Conclusion of the Utility Regulator's Review of the firmus energy (Supply) Ltd Maximum Average Price in the Ten Towns area

March 2016



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

Protecting customers is at the heart of the Utility Regulator's role and ensuring that customers pay the correct price for energy from the price regulated supplier firmus energy Supply Ltd (feSL) is a core part of our work.

We commenced a review of the maximum average price with feSL in January 2016. We have scrutinised the submission provided by firmus to ensure that the maximum average price approved is not more than the sum of the costs allowed under the price control determination. This ensures that customers pay no more than the costs of purchasing and supplying gas plus a pre-determined allowance for the operating costs of the business and an agreed profit margin.

The maximum average price for feSL's domestic and small business customers in the Ten Towns area will decrease to 115.51 pence per them from 1 April 2016.

Audience

Customers and customer groups, industry and statutory bodies.

Consumer impact

feSL's domestic and small business customers in the Ten Towns area will benefit directly from this review as the price they pay for the gas they use will be on average 7.7% lower. The change will take effect from 1 April 2016.

The impact of the tariff change on a domestic customer with average consumption of 12,500 kWh per annum will be a saving of approximately £43 per annum (including VAT) on their gas bill.

Approval by the Utility Regulator of the firmus energy (Supply) Limited Maximum Average Price in the Ten Towns area

Summary

On 8th January 2016 the Utility Regulator, in conjunction with firmus energy (Supply) Limited (**feSL**), the Department of Trade, Enterprise and Investment (**DETI**) and the Consumer Council began a review of the feSL maximum average price for domestic and small business customers using less than 25,000 therms per annum this covers approximately 28,000 customers within the Ten Towns area.

We carry out formal reviews of the feSL maximum average price on a bi-annual basis (in advance of April and October). The Utility Regulator can also initiate a further review at any stage should the wholesale cost of gas change significantly such that it would result in an increase or decrease of at least 5% to the maximum average price.

We initiated the formal review to establish the new maximum average price to become effective from 1 April 2016. The review is a formal process agreed by feSL, DETI and the Consumer Council. It is set out within the feSL price control[1] and details the processes to be followed and the timescales for the review process.

feSL uses the maximum average price to set the actual tariffs that are charged to customers. The tariffs are calculated on a weighted average basis, based on average usage and the number of customers using each tariff. feSL cannot charge more than the maximum average price overall. However, this means that the tariffs may vary at a different rate to the maximum average price.

The maximum average price for domestic and small business customers will be 115.51 pence per therm from 1 April 2016. The new maximum average price has been modelled and forecast over a period of 12 months however it will be kept under constant review and adjusted within that time period if required. We will complete another formal review in advance of 1 October 2016 and will continue to monitor gas prices to identify if an additional review is required before that date.

From 1 April 2016, the unit rates of tariffs for feSL's customers in the Ten Towns area will decrease by 7.7 % on average. These unit rates are detailed in Table 4 later in this paper.

[1] Final Determination on Price Control for firmus energy (Supply) Limited covering 1 April 2015 to 31 December 2016, 15 December 2014: http://www.uregni.gov.uk/uploads/publications/2014-12-15_Supply_Price_Control_final_determination.pdf

Background

In Northern Ireland there are two distinct distribution areas for natural gas. These are the Ten Towns area[2] and the Greater Belfast area. firmus energy (Distribution) Limited (**feDL**) owns and operates the distribution network in the Ten Towns area while Phoenix Natural Gas Limited owns and operates the distribution network in the Greater Belfast area.

feSL holds a licence to supply gas to customers in the Ten Towns area. This licence was granted to feSL with a period of exclusivity for supplying gas to customers within this area, meaning that feSL was the only company allowed to supply gas within the Ten Towns during this period.

From 1 April 2015, the supply market in the Ten Towns area opened to competition from new entrant suppliers in all customer sectors. However feSL are currently the only supplier for domestic consumers in this market. feSL currently supply over 28,000 domestic and small business customers (referred to as tariff customers) in this area.

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

2 The Ten Towns area includes ;Derry/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)

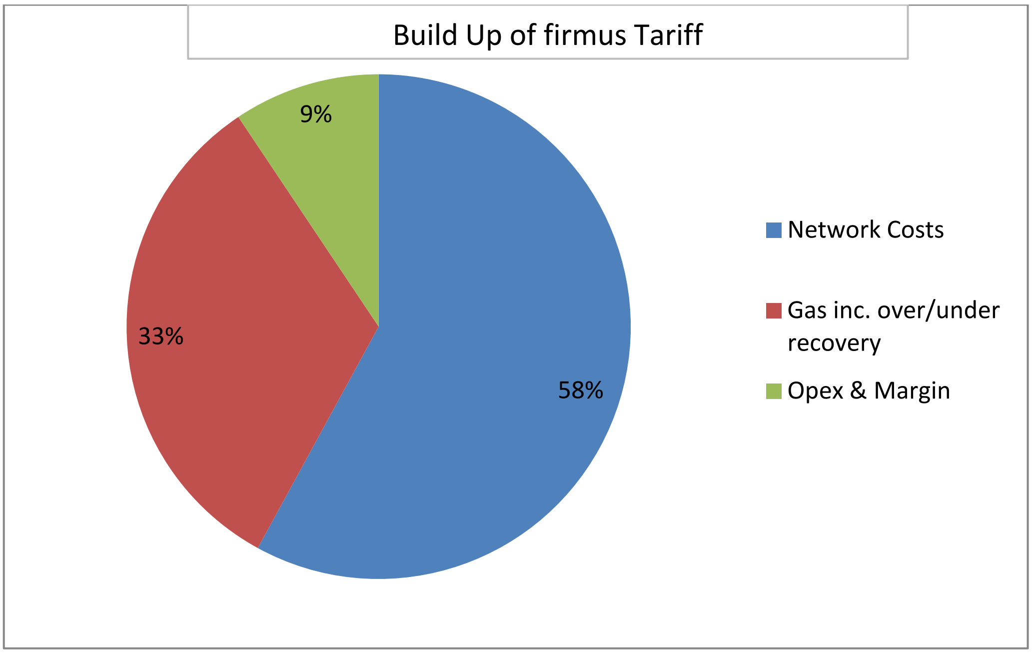
Elements of Maximum Average Price

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

- Operating costs and supply margin;
- Network costs; and
- Wholesale cost of gas.

The breakdown is shown in figure 1 below.

Figure 1 – Makeup of the maximum average price from April 16



The Utility Regulator has taken an active role in scrutinising the costs within each of the elements of the maximum average price of feSL's submission. feSL uses the maximum average price to set the actual tariffs that are charged to customers. feSL cannot charge more than the maximum average price.

Operating Costs and Supply Margin

Operating costs are the costs necessary for feSL to run its supply business for tariff customers. For example the costs of billing, meter reading, customer service, offices, salaries and IT systems etc. The operating costs were determined under the price control carried out by the Utility Regulator.

The margin refers to the amount of profit feSL is allowed to make. The margin was determined within the price control and was set at 1.5% of allowable turnover from tariff customers.

The current price control determination[3] runs from 1 April 2015 to 31 December 2016.

Network Costs

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

The feSL price control determined that the transmission and distribution system charges will be treated as pass through charges 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/ and on the Gas Networks Ireland website at http://www.gasnetworks.ie/en-IE/Gas-Industry/Northern-Ireland/Transportation-services/Postalised-Tariffs/.

The costs for the distribution system are those costs associated with moving gas throughout the Ten Towns area to homes and businesses. These can be found on the feDL website at http://www.firmusenergy.co.uk/about_us.aspx?dataid=507590.

For the purposes of setting the maximum average price the Distribution charges for the firmus energy Distribution network have been estimated from October 2016 onwards as these charges have not been published at this time.

3 Final Determination on Price control for firmus energy (Supply) Ltd http://www.uregni.gov.uk/uploads/publications/2014-12-15_Supply_Price_Control_final_determination.pdf

Wholesale Gas Costs

- ***Wholesale Gas Costs***

The feSL price control determined that the gas cost element of the maximum average price incorporates the wholesale cost of gas as well as charges for transporting gas through Great Britain and costs for securing credit.

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.

feSL has a gas purchasing strategy in place which means that they purchase a percentage of their forecast volumes in advance on an ongoing basis. This limits the exposure to fluctuations in wholesale gas prices and therefore aims to create more stability in the gas price for final customers.

When setting the maximum average price, the overall cost of gas is estimated based on a combination of actual gas purchases that have already been secured, along with forecast volumes of gas required, and the wholesale cost of gas from the forward curve. Buying gas in advance (hedging) can help to reduce any over/under recoveries building up as the price of the hedged gas in the maximum average price is known when the price is set.

- ***Over/Under Recovery from Previous Tariff Periods***

Wholesale gas costs make up a large component of the final maximum average price and as these costs can be volatile there will always be a difference between the outturn cost of the wholesale gas compared to the forecast costs that are included in the maximum average price.

Where the wholesale gas costs out turns less than was forecast in the maximum average price, feSL will 'over recover', this means that they have recovered more money from customers than they spent on gas costs and they will subsequently refund the over recovered difference to customers in the following tariff periods.

Or, where the wholesale gas costs turn out higher than forecast in the maximum average price, feSL will 'under recover', the means they have spent more on gas costs than they recovered from customers and they will therefore be able to recharge the under recovered difference to customers in the following tariff periods. This ensures that customers only pay for the actual cost of gas.

Therefore, each maximum average price includes an amount of over or under recovery which was accumulated during previous tariff periods

The maximum average price effective from 1 April 2016 includes an amount of £64k which feSL has under recovered previously and will now be recovered from customers.

Both feSL and the Utility Regulator will strive to keep the over/under recovered amount as low as possible in order to reduce volatility in the tariff. This will be carried out through ongoing monitoring and tariff changes being put through when over or under recoveries are increasing to such an extent that a tariff change is required.

Why is the Maximum Average Price for feSL decreasing?

The maximum average price for feSL's tariff customers in the Ten Towns area will reduce to 115.51 pence per therm from 1 April 2016. Table 1 below shows the movement in the regulated maximum average price from April 2015 (the first regulated tariff) to date.

Table 1 - Historic maximum average price

Effective from date	Approved Maximum Average Price (pence per therm)
01-Apr-15	130.85
01-Oct-15	125.16*
01-Apr-16	115.51

**This figure has been restated to take into account updated volume forecasts. Previously the approved Maximum Average Price was 124.44 per therm).*

The overall decrease in the feSL maximum average price is driven by the decrease in the cost of wholesale gas as explained below.

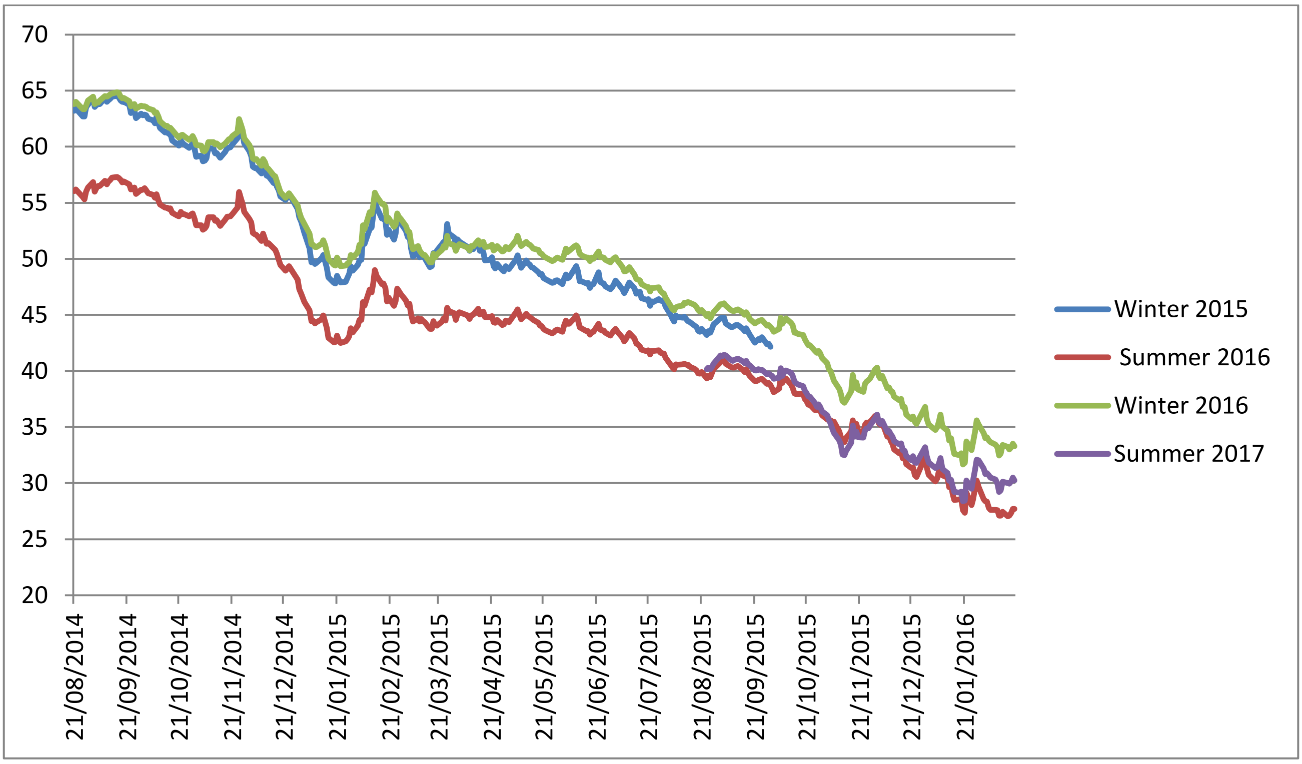
- ***Decrease in Wholesale Gas Cost and Over/Under Recovery from Previous Tariff Periods***

The main driver for the reduction in the maximum average price is the decrease in the forecast wholesale cost of gas (when compared with the forecast wholesale gas cost included in the maximum average price set in October 2015).

Wholesale gas costs on the forward curve have fallen over the last number of months. This means that the forecast cost of wholesale gas included in the April 2016 maximum average price is lower than the cost included in their previous tariff when it was set in October 2015.

Overall forecast gas costs on the forward curve have fallen over the last number of months. This is shown in the graph below.

Figure 2 – Movement in forward curve of wholesale gas cost



Source: Platts McGraw Hill Financial

Table 2 below shows that the forecast cost of gas within the maximum average tariff has reduced from 49.76 pence per therm in the October 2015 tariff to 37.72 pence per therm in the April 2016 tariff.

It is important to note that an element of the gas price included within the maximum average price is a forecast cost and the actual outturn prices may be higher or lower.

If the actual gas prices turn out lower than those forecast then feSL's will over recover, and if actual gas prices turn out higher than those forecast then feSL will under recover. Any amounts that are over or under recovered will be returned to customers or recovered from customers in the following tariff period.

The maximum average price coming into effect from 1 April 2016 will include an under recovery. This acts to increase the maximum average price as feSL need to recoup the money from customers. A forecast under recovery position of £64k at 1 April 2016 (estimated up until the point of the maximum average price change) has been reported. The impact of this in the under recovery on the maximum average price is shown in Table 2 below.

Table 2 - Wholesale Gas Costs and Over/Under Recovery from Previous Tariff Periods within Maximum Average Price

Elements within Maximum Average Price	October 2015 (pence per therm)	April 2016 (pence per therm)
Wholesale Gas Cost	50.86	37.25
Over/Under Recovery	-1.10	0.47
Total Wholesale Gas Cost and Over/Under Recovery from Previous Tariff Periods	49.76	37.72

- ***Increase in Network Charges***

- Transmission Network charges have increased over the level set in the October 2015 maximum average price. The forecast tariff levels for 2016/17 are set to decrease however, a reduction in volume forecast means that the required revenue is spread over fewer therms.
- The table below shows the difference between the forecast annual tariff for 2015/16 and the forecast annual tariff 2016/17. Note that the 2015-16 gas year is the first year for which forecast tariffs have been calculated by entry and exit points.

Table 3 - Annual Forecast Tariffs

	2015/16	2016/17	Difference
Entry Capacity Charge (£ per Kwh/d booked)	0.27044	0.23233	
Exit Capacity Charge (£ per Kwh/d booked)	0.27044	0.23233	
Total Capacity Charge (£ per Kwh/d booked)	0.54088	0.46466	-14.09%
Commodity Charge (£ per Kwh)	.0009445	.0008324	-11.86%

Distribution networks charges are forecast for the purposes of this review to increase at forecast inflation levels, the actual figures will be published on 1 October 2016.

Overall network costs have increased 2% over those in the last tariff. As network costs make up over half of the tariff cost the impact of the tariff is around a 1% increase, however the fall in wholesale costs has acted to counterbalance this increase and reduce the tariff further.

Breakdown of Tariff

Figure 3 below shows the breakdown of the feSL maximum average price which will come into effect from 1 April 2016.

Figure 3 – Breakdown of April 2016 maximum average price compared with previous maximum average price

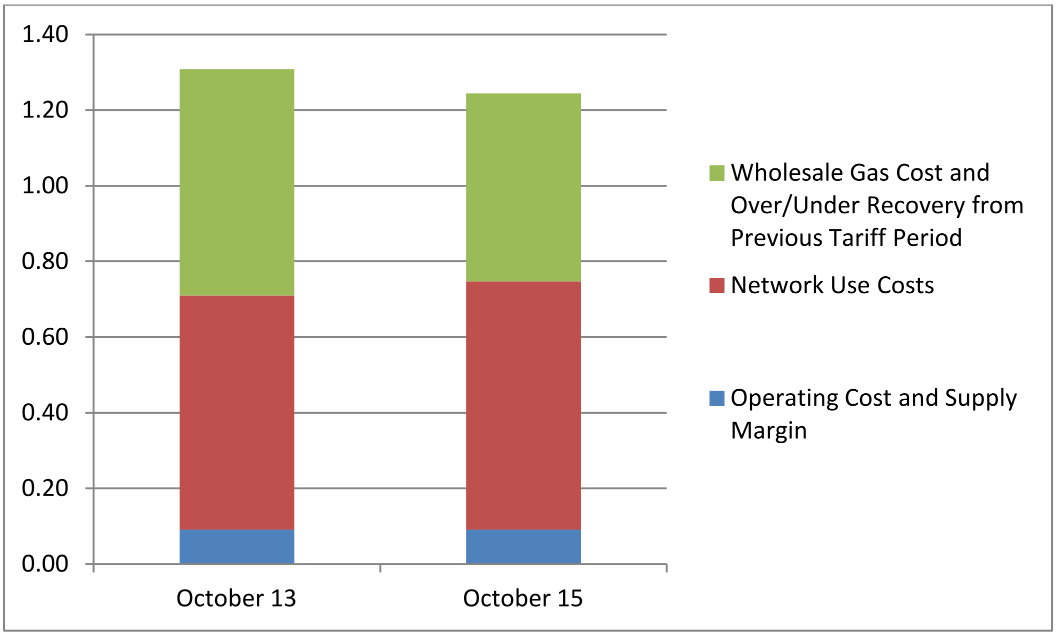
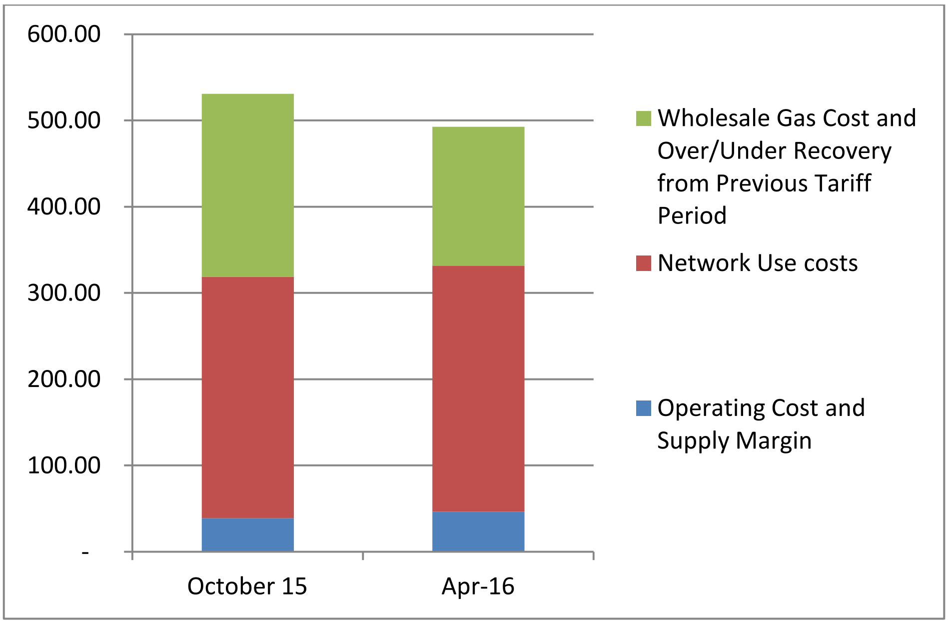


Figure 4 below shows the breakdown in the average annual bill for feSL tariff customers compared with the previous tariff review and illustrates the variation caused by different components of the maximum average price. It can be seen that the decrease in the maximum average price is driven by changes in the wholesale cost component.

The average annual bill amounts in this graph have been calculated based on the maximum average price set at each review (which excludes VAT) and are based on average annual consumption of 12,500kWh[4].

[4] 12,500 annual usage estimate is based on the figure published by Ofgem on their website at https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/typical-domestic-consumption-values;

Figure 4 - Graph to show breakdown of average annual bill



Impact on Tariff

As stated earlier, feSL uses the maximum average price to set the actual tariffs charged to customers. The tariffs are calculated on a weighted average basis, based on average usage and the number of customers on each tariff. feSL cannot charge more than the maximum average price overall. From 1 April 2016, the unit rates of tariffs for feSL's customers in the Ten Town area will decrease by an average of 7.7%.

The new unit rates for tariff customers that will apply from 1 April 2016 are shown in Table 4 below. Table 5 shows the percentage decrease for each individual unit rate of the domestic and small business tariffs.

Table 4 – feSL's tariff unit rates from 1 April 2016 (shown in pence per kWh including VAT)

Pence per kWh	**Home Energy** inc. 5% VAT	**PAYG** inc. 5% VAT	**IC1** inc. 20% VAT	**IC2** inc. 20% VAT
Up to 2,000 kWh	5.965	4.134	7.321	7.321
Over 2,000 kWh	4.022	4.134	4.861	4.861
Over 73,200 kWh				4.500
Direct Debit discount (£)	21			

The change in the feSL maximum average price from 1 April 2016 equates to a decrease in domestic customer bills of £43 per year (including VAT) based on a domestic customer with an average consumption of 12,500 kWh per annum (rounded to nearest pound).

Comparison with GB and Ireland

Figure 5 below, shows the average annual bill of a domestic customer for feSL in the Ten Towns compared to the "Big 6"[5] supply companies in GB, Bord Gais in Ireland and SSE Airtricity Gas Supply (NI) Ltd in NI.

This comparison is based on the latest available information on the standard domestic credit tariffs[6] of each company. The average annual bill amounts in this graph have been calculated based on actual tariff unit rates (including VAT) and are based on average annual consumption of 12,500kWh[7].

This graph shows the feSL tariff that will become effective on 1 April 2016 and also takes account of any tariff changes for supply companies in NI, GB and Ireland which have been published, even if the tariff change has not yet taken effect.

This graph illustrates that the feSL tariff for an average domestic credit customer in the Ten Towns area will be over 10% cheaper than the GB average standard tariff and around 9.7% cheaper than the Bord Gais standard tariff in Ireland.

5 The Big 6 companies are British Gas, SSE, Scottish Power, npower, E.on UK and EDF Energy.

6 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.

7 12,500kWh annual usage estimate is based on the figure published by Ofgem in their Decision:

Figure 5 - Comparison of average annual domestic bills (based on standard domestic credit customers with estimated usage 12,500kWh per annum including VAT)

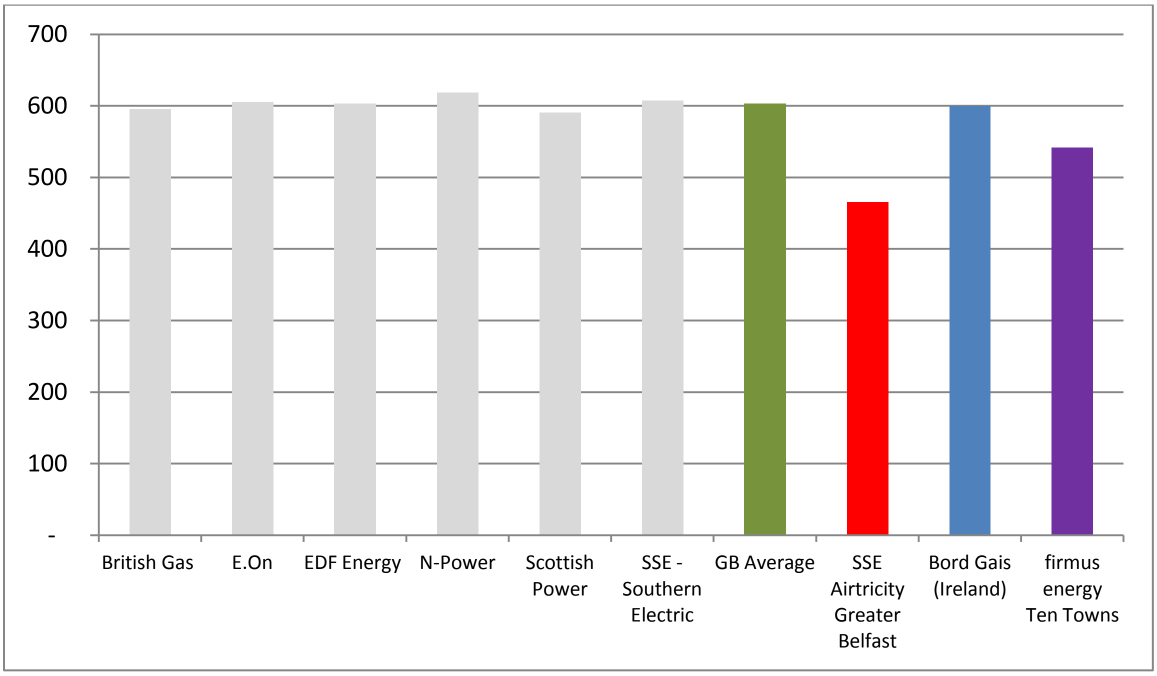
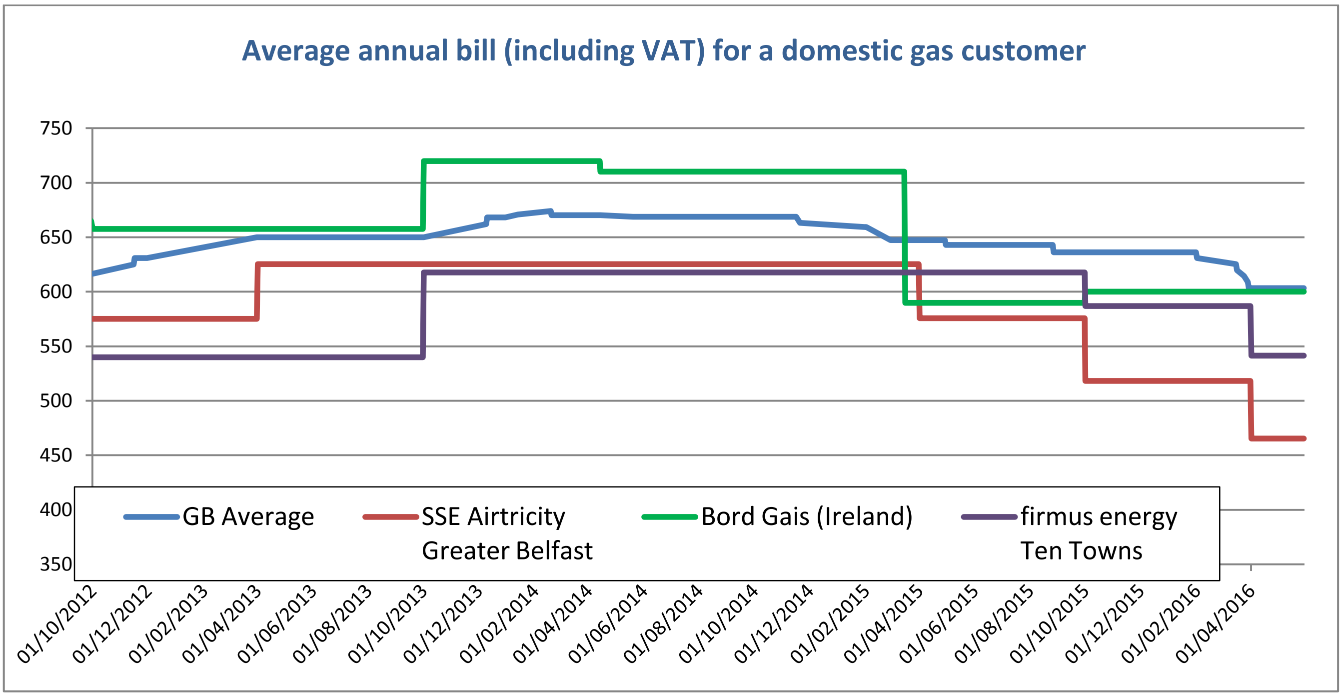


Figure 6 below shows a historic comparison of feSL's domestic annual bill against SSE Airtricity in Greater Belfast, the average in GB and Bord Gais in Ireland. The comparison uses the standard credit tariff unit rates for domestic customers and assumes average annual consumption of 12,500 kWh. The graph shows that since October 2012, feSL's prices have been lower than the average standard tariff in GB of the Big 6 Gas Suppliers.

The GB comparisons include any recent tariff change made by the Big 6 energy providers

Figure 6 - Historic Comparison of average annual domestic bills (based on standard domestic credit customers with estimated usage 12,500kWh per annum including VAT)



Outcome

The Utility Regulator has reviewed the maximum average price submission provided by feSL and reviewed the feSL forecasts against its own market analysis. The Utility Regulator is satisfied that it is appropriate to set a maximum average price of 115.51 pence per therm for tariff customers in the Ten Towns for one year. This represents an average decrease of 7.7% in the actual tariff unit rates that feSL uses to charge domestic and small business customers in the Ten Towns.

The Utility Regulator continues to retain the flexibility to initiate a review of gas prices at any stage if it is considered to be in the interest of customers.