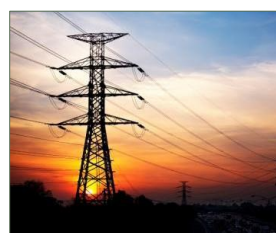


Final Determination on Price Control for firmus energy (Supply) Ltd

1 April 2015 – 31 December 2016

15 December 2014



About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our Mission

Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

This document sets out our determination for a first price control on firmus energy (Supply) Ltd in the Ten Towns gas supply market. The price control will come into effect on 1 April 2015 when the Ten Towns market will open fully to competition. This consultation follows our draft determination published in October 2014 and an initial consultation published in June 2014. The final determination is made on the basis of the responses to the previous consultations, submission from firmus energy (Supply) Ltd and benchmarking with other relevant organisations.

Audience

Industry, consumers and their representative bodies and statutory bodies.

Consumer impact

The price control will protect customers in terms of price by setting a maximum limit on the average price that firmus energy (Supply) Ltd can charge for gas in the Ten Towns area.

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Glossary

Name	Definition
BGE	Bord Gais Energy
CCNI	Consumer Council for Northern Ireland
CMA	Competition and Markets Authority
DETI	Department of Enterprise, Trade and Investment
firmus	firmus energy (Supply)Ltd
firmus distribution	firmus energy (Distribution) Ltd
GB	Great Britain
NI	Northern Ireland
NTS	National Transmission System
PNGL	Phoenix Natural Gas Ltd
Power NI	Power NI Energy Ltd
SEM	Single Electricity Market
SSE Airtricity	SSE Airtricity Gas Supply (NI) Ltd
TSO	Transmission System Operator

1. Introduction

This consultation sets out our final decisions for a price control for firmus energy (Supply) Ltd (firmus) from 1 April 2015. This will be the first supply price control for firmus, previously the supply costs have been part of the distribution price control.

This document sets out the decisions and principles that will form the basis for the price control and provides background information on the gas markets in Northern Ireland.

This determination follows two previous consultations on the price control process.

Most recently the 'Draft Determination on Price Control for firmus energy (Supply) Ltd'¹ was published in October 2014. This consultation set out our proposals for the price control. We received one response to this consultation from firmus energy (Supply) Ltd which is treated as confidential.

In June 2014 we published an 'Initial Consultation on a Price Control for firmus energy'². This consultation set out our high level proposals for the price control. We received two responses to this control.

We consider that our approach has been consistent with the principles of better regulation³ which the Utility Regulator continues to apply: transparent, consistent, proportionate, accountable and targeted.

All costs presented are in January 2014 prices. These prices will be adjusted within the tariff for inflation as discussed in section 10.2.

For ease of comparison costs are presented for the whole of 2015. The price control will take effect from 1 April 2015 therefore the 2015 costs will be apportioned for the remaining nine months of the year, These costs will be apportioned on a linear basis with 75% of the total cost applying to the remainder of 2015.

1 Draft Determination on Price Control for firmus energy (Supply) Ltd, October 2014:
http://www.uregni.gov.uk/uploads/publications/2014-06-09_FE_Draft.pdf

2 Initial Consultation on a Price Control for firmus energy, June 2014:
http://www.uregni.gov.uk/uploads/publications/2014-05-07_Initial_Consultation_fe_supply_price_control.pdf

3 Department for Business Innovation & Skills, *Principles for Economic Regulation*, April 2011:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principles-for-economic-regulation.pdf

2. Background

In Northern Ireland there are two distinct distribution areas for natural gas. These are the Greater Belfast area and the Ten Towns area. The Greater Belfast area is served by Phoenix Natural Gas Ltd and the Ten Towns area is served by firmus energy (Distribution) Ltd (firmus distribution).

The Ten Towns area covers a geographical region that includes Londonderry, Limavady, Coleraine (including Portstewart and Bushmills), Ballymoney, Ballymena (Broughshane), Antrim (including Ballyclare and Templepatrick), Craigavon (including Portadown and Lurgan), Banbridge, Newry (Warrenpoint) and Armagh (Tandragee). firmus energy (Supply) Ltd (firmus) holds a licence to supply gas to this Ten Towns area. The licence grants to firmus a period of exclusivity for supplying gas to customers within the Ten Towns area, meaning that firmus is the only company allowed to supply gas during this period. This period of exclusivity ended on 30 September 2012 for customers using more than 25,000 therms per annum, typically large industrial and commercial customers. The period of exclusivity for all customers using less than 25,000 therms per annum will end on 31 March 2015; this will include all domestic customers and small to medium business customers. From 1 April 2015 therefore, the supply market in the Ten Towns area will be open to competition from new entrant suppliers in all customer sectors.

The Ten Towns Market is a relatively small market, there are currently approximately 24,000 gas customers (comprising of 2,000 small industrial and commercial and 22,000 domestic customers) using less than 25,000 therms per annum, and these customers will be eligible to switch from 1 April 2015. There are 252 meter points using more than 25,000 therms per annum that have been eligible to switch since October 2012. To date 33 meter points have switched, all of whom have switched to SSE Airtricity Gas Supply (NI) Ltd (SSE Airtricity) as the only other active supplier. This equates to around 13% of the market⁴.

In the Greater Belfast Market there are approximately 174,000 customers. This market has been open to competition since 2007. Currently there are five active suppliers in the market. Only two of these companies supply to domestic customers, SSE Airtricity and firmus. SSE Airtricity, as the incumbent dominant supplier (having purchased Phoenix Supply Limited), is subject to price control.

4 Retail Market Monitoring Quarterly Transparency Report, published November 2014: http://www.uregni.gov.uk/uploads/publications/Transparency_Report_2014_NOV_updated.pdf

The current SSE Airtricity price control lasts for a period of five years from January 2012 to December 2016. This price control can be found on our website⁵.

The Utility Regulator is currently undertaking a detailed review of the regulated energy supply markets in NI to assess the effectiveness of competition within these markets and the implications for our regulatory framework.

There are two stages to this review.

1. Phase 1 of this project was published in November 2014 and can be found on our website⁶. This report provides an independent assessment of the effectiveness of retail competition in our energy markets.
2. In light of the findings of phase one of the project, phase two of the project is to define the appropriate policy response and regulatory framework to deal with the issues identified and assess if there is any change required to the current regulatory regime. This regulatory policy review is dependent upon the outcome of phase one and will look at a wide range of regulatory roles in retail markets (price controls, consumer protection licence conditions and requirements from the regulatory framework in different market sectors).

It is our intention that phase two of the project will be completed before the end of this price control period for firmus. Our decision on how to regulate this market going forward will then be based on the policy decisions that form the conclusions to this review.

5 Utility Regulator Determination on Phoenix Supply Price Control 2012-2016, November 2011: http://www.uregni.gov.uk/publications/utility_regulator_publishes_the_phoenix_supply_ltd_price_control_determinat

6 Cornwall Energy's Review of the Effectiveness of Competition in the Northern Ireland Energy Retail Market for the Utility Regulator, November 2014: http://www.uregni.gov.uk/uploads/publications/Review_of_the_effectiveness_of_NI_retail_markets_Final_171114.pdf

3. Basis for Price Control

The following section in the firmus supply licence confers on the Utility Regulator (the Authority) the power to control charges if deemed necessary:

2.4.1 Control over Charges in the absence of competition

Ifconsumers of different cases or classes of cases or for different areas, whose consumption of gas at any premises is reasonably expected not to exceed 2,197,500 kilowatt hours [75,000 therms] in any period of twelve months:

(a) do not have the opportunity of taking a supply of gas from another gas supplier (or if there is such an opportunity it does not safeguard the interests of consumers); and

(b) the Authority determines that competition from fuels other than gas is not safeguarding the interests of those consumers;

then 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...

A price control is the mechanism that we use to determine the costs which are used to establish the maximum average price per therm that firmus can charge to its domestic and small/medium sized business customers in a twelve month period.

In determining if it is appropriate to apply a price control in this instance we have examined both the tests set out in the licence condition above.

(a) Opportunity to take gas from another supplier

Currently firmus supplies 100% of those consumers within the Ten Towns area who use less than 25,000 therms per annum and is therefore in a dominant position in this market. As there is no competition in this market we cannot determine whether the opening of the market to new entrants will safeguard the interests of consumers.

We can examine the experience in the Greater Belfast market; where in the first year of competition around 7% of customers switched to a different supplier. There were a number of factors that promoted this level of switching including a price differential of 35% for a period of time between competitors. If we extrapolate these figures in the Ten Towns market this would indicate that less than 2,000 customers would switch supplier in the first year. This means that over 22,000 customers may not change supplier and would remain with firmus. There is no indication that consumers in the

Ten Towns market will behave in the same way as those in the Greater Belfast market. Additionally we have no indication of how suppliers will seek to compete in the Ten Towns area, or how this will affect the switching levels. Therefore we do not consider that competition, at this stage in the market, will necessarily safeguard the interests of consumers.

(b) Competition from other fuels

We do not consider that these consumers are protected by competition from other fuels. There is a large capital outlay required by consumers to switch fuels, which acts as a significant barrier to switching, and we consider that it would require a significant price shock in the market for consumers to consider changing fuels. This would be the case especially for domestic and smaller business users.

In keeping with our statutory duties to protect the interests of consumers therefore, we do not consider that competition in this market will be sufficiently effective to protect consumers and that as a result a price control on firms is required.

4. Scope and Duration

4.1. Scope

Within the draft determination we proposed that this price control would apply to customers using less than 25,000 therms per annum (typically domestic properties and small to medium sized businesses). This is equivalent to the customer coverage of the price control applying in the Greater Belfast gas market.

The market for those customers using more than 25,000 therms per annum has been open to competition since 1 October 2012. We are carefully monitoring the progress of competition in this market. There is currently only one other supplier active in the Ten Towns market and around 13% of meter points that can avail of competition have switched. We consider there to be potential for more companies to enter the market in the near future.

The results of the review of competition project will affect our decisions on which markets to regulate in the future, but for now we consider it appropriate to treat this market in line with the Greater Belfast Market. We will consider the issue of the customer scope of the controls again at the time of the next firmus (and SSE Airtricity) price controls.

It is our decision that this price control will apply only to customers using less than 25,000 therms per annum.

4.2. Duration

Within our draft determination we proposed to apply the firmus price control for a period of 21 months from 1 April 2015 to 31 December 2016. This was in order to bring the control into alignment with the price control on SSE Airtricity which also ends on 31 December 2016. This will allow synergies in the development of the two price controls, as well as effective benchmarking.

In addition, by the end of 2016 we will have completed our work on the review of the effectiveness of competition in the market and used the results of this project to set out our policies for dealing with price controls in the future. This will allow us to treat both price controls in the same manner where appropriate and in line with the established policies of the Utility Regulator on supply price controls. Therefore in the draft determination we proposed a 21 month price control period.

4.3. Responses to Draft Determination

firmus expressed concern about the short timeframe of the control, stating the need for a stable and predictable policy and regulatory regime. firmus commented that the short control period does not provide the stability required to support firmus' business decisions and places additional costs and risk on the firmus supply business. They have provided no costs or evidence to support this comment.

In principle we would normally refrain from short-duration price controls, however in this circumstance we consider that the benefits of the outcomes from the review of the market and the subsequent alignment of price controls on the basis of this review will outweigh any negatives of an initial short price control period.

Therefore it is our decision that this price control will last for a period of 21 months from 1 April 2015 to 31 December 2016.

5. The Regulated Tariff for firmus

The firmus licence condition 2.4.1 states that firmus

...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...

In order to approve this maximum average price the Utility Regulator will review the proposed tariff of firmus to ensure that it is constructed in line with the provisions set out in the price control.

5.1. firmus Tariff

The tariff is the price that firmus charges its customers for gas. This can be set at or below the maximum average price. The tariff is made up of a number of elements

- Transmission costs
- Distribution costs
- Supply operating costs
- Gas costs
- Margin

Within the draft determination we set out our proposals for how each of these costs would be treated. These costs are discussed further in sections six to nine of this paper and our decisions on these costs set out.

5.2. K Factor

Within the draft determination we proposed that a number of costs were treated as pass through. The k factor is the term for the difference between actual allowed costs and forecasts for those costs. It is our intention to maintain the k factor at a minimum level through the use of regular tariff reviews and a trigger mechanism to monitor the tariff closely and thus minimise the impact of k factor on the tariff.

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

5.3. Tariff Review

A tariff review is the process of analysis and discussion of the tariff to consider if a change to the tariff is needed, and to decide the magnitude and timing of any change. We will review the firmus tariff on a bi annual basis; additionally we will be able to initiate a tariff review under the trigger mechanism as discussed below. This follows the process established within the SSE Airtricity price control. Our experience with SSE Airtricity demonstrates that regular reviews minimise the impact of k factor on the tariff and can help guard against tariff volatility for consumers.

We have established a process in consultation with firmus, CCNI and DETI which sets out the timescales and information required in setting the tariff. The tariff review process is a consultative one where all parties bring their expertise and opinion in relation to the needs of firmus, 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.

This process will provide a robust procedure, which is in line with the requirements of the licence to ensure that all parties are consulted in a timely, prescribed and comprehensive manner for both anticipated and unanticipated tariff reviews. The process is published in Annex 2.

5.4. Trigger Mechanism

In addition to the bi annual tariff reviews we will establish a trigger mechanism within the price control. The aim of this trigger mechanism is to initiate a tariff review should the cost of wholesale gas purchased by firmus vary significantly from the cost forecast within the tariff.

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%. This is the same mechanism that applies to SSE Airtricity in the Greater Belfast market. We consider the 5% level to be an appropriate level, any level under this and volatility in the wholesale market could necessitate a number of tariff reviews in a year. Tariff reviews can be costly and complex for the company. 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 firmus

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

5.5. Tariff Structure

The firmus domestic credit tariff is made up of two charges, a higher charge for the first 2,000kWh used per annum and a second charge for any usage above 2,000kWh per annum. Pay as You Go customers pay a flat tariff for each unit used.⁷

Industrial and commercial customers using less than 73,200 kWh (2,500 therms) per annum are charged a tariff with the same structure as the domestic credit tariff. Those customers using between 73,200 and 732,000 kWh (2,500 and 25,000 therms) per annum are charged a three tiered tariff, with different charges for usage up to 2,000kWh per annum, between 2,001kWh and 73,200kWh per annum and above 73,200kWh per annum.⁸

At each tariff review we will require firmus to demonstrate the assumptions used to create the tariff structure to ensure that the average weighted price charged to customers is equal to or less than the maximum average tariff.

5.6. Responses to Draft Determination

firmus stated in their response that they were supportive of the proposals set out in the draft determination.

It is our decision that the tariff review and trigger mechanism will operate in the method as set out above and as detailed in Annex 2.

⁷ firmus domestic tariff: http://www.firmusenergy.co.uk/for_home_10_towns.aspx?dataid=499871

⁸ firmus business tariff: http://www.firmusenergy.co.uk/for_business_10_towns_content.aspx?dataid=500983

6. Network Costs

Network costs are the charges for the use of the transmission and distribution systems.

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 through the transmission pipeline systems. The tariff for using the transmission pipelines are published on an annual basis on the Transmission System Operator's (TSO) websites. In the draft determination we proposed to treat transmission charges as pass through costs.

The costs for the distribution system are those costs associated with moving gas throughout the firmus distribution network area to homes and businesses. These can be found on the firmus distribution website. Distribution costs are also subject to price control by the Utility Regulator. The latest price control GD14⁹ came into force on 1 January 2014 and will last for a period of three years. Within our draft determination we proposed to treat distribution charges as pass through costs.

6.1. Responses to Draft Determination

In their response firmus agreed with the proposals for the treatment of network costs.

It is our decision to treat network costs as pass through costs.

9 GD14 Price Control for Northern Ireland's Gas Distribution Networks for 2014-2016 Final Determination, 20 December 2013: http://www.uregni.gov.uk/uploads/publications/2013-12-20_GD14_Price_Control_for_NI_GDNs_2014-2016_Final_Determination.pdf

7. Supply Operating Costs

7.1 Supply Business Costs

In the following section we set out our final allowance for the supply operating costs of the firmus Ten Towns supply business. The supply operating costs are those costs that relate directly to supplying gas to customers within the Ten Towns area, with the exception of the costs related to wholesale gas.

In setting our cost allowance it is not our intention to set a cost for firmus for each cost line of their business, but rather to set an overall allowance which we consider to be an efficient level for firmus to finance their regulated activities in the Ten Towns area. This allowance is summarised into three areas

- Manpower costs are those costs related to staffing the Ten Towns supply business including salaries, training and travel costs
- Operations costs refer to the costs of operating the supply business including office costs, insurance, professional fees, IT, network maintenance and call centre costs
- Billing costs include meter reading, paypoint and credit check transaction costs, bill processing, bad debt and bank charges.

In calculating our proposals for the draft determination we analysed the costs submitted by firmus, on both a historical and forecast basis. We analysed the split of these costs between the firmus distribution and supply businesses. Additionally we benchmarked these costs with other relevant organisations where appropriate.

In reaching our final determination we have considered the response made by firmus to the draft determination and made changes to our proposals as we considered appropriate as detailed later in this section.

In Annex 1 we set out a breakdown of our final determined allowance, however, this detailed allowance is not a prescriptive budget for firmus to follow on individual cost headings. Our intention is that firmus will decide how to efficiently spend this allowance in conducting its regulated activities and meeting its gas supply licence requirements.

We will seek from firmus annual cost reporting on a line by line basis in order to understand the total costs of the business and undertake the reconciliation detailed in section 10.1.

7.2 Response to Draft Determination on Operating Costs

Since publishing the draft determination firmus has updated their operating cost submission. The table below shows the final submission of tariff costs from firmus. It shows the initial submission used in the draft determination and the breakdown of differences between the initial submission and the final submission.

firmus resubmitted volume forecasts with updated figures in line with their tariff forecasts. Volume and customer numbers are cost drivers for a number of areas and therefore affect the whole cost base. The impact of the adjustment to volumes is reflected in the following table. In addition firmus requested additional costs in relation to maternity leave and IT costs. These additional requests are also shown in the table below.

Table 1 firmus submission of tariff costs (January 2014 prices)

firmus Submission	2015¹⁰	2016
	£000's	£000'
Manpower initial submission	471	504
Impact on costs of adjustment to volumes	8	8
Maternity leave allowance costs requested	-	38
Adjusted Manpower Submission	479	550
Operations initial submission	240	250
Impact on costs of adjustment to volumes	3	3
IT costs requested	165	165
Adjusted Professional and Legal fees	42	44
Adjusted Operations Submission	450	462
Billing initial submission	565	580
Impact on costs of adjustment to volumes	-	-
Adjusted Billing Submission	565	580
Total final firmus submission	1,494	1,593

The updated volumes and customer numbers are also reflected in the final determination figures.

Additionally firmus raised specific issues with various areas of the draft determination on operating costs. We have summarised firmus' comments and our response to their comments below.

¹⁰ The costs stated in the table for 2015 are for the full calendar year for ease of comparison. As this price control commences on 1 April 2015, the actual costs requested by firmus for 2015 are 75% of the figures stated in the table.

7.2.1 Apportionment of costs

firmus is an integrated business in that its distribution and supply activities all form part of the same business; as such, it is accepted that some of the costs will apply to the business as a whole, such as office costs, insurance, rates etc.

In analysing the costs of the Ten Towns business we considered the apportionment of these costs between the distribution and supply businesses, between the various supply businesses (Ten Towns, Greater Belfast and electricity) and between the regulated and non regulated business within the Ten Towns. It was our conclusion within the draft determination that firmus' allocation of costs to the Ten Towns supply business was not correct and that this led to an overly high level of costs in firmus' submission for the Ten Towns business.

For those costs which relate to the whole business we have examined the treatment of these costs in the distribution price control (GD14) set in December 2013¹¹. We applied a consistent methodology to the apportionment of these costs between the Ten Towns supply business and the distribution and other supply businesses. Additionally we examined those costs which are apportioned between supply businesses including manpower, call centre costs and professional fees and apportioned these costs on the basis of manpower and customer numbers where appropriate.

Finally we allocated costs between regulated customers (those using less than 25,000 therms per annum) and non regulated customers on the basis of customer numbers, volume and manpower to ensure only appropriate costs are allocated to the regulated sector. The apportionment methods used to apportion costs between tariff and non tariff customers are also consistent with those used in the SSE Airtricity price control.

firmus in their response request that we apportion costs on a consistent basis, aligned to GD14 where applicable. As stated above where the costs apply to the whole business we have been consistent in the treatment of these costs with the allocations set in GD14. We consider that the apportionment methods as set out above provide for a fair and consistent allocation of costs between businesses and across customer groups.

¹¹ GD14 Price Control for Northern Ireland's Gas Distribution Networks for 2014-2016 Final Determination, 20 December 2013: http://www.uregni.gov.uk/uploads/publications/2013-12-20_GD14_Price_Control_for_NI_GDNs_2014-2016_Final_Determination.pdf

7.2.2 Benchmarking

In order to assess an appropriate level of costs for firmus within the draft determination we examined the historical and forecast costs of the business and benchmarked these costs against the other regulated supply companies SSE Airtricity in gas, and Power NI in electricity.

In their response firmus recognised the importance of benchmarking but highlighted some shortcomings in relation to size and scale. They highlighted the difference in the market sizes with the firmus market being 5.5 times smaller than SSE Airtricity and 25 times smaller than Power NI.

In using benchmarking as an analytical tool we have sought to compare the firmus costs to the costs of the other businesses and to understand where and why there might be differences in the costs. We consider that benchmarking is a very useful tool in understanding where companies might seek to achieve efficiencies. We took account of the relative size of the firmus business in comparison to the other companies. We also took into account the economies of scale firmus has with its other supply business in the Greater Belfast area. We are satisfied that the results of our analysis provide an efficient cost base for firmus.

7.2.3 Manpower

Within the draft determination we proposed a reduced allowance compared to firmus' submission as we considered the submitted manpower levels to be high for a supply company.

In their response to the draft determination firmus reiterated the fact that they had asked for a number of additional staff on top of the existing staff base within the Ten Towns business. They requested that we conduct a bottom up exercise on staffing to determine an appropriate staff level for the business. In addition they requested an additional staff member to cover maternity leave and an increase to the manpower allowance to cover maternity pay.

We consider that the proposed level of staff is proportionate for a supply company of firmus' size. In setting our proposed allowance we benchmarked the manpower levels and costs with both SSE Airtricity and Power NI, taking into consideration the scale of the firmus business and deemed that this level is sufficient for firmus to run the supply business efficiently. For the final determination we considered firmus' response and have concluded that the analysis completed for the draft determination was appropriate and the level of staff proposed in the draft determination is sufficient.

However, in addition to the manpower allowance proposed in the draft determination we will allow maternity leave costs for the final determination, but do not consider that an additional staff member is required for maternity cover as the existing staff member's salary can be used to finance their replacement.

firmus requested additional staff to cover market opening should the number of switches increase beyond current estimations. We will not allow these additional staff in the final determination, however we will monitor switching levels closely within the Ten Towns market and will consider an allowance for additional staff should there be a significant increase beyond current estimations.

Within their response to the draft determination firmus provided a comprehensive breakdown of training costs to evidence the requested cost level within their submission. We have considered these costs and decided to allow training costs at the requested level.

firmus requested an increased allowance for travel and subsistence over that granted in the draft determination. We do not consider that the requested costs are efficient for a supply business as the majority of staff would be office based. On this basis we will not increase travel costs.

firmus requested that any change to manpower be reflected in the apportionment of costs. Manpower numbers are used as a cost driver to allocate costs between businesses. We have not made any changes to the number of staff allowed in the Ten Towns area and as a result there will be no impact on the allocation.

Costs relating to manpower will be treated as a fixed allowance.

7.2.4 Operations Costs

Within their original submission firmus requested IT costs of £15k per annum to cover the costs of annual licences. firmus stated that due to the transfer of ownership of the business they were not in a position to provide an overall annual cost base at that time. Within their response to the final determination firmus has now provided a breakdown of its forecast annual IT costs to include the cost to the business. We have considered the submitted costs and benchmarked with other similar organisations and we will allow the requested level of IT costs.

In the response to the draft determination firmus requested that we review our decision on granting an allowance for meter tampering due to the impact this has on bad debt. We do not consider that there is sufficient evidence or historical costs on which we can base an efficient forecast allowance for meter tampering, this is discussed further in Section 7.2.5 below.

We will grant firmus a ring fenced amount of £25k per annum (pro-rated for 2015) to spend on identifying and dealing with incidents of meter tampering. firmus will be granted this allowance if they can demonstrate that the allowance has been spent on seeking to identify and deal with levels of meter tampering. Operations costs will be treated as a fixed allowance.

7.2.5 Billing Costs

Within our draft determination we stated that billing costs should be treated differently as these costs are driven by actual volumes of gas burned and actual customer numbers and can therefore be affected by factors outside of the control of firmus. The draft determination proposed to treat these as retrospective costs, meaning that final costs will be adjusted for actual cost drivers.

The billing costs which will be retrospectively adjusted are

- Bad debt – adjusted for actual tariff credit revenue
- Paypoint costs & credit check costs – adjusted for actual rate charged by paypoint and credit check agency and number of transactions
- Bill processing– adjusted for actual number of customers and determined unit rates
- Meter reading – adjusted for actual number of meters read and determined unit rates
- Bank and interest charges – set allowance

For bill processing and meter reading costs we have set a unit rate per transaction and determined a forecast allowance based on the forecast cost driver (customer numbers and number of meters read respectively). This allowance will be retrospectively adjusted to amend the forecast allowance based on the actual cost driver. For paypoint transaction costs we use forecast unit rates and forecast number of transactions to set an allowance. This will then be retrospectively adjusted based on the actual unit rates and actual number of transactions. Bad debt is set at 0.2% of credit revenue. The allowance is set based on the forecast credit revenue. This allowance will be adjusted for the actual tariff credit revenue received multiplied by 0.2%. We will provide firmus with spreadsheets showing the detailed breakdown of the cost base including the retrospective items and the determined unit rates. Billing costs for 2015 will be allowed at actual costs incurred from 1 April 2015 to 31 December 2015; this will apply to paypoint costs, meter reading costs and bill processing costs where appropriate. Other costs will be treated on a pro rata basis.

Within our draft determination we proposed that bad debt levels were set at 0.2% of tariff credit revenue and we stated that this bad debt level also included the allowance for debt accumulated through meter tampering. firmus, in their response, requested that we reconsider our rationale for calculating bad debt on the basis of credit revenue as unrecoverable meter tampering costs should also be included.

In calculating the bad debt level we examined firmus' historic levels of bad debt experienced by customers using less than 25,000 therms per annum in the Ten Towns area. We based our calculation on the average bad debt levels per year and the annual credit revenue. This average level of bad debt included not only the bad debt from credit meters but from other sources such as meter tampering. Therefore the 0.2% allowance includes an allowance for meter tampering.

However we recognise that firmus' record on bad debt is very strong and that their bad debt allowance is substantially lower than that of the other regulated gas supplier in Northern Ireland. SSE Airtricity has an allowance of 1% of credit tariff revenue. However we have stated in the SSE Airtricity price control that we consider this allowance to be too high and that we expect to see an improvement in the company's policies and procedures for dealing with customers in debt before the next control. We will closely examine the area of bad debt allowance in the next price control, comparing suppliers' performance across Northern Ireland in both electricity and gas to understand best practice in Northern Ireland.

We also recognise that firmus is proactively seeking out incidents of meter tampering and seeking ways to minimise its impact and we understand that this may increase the impact of meter tampering on the bad debt level. However on the basis of the information provided by firmus to date it is difficult to forecast the level of meter tampering that may be discovered and the subsequent impact on bad debt levels. As such we cannot justify an increase in the level of bad debt above the 0.2% of credit tariff revenue level.

However we will allow a ring-fenced amount of £25k per annum (pro-rated for 2015) to spend on identifying and dealing with incidents of meter tampering. firmus will be granted this allowance if they can demonstrate that the allowance has been spent on seeking to identify and deal with levels of meter tampering. This allowance is included within the Operating Costs cost line.

In the draft determination we reduced the allowance for bill processing costs compared to firmus' submission by capping the retrospective adjustment to 80% of customer numbers. This was to incentivise firmus to encourage customers to opt for other forms of communication, for example online communication rather than sending communication by post. firmus, in their response, requested that we allow the bill processing costs at their original request. We have reviewed this

cost and consider that the 20% target would be difficult to meet within a short control period. We have therefore reduced the target to 10% which means that the allowance for bill processing costs is capped at 90% of customer numbers for the period of the control.

Billing costs will be retrospectively adjusted as set out above.

7.3 Final Determination on Costs

Having reviewed our proposals on the draft determination in light of the response made by firmus, we set out below our final determination on operating costs for the supply business in the Ten Towns area. Tables 2 and 3 below shows the firmus submission against our final determination.

Table 2 – firmus final submission of tariff costs v Utility Regulator’s final determination of tariff costs (January 2014 prices)

	2015		2016	
Overall Allowance	firmus submission	Final determination	firmus submission	Final determination
	£'000	£'000	£'000	£'000
Manpower	479	375	550	380
Operations	450	331	462	329
Billing	565	468	580	479
	1,494	1,173	1,593	1,188

NB: The final determination for operations costs includes a ring fenced amount of £25k per annum for meter tampering.

Table 3 – firmus final submission of tariff costs v Utility Regulator’s final determination of tariff costs for 1 April 2015-31 December 2016 (January 2014 prices)

	1 Apr 2015 – 31 Dec 2015		1 Jan 2016 – 31 Dec 2016	
Overall Allowance	firmus submission	Final determination	firmus submission	Final determination
	£'000	£'000	£'000	£'000
Manpower	359	281	550	380
Operations	338	248	462	329
Billing	424	351	580	479
	1,120	880	1,593	1,188

NB: The final determination for operations costs includes ring fenced amounts of £18.75k and £25k in 2015 and 2016 respectively for meter tampering.

Costs relating to manpower and operations costs will be treated as an overall fixed allowance whereas billing costs will be retrospectively adjusted. We will however continue to require annual cost reporting on a line by line basis in order to monitor the actual costs of the business.

7.4 Efficiency Factor

Within our draft determination we proposed an efficiency factor of 0%. We considered our proposed allowance to be an efficient amount for firmus to carry out its regulated activities. Additionally we considered that achieving this proposed cost level within the relatively short control period provided sufficient challenge to firmus.

In their response firmus agreed with the proposed efficiency factor.

We determine that an efficiency factor of 0% will be applied to this control.

8. Gas Costs

The wholesale cost of gas and the associated costs of purchasing gas make up more than half of the final tariff price to gas customers. This section sets out our final decision on the treatment of gas costs.

8.1 Wholesale Costs

The wholesale costs of gas make up the largest single element of the gas tariff. It is these costs that also provide the greatest risk to changes in the tariff. The Committee on Climate Change demonstrated that over the past number of years (2004 to 2011) gas prices in Great Britain have risen by 121%. Of this rise 80% is due to increasing wholesale costs¹². Over the past two years the wholesale gas forward curve has remained relatively stable, however this is not an indication that prices will remain at this level. Ofgem has stated that wholesale prices are likely to rise over the next number of years as Great Britain relies more on gas imports from Europe and further afield and prices are increasingly influenced by global events¹³.

We consider that in the wholesale gas market firmus is a price taker; it has no control over the price of wholesale gas. As a result we proposed within our draft determination to allow gas costs as pass through costs for the duration of the control. This is in line with the treatment of gas costs in the SSE Airtricity price control.

In their response firmus supported this view. It is our decision that gas costs will be treated as pass through and to support this we will require the following information from firmus

- The purchasing strategy of firmus
- The apportionment of costs among customer groups and firmus businesses (Ten Towns/Greater Belfast)
- 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

firmus have undertaken in their response to provide this information. We will closely monitor the level of over/under recoveries and will act to ensure these remain at a low level so as not to distort prices.

¹² Household energy bills – impacts of meeting carbon budgets Committee on Climate Change, December 2011

¹³ Ofgem's Understanding energy prices in Great Britain: <https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/understanding-energy-prices-great-britain>

8.2 Network Costs

firmus is responsible for paying national transmission system (NTS) transportation charges in order to transport gas through the transmission system in Great Britain. These costs are set and published by National Grid. Within the draft determination we proposed to allow these costs as pass through costs at the published rate. Additionally we proposed that charges for removing gas from the NTS, known as Moffat exit charges would be treated as pass through costs.

firmus will also be required to purchase additional gas in order to meet the Shrinkage Factor set by firmus distribution. We also proposed that this cost was treated as a pass through cost.

In their response firmus agreed with our proposed treatment of these costs. It is our decision to treat costs for NTS transportation, Moffat exit charges and Shrinkage as pass through costs. These costs will form part of the tariff costs.

8.3 Energy Balancing

In reviewing the gas costs for the final determination we consider it appropriate to set an additional allowance for energy balancing. 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 reflects the impact of the timing of purchasing the gas. firmus will hedge the majority of their purchases before the month but some gas will remain to be purchased within the month to match the actual consumption profile.

We will set the energy balancing figure in the tariff as follows

- where firmus has 40% or less of their gas requirements for the month remaining to be secured, there will be a 10% premium applied to the remaining gas to be purchased
- where firmus has more than 40% of their gas requirements for the month remaining to be secured, there will be a 10% premium on 40% of the total purchases for the month.

This is in line with the energy balancing figure within the SSE Airtricity tariff. This cost will form part of the tariff costs.

8.4 Credit Support

Within the draft determination we proposed an allowance for credit support of 0.51ppt and 0.52ppt for 2015 and 2016 respectively. This allowance was based on forecast figures provided by firmus to meet their credit requirements.

Previously these costs had been borne by firmus' parent company, BGE, but a transfer of ownership means that these costs are now the responsibility of firmus.

In their response to the draft determination firmus provided updated credit costs based on the actual value of the parent company guarantee. They requested credit costs of 0.74ppt and 0.75ppt for 2015 and 2016 respectively. It is our view that firmus have failed to adequately evidence the basis for the increase in credit costs. Furthermore the allowed costs are significantly higher than those allowed for SSE Airtricity. On this basis we determine that allowed credit costs for 2015 and 2016 are set at 0.51ppt and 0.52ppt respectively in line with our draft determination.

9. Margin

During the 2013 price control of the regulated dominant supplier in the electricity market, Power NI, we engaged consultants to carry out a robust and comprehensive analysis of the retail margin. This analysis took into account theoretical and evidence based perspectives of required supply margins for regulated energy businesses and resulted in a margin of 2.2% for Power NI (historically at 1.7%).

For the firmus supply price control we engaged consultants to carry out a similar analysis to the Power NI analysis. This analysis used the Power NI margin as a basis for comparison and considered whether it would be appropriate for the margin for firmus to be the same or different from the Power NI margin of 2.2%.

We considered that these principles would result in an appropriate margin for firmus based on the capital requirements of the supplier and the risks they faced, balancing our statutory duties to protect customers while ensuring that regulated companies can finance their efficient licensed activities.

The Power NI margin is an appropriate basis for comparison due to the similarities between the companies. Power NI and firmus are broadly similar in a number of respects; they hold dominant positions in their respective markets, their customer base overlaps and they retail similar products. However there are a number of differences between the companies and it is these differences which play a key part in determining the final margin.

The major difference is in relation to the capital requirements for energy purchasing. Power NI buys most of its electricity from the Single Energy Market (SEM). The rules of the SEM impose high collateral requirements on electricity supply companies which are not replicated in the gas market. Additionally the SEM is a dual currency market and as such Power NI considers it necessary to hedge against currency risk which increases collateral costs. This leads to a higher working capital requirement for Power NI.

As Power NI has a higher working capital requirement, this suggests that the margin for firmus should be less than the 2.2% Power NI margin. In fact, re-working the Power NI-type methodology on the basis of the reduced working capital requirements of a gas supplier, results in a suggested margin for firmus of no more than 1.5%.

In addition, we consider that the margin determined for SSE Airtricity (the other regulated gas supplier in NI), and accepted by them for their current price control, is an important benchmark and comparator. This was set at 1.5% of turnover. SSE Airtricity and firmus operate similar gas supply businesses in the same

regulated market environment and under the same licence requirements. The price controls and tariff review arrangements are also largely similar in design and approach. In the draft determination we therefore proposed a margin of 1.5% for firmus.

firmus state in their response that they feel the proposed margin is too low. They argued that

- it is not consistent with their capital requirements
- it is insufficient for the risk of under-recovery in the tariff, and
- it is not in the interests of consumers with a negative effect on competition and investment.

firmus argue that the actual collateral they have in place with counter-parties, including recently submitted, but unexplained and unsubstantiated, figures for a parent company guarantee, and all their working capital, should be considered in calculating the margin. firmus consider that when these new figures are factored in to the Power NI-type methodology that this would give them a margin of 3.6% - 4.1%.

We will deal with each of these issues separately below.

9.1 Collateral and Working Capital Requirements

firmus argue that their trading collateral requirements are based on an actual Parent Company Guarantee (PCG) that they provide to Bord Gais Energy (BGE) to facilitate wholesale gas purchasing for the ten towns. They state that this PCG encapsulates the implied capital required by firmus' parent company in support of its credit rating.

We have the following observations

- implied capital is not the same as the actual cash required for security deposits or the letters of credit that Power NI pays for when buying from the SEM
- the figure that firmus' parent needs in order to be a creditworthy guarantor needs far greater explanation than firmus has offered in its response. firmus have not supported or substantiated this new figure. It is not clear
 - how this number has been calculated
 - what assumptions firmus is making about the use to which this capital is put – e.g. is firmus assuming that it is held as cash that the shareholder would not otherwise inject into the business or can it be money that has already been invested in other return-generating businesses; and, hence

- the extent to which a parent company guarantee imposes an additional cost on shareholders, as opposed to a situation in which firmus' parent naturally has the required credit quality by virtue of the other businesses that it operates (e.g. the gas network business);
- the scale of the number is such that firmus is arguing that a gas supplier needs more capital than an electricity supplier that buys electricity from the SEM and hedges its exposure to price fluctuations using contracts for differences.

firmus also suggest that we downplayed the scale of its working capital requirement. However as firmus have a high percentage of prepayment meters we would expect a smaller working capital requirement than Power NI in terms of a percentage of turnover.

We based our working capital requirements for firmus on the assumption that there are no intra-company transactions and cost allocations with its associated network business and/or less than efficient management of customer payments.

We would point out that there is a difference between the collateral required to be posted in a wholesale market in order to be able to trade and the actual total amount of working capital held in the company. It is the efficient amount of working capital needed to operate in the current gas wholesale market, or a proxy for this in terms of servicing a credit rating, that should be the consideration. We do not therefore accept the analysis that firmus provide supporting a 3.6%-4.1% margin.

We conclude that the point made in the draft determination still stands – i.e. that capital requirements for a dominant electricity supplier in the SEM are different in nature and higher than capital requirements for a monopoly gas supplier that buys gas through bilateral contracts. We find it difficult therefore to accept the implication of firmus' argument that the gas supply business requires double the capital intensity of the electricity supply business.

9.2 Under/Over-Recovery in the Tariff

As is acknowledged by firmus in the response to the draft determination the amount of any over/under recovery in the tariff is managed and reduced by the proposed tariff review process, which both the regulator and the company actively monitor and consider in relation to the need for in-year tariff reviews. Also given firmus' hedging strategy, exposure to under-recovery over the period of the tariff will be low.

firmus have 100% of the regulated customer base at this point. It is therefore highly improbable that market penetration by a new entrant in the short period of

this control would reduce the market share of firmus to such a point that it would be unable to recoup any under recovery.

In relation to under-recoveries against the price control firmus argue that a discount rate of LIBOR plus 1.5% falls short of the actual price it pays if it does not recover its costs in full. We note that

- the arrangements for under- and over-recovery are symmetric, and it is not at all clear why there should be an assumption that firmus will under-recover; and
- it is open to the Utility Regulator to choose the discount rate in such a way as to deter a supplier from under-recovering and putting upward pressure on next year's prices.
- this is in line with the treatment of these costs in the SSE Airtricity price control. The proposed rate of interest was set to reflect the cost to firmus of financing the under recovery or the benefits to them of holding any over recovery.

This area is also discussed under Section 10.3.

9.3 Effect on Competition and Investment

The recent work on reviewing competition in energy supply markets specifically considered the role of regulated prices and margins and the impact that regulatory framework had on markets, competition and consumers. Overall, Cornwall's findings¹⁴ made clear that the regulation of prices was necessary to deliver consumer protection and had not hindered the development of competition, nor of tariff offerings that were significantly below the level of regulated end-tariffs.

Customers in effect benefit from the hybrid approach of competition and regulated prices.

9.4 Conclusion

A supply margin for firmus is set at 1.5% on allowed turnover for firmus in line with the thinking underlying the Power NI allowed margin, and the margin applied to and accepted by SSE Airtricity. These gas businesses offer identical products and hold dominant positions in their respective markets. They are under similar regulatory controls so we consider it appropriate that they achieve the same margin.

14 Cornwall Energy's Review of the Effectiveness of Competition in the Northern Ireland Energy Retail Market for the Utility Regulator, November 2014:
http://www.uregni.gov.uk/uploads/publications/Review_of_the_effectiveness_of_NI_retail_markets_Final_171114.pdf

10. Reconciliation

This section sets out how the price control will be reconciled to actual allowed costs on an annual basis.

10.1 Reconciliation

On an annual basis we will reconcile the forecast costs that are allowed in the price control with the actual allowed costs (i.e. the retrospectively adjusted allowed costs) to determine a reconciliation amount. This amount will then form part of the k factor.

The reconciliation will take into account

- Billing costs which are retrospectively adjusted as detailed in section 7.2.5
- Ring-fenced allowances
- Inflation
- Rate of interest applicable

In addition to the information required to complete this reconciliation we will also require from firmus annual cost reporting to show their actual costs on a line by line basis reconciled with regulatory accounts.

10.2 Inflation

All costs presented in this paper are in January 2014 prices. These costs will be adjusted to account for inflation where appropriate. Inflation will be treated as a pass through. The costs used to make up the tariff at each tariff period will be adjusted to reflect the current price base. For reconciliation purposes the inflation figure will be the average figure for the year.¹⁵

10.3 Rate of Interest

Within the draft determination we proposed that any reconciled amounts, whether under or over recovered, including gas costs, would be rolled forward at an interest rate of LIBOR plus 1.5%. This is in line with the treatment of these costs in the SSE Airtricity price control.

¹⁵ RPI figure from Office for National Statistics <http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/october-2014/stb---consumer-price-indices---october-2014.html>

The proposed rate of interest was set to reflect the cost to firmus of financing the under recovery or the benefits to them of holding any over recovery.

firmus stated that the proposed rate of LIBOR + 1.5% does not reflect their actual cost of capital. Instead they suggested an interest rate of 8.7% would be representative of their cost of capital. firmus stated that they consider under recoveries of around £1m each year are possible.

Under our proposals for the rate of interest the arrangements for under and over recoveries are the same. We do not consider that there is more risk of over or under recovery and do not understand why firmus would consider that there is a greater risk of under recovery.

firmus have the ability to hedge their gas purchases and these hedges will be reflected in the tariff, reducing the risk of over/under recovery on gas prices. Additionally the trigger mechanism operates to initiate a tariff review should there be a significant change in gas prices that would lead to a build up of over/under recoveries.

It is our decision that an interest rate of LIBOR¹⁶ + 1.5% will apply to both under and over recoveries.

16 The LIBOR rate to be used will be the GBP 12 month average LIBOR rate in July of each year.

Annex 1

The tables below shows the breakdown of the firmus submission and the proposed allowance as referred to in section 7.1. These tables are for information purposes only to show the build up of the proposed cost allowances.

Table A1: Breakdown of firmus actual costs and forecast costs v final determination (January 2014 Prices)

	firmus submission				Final Determination	
	2013 (£000)	2014 (£000)	2015 (£000)	2016 (£000)	2015 ¹⁷ (£000)	2016 (£000)
Operating Expenditure Totals						
Manpower costs						
Manpower	505	392	446	516	359	365
Training	10	6	6	6	5	5
Labour Recharge	27	7	8	8	8	8
Travel and subsistence including Fleet Costs	22	17	19	21	3	3
Total Manpower Costs	564	422	479	550	375	381
Operations Costs						
Office Costs including stationery, telephone and postage	76	60	67	70	43	39
Rates	5	3	3	3	2	2
Professional and Legal Fees	36	7	14	14	4	4
Insurance	24	18	21	24	8	8
Information Technology	86	15	180	180	179	179
CAPEX	-	-	-	-	-	-
Licence Fee	- 9	0	0	0	0	0
Network Maintenance ¹⁸	27	118	135	140	64	66
Call centre	-	-	30	31	30	31
Total Operations Costs	245	222	450	462	331	329
Billing Costs						
Bad debt ¹⁹	136	102	113	118	27	28
Paypoint & credit check costs	105	217	237	247	230	240
Bank and Interest Charges	9	3	2	2	3	2
Meter reading	102	92	126	127	126	127
Bill Processing	9	102	87	87	82	82
Total Billing Costs	361	516	565	580	468	479
Total	1,171	1,160	1,494	1,593	1,173	1,188

17 The costs stated in the table for 2015 are for the full calendar year for ease of comparison. As this price control commences on 1 April 2015, the actual costs requested by firmus and determined by the Utility Regulator for 2015 are 75% of the figures stated in the table. The actual costs for 1 April 2015 – 31 December 2015 are shown in table A2 below.

18 The final determination for the Network Maintenance cost line includes a ring fenced amount of £25k per annum for meter tampering.

19 The firmus submission for bad debt was not split into tariff and non tariff. The adjusted tariff figures for 2015 would be £26k and £28k.

Table A2: Breakdown of firmus actual costs and forecast costs v final determination from 1 April 2015 to 31 December 2016 (January 2014 Prices)

	firmus submission				Final Determination	
	2013 (£000)	2014 (£000)	1 April to 31 December 2015 (£000)	2016 (£000)	1 April to 31 December 2015 (£000)	2016 (£000)
Operating Expenditure Totals						
Manpower costs						
Manpower	505	392	334	516	269	365
Training	10	6	5	6	4	5
Labour Recharge	27	7	6	8	6	8
Travel and subsistence including Fleet Costs	22	17	14	21	2	3
Total Manpower Costs	564	422	359	550	281	381
Operations Costs						
Office Costs including stationery, telephone and postage	76	60	50	70	32	39
Rates	5	3	2	3	2	2
Professional and Legal Fees	36	7	11	14	3	4
Insurance	24	18	16	24	6	8
Information Technology	86	15	135	180	134	179
CAPEX	-	-	-	-	-	-
Licence Fee	- 9	0	0	0	0	0
Network Maintenance ²⁰	27	118	101	140	48	66
Call centre	-	-	22	31	22	31
Total Operations Costs	245	222	338	462	248	329
Billing Costs						
Bad debt	136	102	84	118	20	28
Paypoint & credit check costs	105	217	178	247	173	240
Bank and Interest Charges	9	3	2	2	2	2
Meter reading	102	92	94	127	94	127
Bill Processing	9	102	65	87	62	82
Total Billing Costs	361	516	424	580	351	479
Total	1,171	1,160	1,120	1,593	1,173	1,188

²⁰ The final determination for the Network Maintenance cost line includes a ring fenced amount of £18.75k and £25k in 2015 and 2015 respectively for meter tampering.

Annex 2

Gas Tariff Review Process

Introduction

The aim of this document is to outline the process for tariff reviews for the incumbent gas suppliers in Northern Ireland, currently SSE Airtricity Gas Supply Ltd (SSE Airtricity) in the Greater Belfast Area and firmus energy (Supply) Ltd (firmus) in the Ten Towns area. The tariff review process is a consultative one which involves the supply company, Utility Regulator, 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 the company, 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.

Under the terms of the price control supply companies set a tariff in April each year, followed by a mid-year 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 tariff to consider if a change to the tariff is needed, and to decide the magnitude and timing of any change.

This process applies to SSE Airtricity as set out within the SSE Airtricity price control (PC03)¹, which covers 2012-2016 and to firmus as set out in the final determination on the price control for firmus which covers 1 April 2015 until December 2016.

Requirement for process

According to the terms of the gas supply licence², the supply company 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. The price controls for both companies also provide for a trigger mechanism which allows the Utility Regulator to initiate a further tariff review.

The aim of the trigger mechanism is 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%.

1 Utility Regulator Determination on Phoenix Supply Price Control 2012 - 2016, November 2011:
http://www.uregni.gov.uk/publications/utility_regulator_publishes_the_phoenix_supply_ltd_price_control_determinat

2 Condition 2.4.1: 'Control over Charges in the absence of competition'.

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 the supply company

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

Elements of the tariff

The following table shows the makeup of the gas supply tariff and the treatment of these items in the SSE Airtricity and firmus price controls.

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 – based on forward purchases made to date and the average forward curve taken on prescribed five days
Over/under recovery	Analysed as part of tariff review
Supply Opex	Set in price control
Margin	Set in price control

Process

The supply licence condition 2.18.11 states that

‘Where the Licensee proposes to vary any of the terms and conditions of a Contract it has with a domestic customer, it shall....notify each such domestic consumer of the proposed variation...at least 21 days in advance of the date the variation is due to take effect.’

The process will start eleven weeks before the intended effective tariff date for formalised reviews. Where the trigger mechanism is activated the tariff review process will start. To start the process the supply company and the Utility Regulator will agree the analysis of the tariff. This analysis will be based on the principles set out in the price control, including elements such as gas costs, over/under recovery, transmission and distribution costs.

The supply company 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 supplier;
- volumes still to be purchased at a price taken as an average of five working days on the forward curve.

The five working days will commence twelve working days before the latest date by which domestic customers must be notified under licence condition 2.18.11. For example for a new tariff effective from 1 April 2015 the latest date by which customers must be notified will be 11 March 2015 and based on this notification date the five working days will be 23 to 27 February 2015.

	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
Feb 15	23	24	25	26	27	28	1
Mar 15	2	3	4	5	6	7	8
	9	10	11	12	13	14	15
	16	17	18	19	20	21	22
	23	24	25	26	27	28	29
Apr 15	30	31	1	2	3	4	5

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 supply company and the Utility Regulator will present the results 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:

- January to March (for an April tariff change)
- July to September (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, the supply company 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 a tariff change 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

11 weeks before a new effective tariff date the supply company 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 the supply company.

2. Meeting with Utility Regulator and Supplier

Within two weeks of analysis being received the Utility Regulator and the supply company meet to discuss analysis and consultation paper. Final analysis will use gas figures for five working days commencing twelve working days before the latest date by which domestic customers must be notified under licence condition 2.18.11. These dates will remain flexible particularly where the market is volatile.

3. Tariff Analysis Consultation Paper

Eight weeks before a new tariff date supply company to circulate consultation paper to all parties with information on

- Elements of tariff
- Analysis
- Over/under recovery
- Supplier preferred option

4. Meeting with Supplier, 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 a record of the meeting forwarded to all parties.

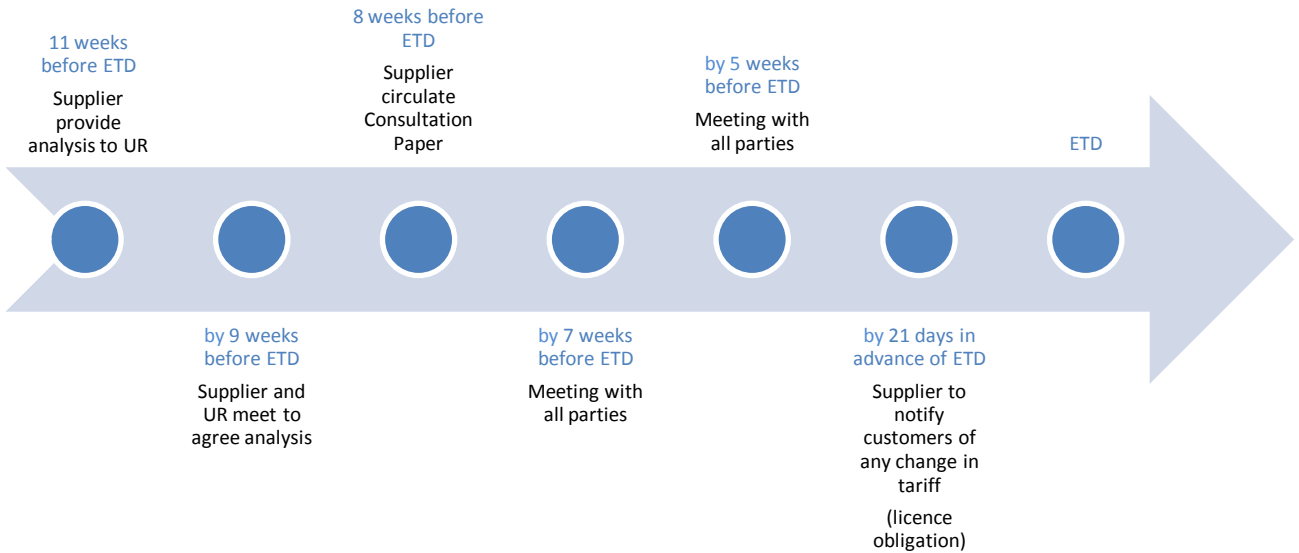
5. Meeting with Supplier, CCNI, DETI and Utility Regulator

At least five weeks before the new effective tariff date all parties meet to discuss the tariff and timings of press releases and statements from all relevant parties.

6. Customer Notification Date

Customers must be notified by the supplier of any change in tariff at least 21 days before the effective tariff date (in accordance with the gas supply licence).

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 2015.

