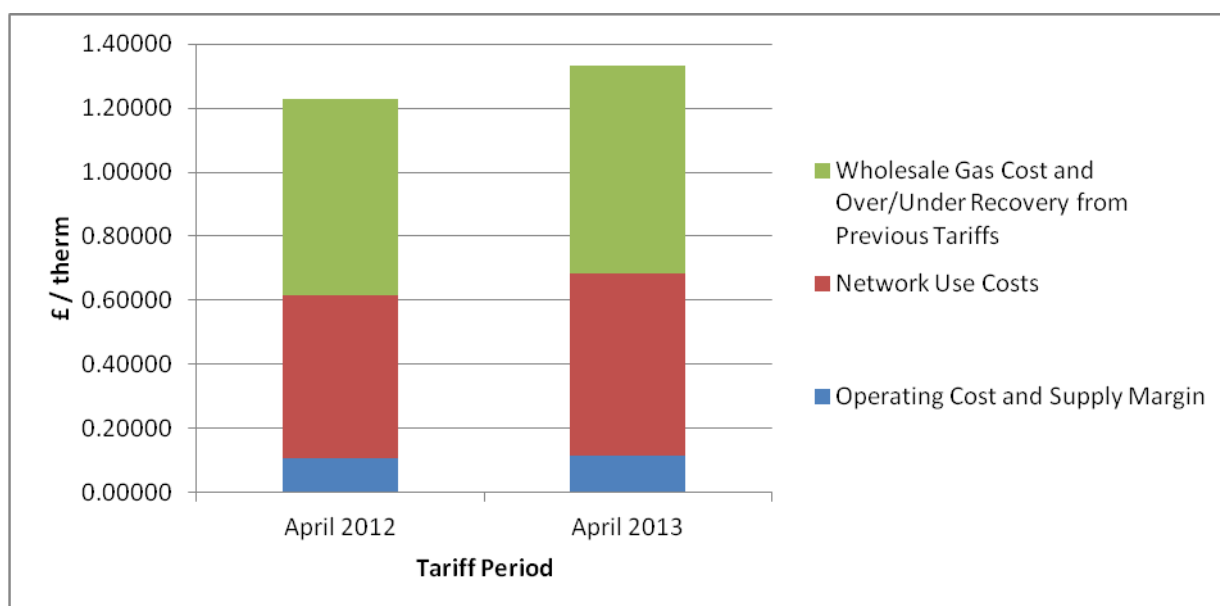
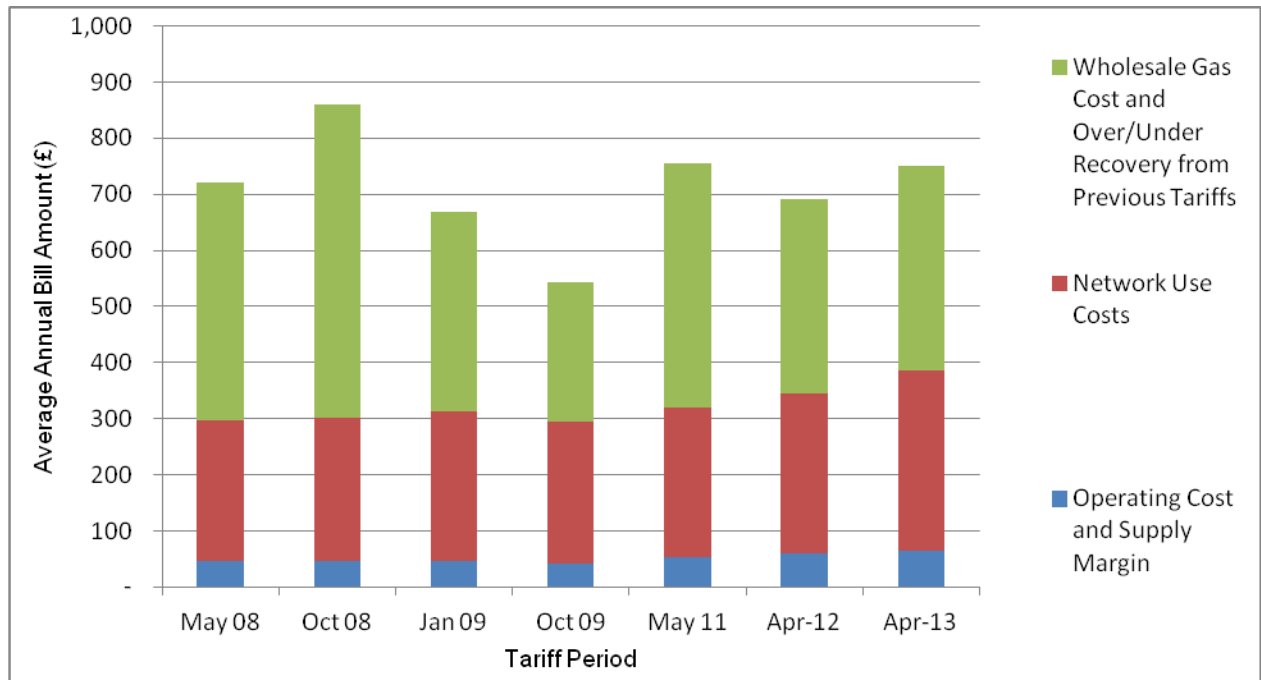


Figure 3 below shows the breakdown in the average annual bill for Airtricity consumers over the past few years and illustrates again the variation caused by various components of the tariff. The average annual bill amounts have been calculated based on the maximum

average price set at each tariff review (which excludes VAT) and are based on average annual consumption of 16,500kWh<sup>3</sup>.

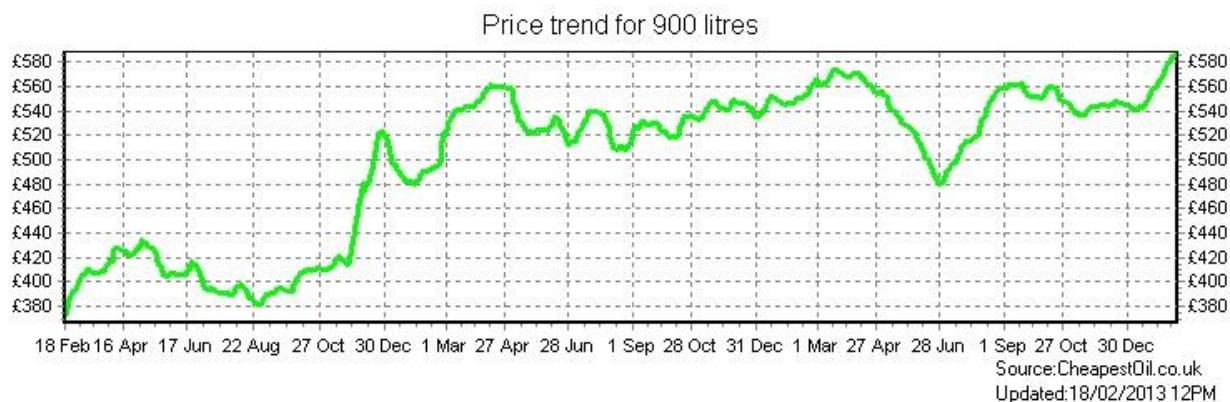
**Figure 3 - Graph to show breakdown of average annual bill**



## Comparison with Oil

Oil prices continue to be high and are significantly more expensive than natural gas. Over the past year heating oil prices have been consistently more expensive than natural gas prices. The graph in Figure 4 shows the trend in the average price for 900 litres of oil over a three year period from February 2010 to date.

**Figure 4 – Price of 900l Home Heating Oil Compared to Price of Natural Gas**



<sup>3</sup> 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>

## Comparison with GB and RoI

Figure 5, below, shows the average annual bill for an Airtricity domestic credit customer compared to the Big 6<sup>4</sup> 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<sup>5</sup> of each company from 1 April 2013 and is based on average annual consumption of 16,500kWh<sup>6</sup>. This graph 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 pa)**

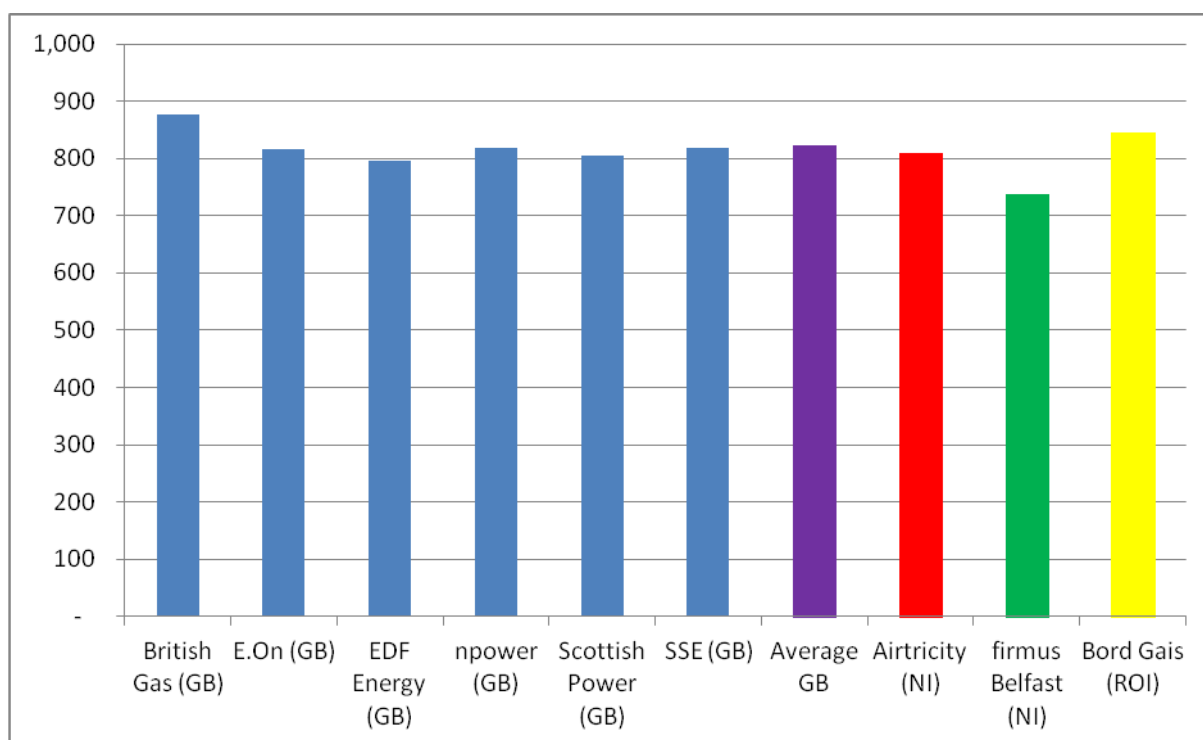


Figure 6 illustrates that the Airtricity tariff for an average domestic credit customer will be just over 1% cheaper than the GB average standard tariff, and will be more than 4%<sup>7</sup> cheaper than the Bord Gais tariff in RoI.

Figure 6 illustrates the historic comparison of Airtricity prices against the average standard tariffs in GB and ROI. It shows that since April 2012, Airtricity prices have been lower than

<sup>4</sup> The Big 6 companies are British Gas, Scottish and Southern Electric, Scottish Power, npower, EDF and E.on

<sup>5</sup> 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.

<sup>6</sup> 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>

<sup>7</sup> Comparison based on Bord Gais domestic standard credit tariff effective from 1 October 2012 and calculated using the exchange rate which applied at 1 October 2012.

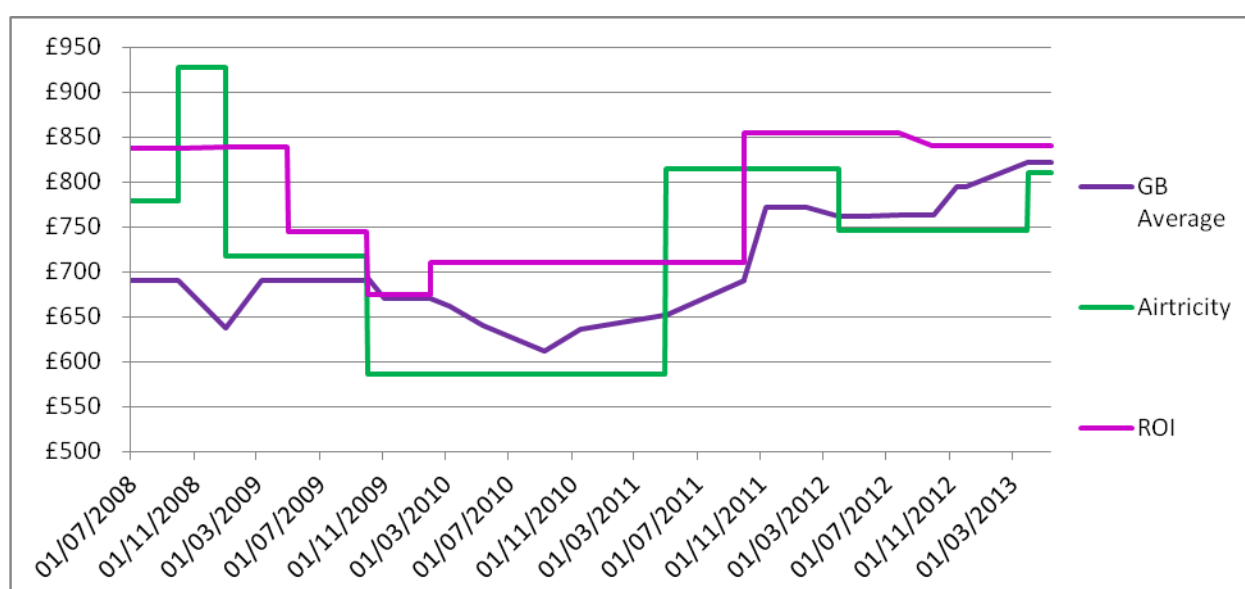


the average standard tariff in GB of the Big 6 Gas Suppliers.

Since September 2012, each of the Big 6 Gas Suppliers in has announced increases to their gas tariffs. These increases have ranged from 6% to 10.8%. In ROI, Bord Gais increased tariffs by 8.5% effective from 1 October 2012. The graph in Figure 6 however shows a slight decrease in the ROI tariff at this date. This is due to the changes in the exchange rate as the ROI tariff is converted into pounds sterling for comparison purposes using the applicable exchange rate at the time of each tariff change.

**Figure 6 - Historic Comparison of GB and ROI prices against Airtricity prices**

(Average annual bill (including VAT) for a domestic gas customer on standard credit tariff shown in £ per year)



The 8.7% increase in the Airtricity tariff from 1 April 2013 equates to an increase in consumer bills of £65 per year (including VAT) based on the Airtricity standard domestic credit tariff using average annual consumption of 16,500 kWh.

## Outcome

The Utility Regulator has reviewed the Maximum Average Price Review submission provided by Airtricity and reviewed the Airtricity forecasts against its own market analysis. The Utility Regulator is satisfied that this increase is justified and therefore approves the tariff of £1.3326 per therm effective from 1 April 2013 for one year. This represents an increase of 8.7% over the previous tariff which became effective on 1 April 2012 of £1.2264 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.