Response to UR SPC17 Draft Determination

Consultation on Draft Determination for electricity and gas retail supply price controls (SPC17)

9 August 2016

If you have any questions in relation to our response, please don't hesitate to contact me at
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Introduction

The Utility Regulator (UR) published its SPC17 approach document for consultation in October 2015. Since then SSE Airtricity Gas Supply Northern Ireland (AGSNI) has been engaging with the regulator in the price control review process. AGSNI made its initial submission to the UR for the allowances required to run the business in SPC17 period in January 2016. AGSNI has engaged extensively with the UR during the Draft Determination (DD) development stage seeking to ensure the regulator fully understands the requirements of the business and its objectives over the SPC17 period.

The UR published its DD in June 2016 which set out its view and position on the costs being sought by AGSNI. AGSNI welcomes the support that the DD gave to the need to invest in IT systems to allow the business to maintain current levels of service and add additional functionality that was underpinned by the customer research conducted as part of the AGSNI price control submission. We also welcome the URs recognition that a regulated business needs to make an adequate return on its investment, which has led to a proposed margin increase from 1.5% to 2%. This assists in ensuring the AGSNI business is sustainable within NI. However, having reviewed all of the UR's proposals, AGSNI cannot reconcile some of the proposed allowances with the overall costs of the business or the proposals made. Unfortunately, this means there are significant shortfalls in a number of areas which are business critical.

Over the course of the consultation period we have provided clarification and additional information on our submission and the DD. There were a number of areas in the DD where the UR stated that allowances would not be granted due to insufficient information or supporting evidence. While we are disappointed that the initial submissions were not considered to contain sufficient information, AGSNI has provided a substantial volume of additional information to the UR during this phase of the process to demonstrate the actual needs of the business and to satisfy the UR that the submitted costs are correctly sought. We have also provided detailed challenge and clarification where we believe that the information has been incorrectly interpreted by the UR. We consider that the evidence we have provided during this process supports a number of changes to the DD and that it would be unreasonable to expect AGSNI to otherwise operate in absence of the required allowances.

While the consultation paper is supportive in general of the changes made by AGSNI in order to become part of the SSE group, there is a shortfall in the funding provided to support key areas like manpower and IT. The costs required to achieve the underlying objective, that is supported by the UR, have not been provided in totality. These allowances are required in order to provide customers with the level of service that we have committed to. AGSNI has confidentially provided further evidence to demonstrate these business needs.

Overall, we are concerned that there seems to be a level of arbitrary efficiencies being applied, particularly in areas where clear evidence of the necessary costs has been provided. It is unclear how the UR expects these efficiencies to be achieved given the scale of the business and the nature of the costs. If retained, we consider that any proposed benefit of an increase in margin would be negated and in fact the level of cut would lead to a lower return than is currently experienced by the business. There is little acknowledgement of the level of risk that sits with AGSNI given the structure of the price control mechanism and inflexibility of the final determination.

AGSNIs response is structured as follows;

1. Scope and duration,
2. Manpower costs,
3. Operations costs
4. Billing costs
5. Margin
6. Gas to the West
7. Conclusion

We have also provided a response developed by our economic consultant Frontier Economics which addresses the margin element of the price control.

1. Scope and duration

The UR has reduced the price control period for the next control to 3 years. This means the next price control will be in place from 1 April 2017 – 31 March 2020.

The UR has also removed the EUC 2 category from the scope of AGSNIs price control. The deregulation of this segment is a direct result of loss of market share to below the threshold of 50%.

AGSNI supported both the reduction of the price control period and the deregulation of the EUC2 category during the October 2015 consultation period and welcomes these changes.

2. Manpower

At the outset AGSNI would like to express its serious concern with respect to the manpower allowance proposed by the UR. The allowances proposed are insufficient to support existing staff costs, before including the additional headcount the UR has stated are included in it. The AGSNI business is largely a customer facing business with many manual processes to support it. To successfully operate it needs to attract and retain a high calibre of employee who will ensure that customers receive the service they deserve and need. Based on AGSNIs understanding of the DD, the UR has stated it has allowed existing headcount of 56 FTEs + 7 additional FTEs, however the proposed budget is £400k less than the costs submitted by AGSNI to cover the equivalent headcount. We cannot reconcile the logic applied in the draft determination allowance to the actual headcount proposed or the needs of our business.

Our concerns with the DD in relation to manpower can be split into 2 sections – remuneration and headcount. In order to operate sustainably, AGSNI requires sufficient headcount, but also the appropriate allowances to ensure staff within the approved headcount are appropriately remunerated.

Remuneration

Salary

During the course of the current price control, AGSNI has struggled with ongoing staff attrition. Evidence has been provided to the UR which sets out this issue and shows that in some areas we have seen almost total turnover of staff. The key reason for leaving given has been salary levels as people are able to obtain similar roles in other businesses at higher pay rates.

In the last price control PSL sought the ability to increase salaries for its employees in order to attract and retain staff. The UR determination stated: "*The Utility Regulator does not see any justification for an above inflation rise in salaries. Instead the Utility Regulator will roll forward the 2011 salary at inflation".* AGSNI believes the level of attrition experienced evidences the impact that not allowing any form of real salary increase has on a business. In the event this position is maintained for all roles outside the living wage increases, this would mean the UR has not allowed for any real increase in salaries for 10 years. AGSNI can find no evidence to demonstrate that businesses in Northern Ireland have operated in this way for an extended period of time. This is not reflective of how any non-regulated company or public sector organisation would operate. The objective of a price control is to simulate an efficient competitor; most employers have performance management programmes to evaluate performance which are linked to salary reviews. This practice extends to government and public agencies including the UR.

In not providing a business scope to review its salaries in the control period the regulator will have a direct impact on the company's performance, staff retention and in turn customer experience when high levels of staff churn occur.

Since the purchase of PSL in 2012, SSE has undertaken a full review of the AGSNI headcount, structure and associated salaries to align these areas with what would be expected in a similar business. It has carried out benchmarking of roles and salaries using the internationally recognised Hay Methodology.

The Hay job evaluation methodology is used in order to fairly, consistently and logically rank and compare jobs across the organisation to local benchmarks. The output from a job evaluation is a job evaluation score which is translated into a Hay organisation level. Using Hay's Paynet, terms and conditions are applied to jobs based on their organisation level. We use Hay Paynet as it is one of the most comprehensive and up to date sources of pay data. It draws on pay data from over 20 different industry sectors across over 600 organisations, and involving over 1 million incumbents.

In addition to undertaking the Hay review, in 2013, SSE became the first UK energy company to become an accredited Living Wage employer, in doing so it recognises the value of its employees and the role they play in achieving company success. SSE as a living wage employer is committed to ensuring all employees receive the pay they need to cover their living expenses.

AGSNI welcomes the UR's acceptance of its approach to the living wage in its submission and its approval of proposed increases in salary for our lowest paid staff members. However, in its proposals, AGSNI set out the need to maintain the increases for additional headcount levels to ensure that more skilled roles did not become on a par with lower grade roles as a result of the increases. The price control DD only provides for living wage increases to be applied to levels 8 and 9. The UR clarified that it has allowed a 2.8% increase across all salaries to reflect living wage increases. AGSNI has also provided the UR with further detail on the appropriate calculation of this increase and would welcome revision in this area.

In conjunction with introducing a level of pay that ensures its employees can cover their basic expenses, SSE has changed a number of its HR and training practices to more reflect an efficient and positive work place. A number of these changes have been possible within the existing price control allowances meaning that efficiencies have been recycled into the business to create a better workplace and in turn better services to customers. We have implemented a performance management system which impacts (non living wage) salary reviews to ensure continued improvement and maintenance of standards in the business.

AGSNI's view is that the average approach to salary taken by the UR in the draft determination does not recognise the level of cost evidenced to it, the methodology used to reach those costs appropriately and the needs of the AGSNI business. Using an average approach is not appropriate given the size of the business and the low level of headcount, where a change in one role could have considerable impact on an average calculation. In reaching an average calculation, AGSNI also believes there are fundamental omissions in the methodology used to reach the figure used to produce the proposed draft determination. We have clarified these with the UR to ensure full understanding of the information submitted. For example, the average used in the draft determination does not recognise the shift in organisational structure in 2015/16 which saw headcount move from recharged roles to direct cost.

In order to reach an appropriate determination, AGSNI believes a bottom up approach to costs is warranted. The UR has been provided with the full bottom up detail of the costs associated with manpower for the business. These are real and ongoing costs to the AGSNI business and are needed in order to sustain the headcount of the business.

AGSNI has also provided the UR with a detailed analysis of the average salary calculation, however we would stress that this approach is not appropriate and does not provide for the real costs of AGSNIs business regardless of headcount numbers.

For the reasons outlined above and to ensure the price control appropriately recognises the costs of the business AGSNI believes it is essential to consider a bottom up approach to calculating the salary allowance.

Recharges

The UR has applied a 20% cut to the recharges submitted by AGSNI. AGSNI cannot see a methodology behind this proposed reduction, however in the paper the UR stated it would consider additional evidence to support the costs sought. AGSNI has provided further information to the UR on a confidential basis which sets out the costs to the business and how these are calculated.

The AGSNI recharges come from SSE Airtricity and are developed on a full time equivalent (FTE) salary by proportion of time spent basis. Since business acquisition in 2012 the recharges for AGSNI have been developed on a bottom up basis to reflect the cost directly attributed from services in the SSE Airtricity business to AGSNI. No overhead costs are included in the manpower recharges only the time spent apportionment is charged.

The Manpower Recharges include the proportion of direct employment costs attributable to the gas business for actual services provided. Direct employment costs include social security costs and conservative average assumptions around pension. There are no recharges in relation to other indirect group costs required to support these various functions (eg. office costs). This enables AGSNI to avail of group resource efficiencies rather than directly employing individual staff members. For the avoidance of doubt there are no recharges in relation to SSE plc corporate expenses.

For clarity, this approach represents a saving to AGSNI as a decision was made to treat it in this way given that it is a regulated business. The stated basis for the 20% cut in the recharge allowance was a lack of information. AGSNI can see no evidence to support this cut and has provided additional information to the UR to demonstrate the level of costs being passed through to the business; therefore we request that the UR reverse the proposed reductions.

It is worth noting that the forecast recharges are less than those allowed in the current 2012 – 2016 period control period and that the PNG manpower recharge has been removed. AGSNI has provided a breakdown of the manpower recharge calculations to the UR for further information.

Recruitment costs

This line item covers the additional costs associated with the use of agency staff during periods of long term sickness, maternity and attrition coverage. The allowance sought in this area is premised on actual levels of absence experienced in the business since acquisition and an assumed level for the SPC17 period. There are 3 elements to this cost line; long term sickness, maternity and attrition.

AGSNI has had to support the roles of a number of employees who have unfortunately, for reasons outside their control, experienced long term absence due to sickness over the current price control period. All employees are treated in a consistent manner in line with legal obligations and SSE group policy will on sickness absence.

Given the demographic of AGSNIs workforce an assumption has also been factored in for a level of maternity leave. This is based on experience to date. Again, employees are treated in line with legal obligations and SSE policy resulting in a real cost for the business.

In situations where employees are absent for extended periods of time, AGSNI must replace these roles on a temporary basis to maintain its operation. To do this, at times agency staff are used.

AGSNI is anticipating a reduction in the use of agency staff over the SPC17 period and this has been reflected in its cost submission. Agency staff are often required on short notice for fixed term contracts – this type of employment results in a premium being paid by AGSNI. This issue has been discussed in detail with the UR and AGSNI is seeking to minimise the churn. 2015 – 16 saw over 20 permanent staff leave the business.

Headcount

In its original submission, AGSNI sought an increase in headcount of 17. The UR has allowed 7 additional heads for the SPC17 price control period. AGSNI welcomes this increase and the acknowledgement that resource requirements within the business have changed in the 2012 – 2016 period. However, in addition to the allowed headcount, there are a number of roles that have not been provided which AGSNI believes are essential to the efficient and effective operation of the business over the next price control period.

Detailed information on all of the roles requested was provided to the UR in AGSNIs original submission document as well as in supplementary submissions.

AGSNI has sought additional headcount in areas that are either under-resourced at present, are currently or will experience increased work volume or need to target resources in a particular area.

Additional headcount

PPM

Following acquisition, AGSNI established that due to the nature of prepayment metering (PPM) accounts, PSL had chosen not to reconcile these accounts on an ongoing basis. However, given new regulatory requirements to issue statements to PPM customers, AGSNI had to undertake an exercise to reconcile accounts and maintain them as changes occur. AGSNI has had 6 people, sitting outside current headcount, undertaking this activity since 2014. In its submission AGSNI sought to convert these roles to permanent headcount as it has demonstrated their ongoing need.

The UR has acknowledged in its DD that the work of the PPM team is necessary, however has only allowed 4 out of 6 heads currently undertaking this activity.

The PPM headcount was put in place to ensure that when each account is billed in line with the Billing Timetable (currently annually), HiAffinity accurately reflects the balance of the account by clashing the combined value of vends against gas usage for the billing period. AGSNI cannot see the evidence to support reducing the headcount from 6 to 4. At this time the activity takes and has 6 persons supporting it. AGSNI asks the UR to reconsider the allowed headcount for this activity.

Opening Hours and Energy Efficiency Directive

AGSNI, in its submission, sought to increase services to customers and to extend its call centre to 8-8pm. This would bring clear benefit to customers who may not be able to get in contact due to their work hours during the day. We are happy to see the UR recognises the customer benefit this initiate would bring. In the DD the UR stated it supports AGSNIs request to increase opening hours but did not accept the level of resource requested. 3 out of 5 heads were approved for this activity and the UR has suggested that a change in shift pattern would be sufficient to support the activity with this number of people.

Complex complaint handlers

In its submission, AGSNI sought an additional 2 headcount to support complex complaints received from customers. The aim was to provide a single transfer point to customers to talk to a more skilled member of staff where a complex issue arises. The UR has suggested that the work associated with these roles can be carried out by staff freed up by internal efficiencies. This is not reflective of the situation being experienced in the customer operations team nor is it reflective of the expertise in the team.

Complex queries coming into the call centre are being redirected to other teams and more senior and experienced staff which puts pressure on the team in which that person is sitting. Aside from the operational impacts, this often leads to a customer having to repeat their issue more than once which is frustrating.

AGSNI is seeking to address this by recruiting higher skilled resources into the call centre to carry out day to day activities as normal but to be available to address complex complaints and support other staff dealing with these issues. This will have a direct benefit for customers who will experience better customer service through a reduction in resolution time and minimal engagement required on their part to explain an issue. In the event the UR believes that this headcount can be achieved through efficiencies, AGSNI believes that recognition should be given to the need for additional skill level for these roles and an uplift to SME level should be given to two existing positions.

Field Operative

During the current price control, AGSNI was tasked with reducing its revenue protection issues and overall bad debt level. An allowance was ring fenced and provided for both of these areas. One of the activities undertaken using the allowances was to employ a field operative to concentrate on visiting properties and following up on issues that were identified during desk exercises. This was seen as a very successful project and as a result, AGSNI made a submission to increase its headcount to provide for a field operative to continue to undertake this activity.

The field operative role was initially submitted by AGSNI as an initiative to address Long Term No Access (LTNA) properties under its bad debt management allowance (BDMA) proposals as we were seeking to retain the original ring-fenced allowance. The UR advised AGSNI to resubmit 'BDMA' items for consideration in the overall cost submission as a ring fenced allowance would not be provided in the next price control. A paper on LTNA and a spreadsheet incorporating BDMA items into overall cost submission has been provided to the UR.

The role of the field operative with respect to LTNA is to undertake out of cycle site visits, complete investigative work and return results to the Credit Control team for analysis, ensure all in-hours and out-of-hours visits are completed and records of all visits updated, regular liaison with the Credit Control team, to carry out warrant visits and any other ad-hoc site visits for the purposes of acquiring access.

In section 7.2.9 of the DD the UR stated that there was insufficient information provided to establish the benefit of this project to customers. AGSNI has provided an additional paper on the LTNA project outlining in further detail the project proposal and the benefits to customers.

High level benefits to customers are:

- Greater access to properties where LTNA has been an issue which in turn ensures confidence that the meter is operating correctly and safely;
- Improved safety for all through early identification of tampered meters;
- More accurate bills for LTNA properties as they are based on actual reads thus minimising risk of falling into unforeseen debt.
- Reduction in the risk of meter isolation reducing risk of inconvenience and costs being passed on to the customers;
- Reduced risk of interruption to supply;
- Faulty meters identification is timely and resolved quicker.

Credit Controller (SME)

As with the field operative role above, a credit controller role (SME) was included as part of the ‘BDMA’ initiatives and subsequently resubmitted for consideration in the overall price control submission.

Working within the Credit Control team, responsibility will be to focus on all LTNA properties and associated debt issues and manage a new Warrant Policy & Procedures from beginning to end - through all attempts to gain access to eventual successful access. This will include desk-top interrogation of data, liaison with the Network Operators and other external agencies, raising site-works visits, liaising with the Field Operative on a daily basis, preparing applications for warrants and undertaking warrant requests at court and at the property as required.

The benefits of the project are the same as those outlined for the field operative and were set out in further detail in the LTNA paper submitted to the UR.

Returning staff member/ Training/Quality Manager

AGSNI had requested the costs associated with one additional head to cover internal training and quality and the return of a manager from career break in 2016. While our original submission was based on two heads being required, we have revised both roles and believe we can provide the services with one additional headcount.

AGSNI believes the training and quality role is essential to its ongoing operation.

3. Operation Costs

Operation costs were adjusted by the UR in a number of areas, most notably in IT. We have engaged with the UR during the consultation process to address any information deficits, errors or clarifications in order to support our original submission.

Office costs

While AGSNI was largely happy with the overall office costs allowed by the UR in its DD, there were a number of areas where information had been incorrectly interpreted which led to inappropriate figures in the DD. AGSNI has engaged fully with the UR to identify where issues had arisen with respect to the understanding of figures, in particular around telephone and postage costs, storage costs and subscription costs. We believe the evidence provided supports the adjustment of these costs.

The office costs associated with LTNA activities have also been excluded. AGSNI would expect these elements to be allowed should the UR decide to allow these heads.

Professional and legal

The professional and legal fees recharge was reduced by 20% in the DD. This cut was applied pending additional information. This allowance is required to cover forecast audit costs, weather data, legal case fees and adhoc legal advice. It also covers services provided by SSE plc to AGSNI such as corporate legal and taxation.

Again AGSNI would like to highlight that the basis for a cut of 20% has not been provided.

Information Technology

There are 2 elements to AGSNIs IT submission – new projects and ongoing costs. In its DD the UR has acknowledged the need for investment in IT systems as a result of historical underinvestment. AGSNI welcomes the recognition that IT systems require investment to meet both operational and customer needs. This is a positive step towards providing our customers with improved services and getting our systems up to an acceptable standard to sustain the business.

The UR engaged Gemserv as its IT consultant for the price control review process to assess submissions and provide an independent opinion on the submission. On the basis of this report the UR has proposed reductions in both the investment and ongoing cost areas. These amendments are outlined in more detail below. The UR also requested AGSNI provide information on the efficiencies to be achieved through the IT investments.

Having provided actual quotes for the projects involved and discussed efficiencies, we are concerned with the level of proposed reduction the UR has made and our ability to meet the objectives of the projects with the allowances. The Draft Determination has set out an allowance of £1.6m over the three year period which included both investment and ongoing costs. This is approximately £500k less than the detailed AGSNI submission.

Project/investment costs

The UR has proposed an overall project allowance of £575k to cover both capital and implementation costs for the ‘approved’ IT projects.

Capital costs

In its price control submission AGSNI outlined the need for investment in IT given the lack of investment prior to its acquisition and changes in legislative requirements. In order to demonstrate the costs of projects AGSNI provided the actual quotes from our service provider for the capital and ongoing costs for new and existing IT systems. AGSNI has a single provider for its billing system and therefore must obtain services directly from it. The basis for the 10% cut is therefore not clear to AGSNI and it seems there is no evidence to support how this cut could be achieved given the submitted costs are based on actual quotes to undertake the work.

AGSNI outlined in its initial and subsequent submissions to the UR that a number of the IT solutions to be installed over the next price control are bespoke modules. This carries an inherent level of risk as the costs of the modules are more likely to go up than down when it comes to implementation. AGSNI does not believe it can deliver the projects in question for the allowed capital allowance. We are happy to discuss this further with the UR. In the event the allowance is maintained at the current level proposed, we can review the projects proposed based on the allowance provided and prioritise what can be achieved with the final allowance.

As the UR is aware, AGSNI operates a billing system which is reliant on one vendor for all activity. As such, we are not at liberty to select a different provider of these services.

AGSNI has proposed to reconcile the capital costs of projects to actual invoiced costs should the UR be concerned in relation to these costs.

Disallowed projects: Reporting and REMM Automation

The reporting project as referenced in the DD includes additional IT functionality to allow AGSNI automate and/or simplify 'normal' reports and REMM reports. In the DD the UR stated that Gemserv were unable to establish the benefit to customers of the reporting project as the basis for not allowing these costs. Additional information was provided to UR/Gemserv in relation to the reporting project and REMM requirements during the consultation period. As outlined in this submission there are currently a number of things AGSNI is unable to, or find it difficult to report on which are considered basic requirements for a customer focussed business and to support ongoing UR and general information requests.

There is a high level of manual input and manipulation of figures to produce the REMM information in the mandated format for reporting with 12 different categories to be reported on. AGSNIs view is that there is a more efficient, accurate and transparent way of producing the figures and is seeking investment to include these modules.

HiAffinity Upgrade

Costs have been included for an annual upgrade to the HiAffinity system. Ensuring systems remain up to date through periodic upgrade is a normal business practice. AGSNI completed an upgrade in March 2016; prior to this the last system update was in 2011. It should be noted that the 2016 upgrade was carried out as the existing version of the system was out of support and in part to ensure the billing system would be able to incorporate the addition of new modules to provide further functionality and improve overall performance.

AGSNI has sought an annual allowance (£120k over 3 years) to upgrade its system to ensure it is up to date and allowing the business to provide customers with more functionality as well as maintaining the accuracy of billing activities.

Given the level of IT investment elsewhere and associated upgrades an allowance in 2018 would be satisfactory. AGSNI could then ensure that its systems are up to date before the next review.

Implementation costs

The UR has proposed an efficiency factor of 20% on the implementation costs of the IT projects in its DD. This is a Gemserv proposal[1] and was discussed in detail in advance of the DD being published. The potential to realise efficiencies was agreed as possible only if all of the IT projects were incorporated into one project and rolled out as a single programme. This would reduce the need for project headcount duplication that arises if projects are run individually.

Based on the number of projects proposed, AGSNI believes the proposed efficiency is too high even if running all projects as a single programme. AGSNI understood that the Gemserv report accepted the day rates for IT resources in its submission as in line with industry averages and actual rates to the business. As such, any efficiency must be driven by a reduction in the number of heads/time allocated to the projects only. The implementation cost of projects has been calculated using the daily rate times to estimate the number of days for each project. AGSNI has discussed the level of efficiency it believes could be achieved if this approach is taken. We would also welcome the opportunity to drive the benefits to customers sooner within the price control.

[1] Paragraph 7.3.11 of Draft Determination

However, we note that within the DD, the UR has proposed to apply the efficiency associated with undertaking all projects as a single programme however is expecting the allowance to be recovered for the duration of the 3 year price control period. While AGSNI understands that this approach is intended to minimise the movement in tariffs, the timing of expenditure is not compatible with the proposed parallel approach discussed with Gemserv which is a fundamental factor in the ability to deliver implementation efficiency.

AGSNI has developed a proposal for the URs consideration to address the disconnect between actual expenditure and recovery, while maintaining tariff stability.

If the URs preference is that the IT allowance remains as outlined in the DD, the costs of implementation will remain the same and the allowance should be adjusted to exclude the 10% capital and 20% implementation cost saving assumptions.

The UR has decided not to allow the year one costs for 3 of the projects[2], AGSNI would appreciate clarity on which projects these are and whether the exclusion of year one costs will impact the order in which projects are rolled out.

Operational costs line item

The DD is unclear on operational costs and operation and maintenance allowances. AGSNI has ongoing costs of close to £400k for billing system licences, support and maintenance, web development or the SSE recharge for IT. These costs ensure that the systems in place can be maintained and used on an ongoing basis without issue. While an allowance of close to £300k has been allowed there is no breakdown or explanation as to what it is to cover. AGSNI cannot implement projects or maintain systems for which support and ongoing costs have not been provided. Failing to maintain systems could lead to an inability to provide services to customers.

AGSNI has provided additional information to the UR and welcomes the opportunity to ensure full understanding of the operational needs of the business is reached.

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[2] Paragraph 7.3.14 of Draft Determination

IT efficiencies

A detailed breakdown of all of the proposed projects was provided in AGSNIs overall submission document and additional papers[3] provided in March and April 2016. Each of the proposed projects is intended to improve customer experience, expand AGSNIs service offerings or drive internal efficiencies. Given that the true benefit of the investment won't be realised until they are in place the following is an outlined of the anticipated benefits and efficiencies of the projects.

There are 7 approved IT projects, since the Draft Determination was published AGSNI has provided further detail on expected efficiencies to the UR. Some of the key efficiency gains are associated with investments associated with the Energy Efficiency Directive which will see customer move to online accounts and e-billing. We also expect to see a benefit in automating the cheque refund process to make customer whole in a more timely and cost effective manner.

There are associated operational benefits for all of the projects from reducing day to day task times, to allowing agents deal with their assigned workload and more efficient use of time.

It should be noted, a number of the investments required in IT are to support the ongoing sustainability of the AGSNI systems. While a direct visible efficiency or benefit may not be clear to customers, the absence of this investment would become extremely visible in the event that systems failed due to a lack of maintenance or upgrade.

Customer Engagement

The UR has allowed a significantly reduced budget for customer engagement over the SPC17 period and amended the name of this cost item to Advertising providing an allowance for customer research and other publications. Customer literature has been moved to customer information in billing costs and will be treated on a retrospective basis.

[3] Supplementary submission of 2 March, 4 April, 12 April and 27 April 2016.

AGSNI is concerned that its customers will not benefit from normal activities that a supplier would undertake as a result of this reduction. While we recognise that it would be inappropriate for the UR to make an allowance that would see AGSNI actively undertaking public advertising campaigns with a view to targeting competitors' domestic customers, recognition needs to be given to the need for customers to see their supplier at events and to highlight that the gas supply business exists. The UR has not provided an allowance for public relation, sponsorship or brand.

AGSNI is invited to participate and/or attend at various events organised by consumer groups, business and charities which raises awareness of the services our business provides to customers, including our vulnerable customer register and free safety checks. We note that other regulated entities have considerable sponsorship and awareness campaigns across NI and it is normal business activity to have some form of Corporate Social Responsibility budget and activity. The gas industry in NI is a growing industry and requires a profile to be developed. At this time, competition has not fully developed and therefore it is the responsibility of those currently engaged in the industry to raise the industry profile and ensure customers are aware of its existence.

AGSNI sought allowances to assist in engaging in industry forums, to undertake some charitable work and also sought a modest allowance for sponsorship. The intention for this allowance was to raise awareness of AGSNIs activities in NI and providing small scale sponsorship to schools, charities etc. In addition, AGSNI wished to undertake a number of energy efficiency programmes.

The activities outlined our submission are normal for any modern business and are not simply selling opportunities for AGSNI but to allow our representatives to engage with customers, contribute to industry discussions and events and to impart our expertise to address challenges highlighted at these events.

AGSNI is requesting that this line item be reconsidered and is satisfied that it could make a meaningful contribution with an allowance of £20k per annum.

4. Billing costs

The UR has provided almost all of the billing costs sought by AGSNI. The majority of costs in this area are retrospectively adjusted and AGSNI has been able to understand the URs allowances and allocation. The only area of concern to AGSNI is the DD proposal in relation to bad debt which has been discussed in detail with the UR throughout the consultation period.

Bad debt

The bad debt provision proposed in the DD is .75% of credit revenue. AGSNI believes this figure is too low and not achievable. The basis for the allowance is unclear but the UR has referenced a figure of .81% for 2014 which was submitted by AGSNI. This figure has been incorrectly interpreted by the UR and a full explanation and detail to support this position has been provided to the UR.

At the start of the current price control, the level of bad debt within the PSL business was considered inappropriately high and therefore not sustainable by the UR. Specific ring fenced allowances were provided to address the issue and an allowance of 1% of credit revenue was set by the UR. Following acquisition, AGSNI undertook a full review of credit control and worked to update systems and undertake projects using the ring fenced allowances to make the needed changes to reduce bad debt. While it was a struggle to reach the UR target, the business has now achieved a level of bad debt which is closer to 1%. Evidence has been provided to the UR which demonstrates the changes made to processes, the levels of debt achieved and the fact that revenue protection (RP) debt is at an all time low. These levels have been achieved through complete changes in process and also having specific allowances available to run special projects to target areas of concern. Given the processes are now in place and embedded and the UR is not proposing any allowance in this area, it is unclear to the AGSNI how any additional reduction in level is possible.

It is the view of AGSNI that it is more likely that levels will rise than fall during the next price control and a lower allowance could only be considered if RP related debt was removed from the target and treated on a pass through basis. AGSNI has no control or foresight of the level of RP bad debt on its books. This is an unknown risk where there are no obvious mitigative measures to reduce or manage the level of write off.

AGSNI has submitted further detail and justification to the UR for the 1% of credit revenue allowance originally sought. While the UR has acknowledged the improvements made in this area, AGSNI is concerned with the potential for increases in bad debt and requests that the current provision is maintained.

5. Margin

Throughout the price control consultation process, ensuring an appropriate return on investment has been a key issue for AGSNI. It has been the belief of AGSNI that the allowed margin of 1.5% does not appropriately remunerate SSE. The impact of too low a margin can cause a market to stagnate in terms of new entrants but can also lead to poor investment in services and a reduction in benefit to consumers.

AGSNI engaged Frontier Economics to review the NI market and to propose a reasonable rate of return which considered the economic climate in which energy suppliers operate. This includes the cost of debt and equity, volatility and risk premium. Frontier Economics used the CMA methodology in calculating an appropriate return for the AGSNI business and the full detail of this analysis was provided to the UR in the original AGSNI submission.

While AGSNI welcomes the UR's proposed margin of 2% and the recognition it gives to the fact the current level of margin is insufficient, in the DD the UR indicated it had applied the CMA methodology to reach its proposal. Having reviewed the DD, Frontier Economics have identified some issues in the use of the CMA methodology which they have set out in the attached paper. These issues indicate that should the methodology be applied fully, the margin for the business should be returned as higher.

6. Gas to the West (GttW)

AGSNI has been appointed the commissioning supplier for the GttW area. Following discussions with the UR, this new gas market area will be price controlled with the associated allowances being determined as part of the SPC17 process. The following table outlines AGSNIs submission[4] and the URs DD.

	AGSNI Request			UR Draft Determination		
	2017	**2018**	**2019**	**2017**	**2018**	**2019**
Meter Reading	4,181	19,392	46,562	181	19,392	46,562
Manpower – contact centre	600	3,000	7,000	-	-	-
Manpower – back office	600	3,000	7,000	-	-	-
Customer Billing and Engagements	224	987	2,426	224	987	2,426
Network Maintenance	1,992	2,697	4,025	500	1,000	1,500
Geocoding Data	3,543	3,685	3,832	3,543	3,685	3,832
Brand Awareness	-	15,000	15,000	-	-	-
Setup Costs	85,000	-	-	25,000	-	-
Total (£)	**96,140**	**47,761**	**85,845**	**29,448**	**25,064**	**54,320**

The UR has provided an allowance of £109k over 3 years for the GttW area for meter reading, customer billing and engagements, network maintenance, geocoding and a proportion setup costs requested.

AGSNI forecast the need for 1 additional FTE in the customer operations department over 3 years. This has not been provided. Given the disallowance of requested heads in this department for the Greater Belfast area AGSNI does not have the

[4] 2017 meter reading cost amended to reflect AGSNI submission.

capacity to cover GttW. While AGSNI recognise the newness of this market and uncertainty with uptake levels, not providing headcount to service the market is not appropriate particularly in the context of the price control methodology.

AGSNI requested costs for brand awareness in the GttW area as this is a new market. We have been advised by the UR that provision for advertising and raising customer awareness has been provided in the SGN price control.

It is important that customers are fully informed of the benefits and the access path to the gas market in order for the network investment to be fully realised. The reality is that the lower the number of customers, the higher the network cost apportionment. This will decrease the attractiveness of natural gas in the home.

AGSNI therefore requests that the UR reconsider this request to ensure that customers have both access to and can maximise the benefit from installing natural gas in the home.

AGSNI welcomes the allowances that have been accepted by the UR.

7. Conclusion

AGSNI and the UR have engaged extensively through the price control review process. This has been a two way engagement and AGSNI has provided full and detailed information and evidence to support its original submission, any follow up requests for information received and its further submission based on the DD. AGSNI is happy to provide further evidence should this be deemed required, however given the level of detail now available to the UR, we believe a fully informed decision can be made to reach appropriate allowances for our business.

We believe all areas where confusion or misinterpretation of previous submissions have been addressed in our follow up documentation and this should lead to reconsideration of allowed costs in a number of areas.

The overall objective has been to reach a price control determination where there is clear understanding of the actual costs faced by the business and the return on investment needed to sustain the business.

AGSNI recognises the inclusion of substantial allowance for IT improvements and operational change to improve the AGSNI business as a whole and to increase its service offerings for customers. We also recognise that the UR supports the move made to ensure all staff members receive a basic minimum salary to meet their living needs. However there are a number of areas where the UR has not allowed sufficient allowances to allow the business to operate in a sustainable way. AGSNI has provided clear evidence to support those allowances and would expect reconsideration in these areas.