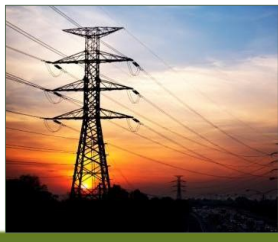
Utility Regulator
ELECTRICITY GAS WATER

Conclusion of the Utility Regulator's Review of the Power NI Ltd Maximum Average Price

February 2015



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 the markets, networks and corporate affairs functional areas of the organisation. 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

Abstract

Protecting consumers is at the heart of the Utility Regulator's (UR) role and ensuring that customers pay the correct price for energy from the price regulated supplier Power NI Ltd is a core part of our work. To this end the UR scrutinizes Power NI submissions and ensures that the maximum average charge per unit supplied is not more than the sum of the input costs agreed as part of the Power NI price control formula. This ensures that customers pay no more than the costs of purchasing and supplying the electricity plus an agreed profit margin.

Audience

Consumers and consumer groups, industry and statutory bodies.

Consumer impact

The direct consumer impact of this review will be a change to their energy tariff. This change will affect domestic customers and small business users. Those domestic and small business users who are currently customers of Power NI will see an immediate change to their tariff rates from 1st April 2015. Those domestic and small business users who are currently customers of other suppliers can avail of the new tariff rates subject to Power NI terms and conditions.

Approval by the Utility Regulator of the Power NI Ltd Maximum Average Charge per Unit Supplied

Summary

On 6th January 2015 the Utility Regulator, in conjunction with Power NI, DETI and the Consumer Council began a review of the Power NI maximum average charge for domestic customers and small business customers consuming less than 50 MWh per annum. The current maximum average price has been effective from 1 July 2013. This review has been triggered (as part of ongoing monthly monitoring) primarily as a result of a fall in the forward gas curve which results in a lower forecast wholesale electricity price. Therefore, a review was initiated to establish the new maximum average charge to become effective from 1 April 2015.

The new price for tariff customers on the Standard Home Energy tariff will decrease to 15.6 pence per kWh (ex VAT) from 1 April 2015. This represents a decrease of 9.2%. The tariff has been modelled and forecast over a period of 24 months. However, as is the usual practice, it will be kept under constant review and adjusted within that time period if required. An adjustment would be necessary if changes in actual input costs (for example wholesale costs) created a significant difference between Power NI costs and revenues. The tariff would then need to be adjusted upwards or downwards to align costs and revenues.

Background

The domestic electricity supply market has been fully open to competition since 1 November 2007 and since June 2010, a number of suppliers have entered the domestic market. Since this time there has been an ongoing steady level of customer switching activity in the market. However, whilst facing competition from other suppliers, Power NI is still dominant in this sector of the market.

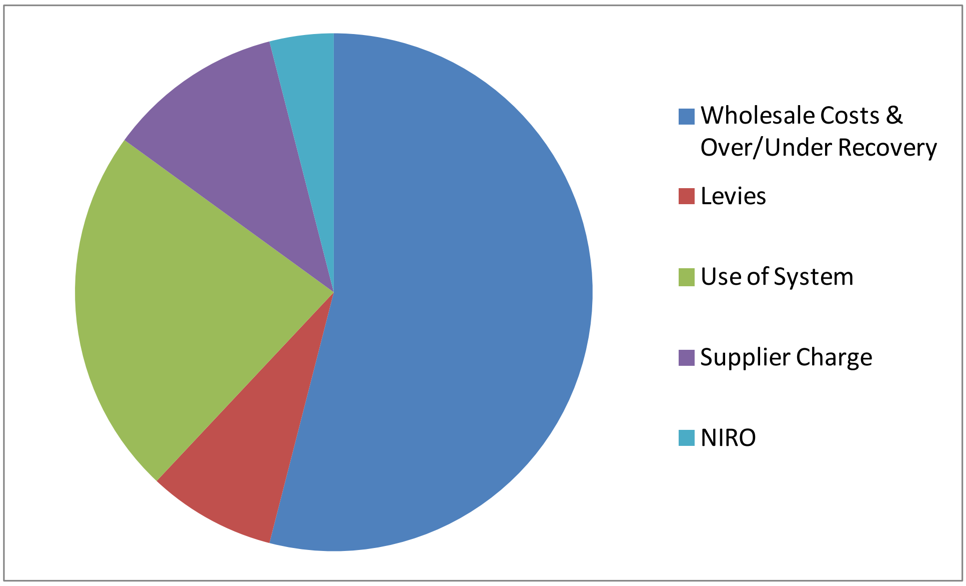
Under the terms of Power NI's licence to supply electricity, the Utility Regulator ("the Authority" or "UR") has the power to control the maximum amount that Power NI can charge for Electricity to domestic (and small business) customers.

Elements of Maximum Average Charge

The UR takes an active role in scrutinising Power NI's proposed retail tariffs, which are the final prices customers pay. The UR also continues to set a price control that sets allowances for Power NI's operating costs and profit margin. In addition to this, any other Power NI own operating costs that are passed through the tariff (which are not allowed for in the price control e.g. licence fees) must be approved by the UR. The aggregate of the price control allowances and pass through costs are termed the supplier charge (see Figure 1 below).

Power NI retail tariffs (derived from the maximum average charge) for this upcoming year are made up of a number of components (including the supplier charge discussed above):

Figure 1 - Makeup of the maximum average tariff



Levies and Use of System Charges

Several of the final tariff components are common across all suppliers and the final customer will usually pay these regardless of who their supplier is. These components are all subjected to regulatory review and approval:

- Levies - SSS charges (System Support Service)/Cair$_t$ Charges (if applicable)/PSO Levy (Public Service Obligation); and
- Use of System charges (UoS) – these are the costs of transmission and distribution of electricity through the NIE Ltd network to homes and business.

These costs are regulated because they are levied to recover the costs of parts of the electricity industry which are natural monopolies. Independent suppliers are free to enter the market and purchase power. They will usually add on the charges outlined above before setting the final price to sell to customers. This is because they are required to pay these charges in order to transport the power to the customer.

For the purpose of setting a 1 April 2015 tariff, forecast estimates for these network components have been used to derive the Power NI revenue requirement for them. This is due to the fact that the tariffs for the network components were set in October 2014. The next date for any new network tariff rates will be October 2015. An increase for RPI has been assumed for these elements in the absence of actual tariff rates from October 2015 onwards.

The remaining components of Power NI's tariffs are subject to regulatory scrutiny which is detailed in the following paragraphs.

Wholesale Costs and Over/Under recovery

There is a competitive and regulated wholesale market known as the Single Electrcity Market (SEM). This is an all island market encompassing the generation plants of Northern Ireland and RoI. Whilst all power in the SEM is purchased on a half hourly basis via a mandatory "pool" suppliers will enter into hedges with generators to limit their exposure to fluctuations in the half hourly pool price. These hedges effectively mean that the supplier is purchasing power on a forward basis at a fixed price based on forecast pool prices plus a premium. The approval of Power NI hedging methodology is given by the UR as well as the approval of the "G_t" (which is the forecast of the total of Power NI wholesale costs for the estimated demand for the tariff period). Because the wholesale component of final tariffs is both large and subject to volatility, over or under recoveries of revenues in any tariff period are generally caused by wholesale costs out turning lower or higher respectively than was forecast at the time of tariff setting.

Supplier charge

These charges are asssesed and implemented through the application of Power NI Supply Price Control 2014 – 2017[1] and any other costs approved on a pass through basis (after thorough regulatory scrutiny). The allowance set in the price control is for Power NI own operating costs e.g. salaries, IT systems, legal fees and profit margin of 2.2% of forecast turnover. Other costs which are unknown, but treated as "passthrough" as they are unavoidable (e.g. licence fees), are allowed on a passthrough basis and these also go into the overall supplier charge.

NIRO costs

These costs are audited on behalf of the UR by Ofgem as part of its UK-wide audit. NIRO is the Northern Ireland Renewables Obligation and the costs of it go towards the subsidisation of investment in renewable energy e.g. windfarms in Northern Ireland.

Why are Power NI's Tariffs decreasing?

The maximum average charge for tariff customers will decrease by 9.2% from 1 April 2015. Table 1 below shows the movement in the regulated tariff from October 2010 to date.

Table 1 - Historic tariff

Effective from date	1 Oct 2010	1 Oct 2011	1 Oct 2012	1 July 2013	1 April 2015

[1] http://www.uregni.gov.uk/news/view/ur_publishes_power_ni_supply_price_control_2014-2017/

Approved Tariff (pence per kWh)	14.31	16.97	14.58	17.18	15.6
% Change	0%	+18.6%	-14.1%	+17.8%	-9.2%

Decrease in the Wholesale and Over/Under recovery element

The decrease in the Power NI tariffs is in large part being driven by the decrease in the forecast wholesale cost (when compared with the forecast wholesale cost included in the tariff charge set in July 2013). The general decrease in current wholesale costs has also lead to an over recovery (estimated up until the point of the tariff change).

The decrease in forecast energy prices (versus those set at the last tariff in July 2013) represents circa 40% of elements of the tariff contributing to the tariff decrease. This is due to the forward gas curve showing a downward trend. This results in the forecast wholesale price of electricity being lower than that wholesale cost which was forecast at the time of the last tariff setting.

Another factor in the tariff decrease is the amount of over recovery (which is also included in the wholesale element) applied to this year's tariff. In the April 2015 tariff, the over recovery amount (which represents money which Power NI has over recovered and is returning to consumers through a reduction in the tariff) is moving from an under recovery position at the setting of the July 2013 tariff. This 'swing' is also a contributing factor resulting in a lower overall tariff.

Over or under recoveries are generally caused by wholesale costs out turning lower or higher respectively than was forecast at the time of tariff setting.

The position moved from an under recovery of circa £14.7m at the setting of the July 2013 tariff to a forecast over recovery position of circa £6.3m at April 2015.

Both Power NI and the Utility Regulator strive to keep the over/under recovered amount as low as possible in order to reduce volatility in the tariff. This is carried out through ongoing monitoring and tariff changes being put through when over or under recoveries are in danger to becoming too large.

Breakdown of Tariff

The graph shown in Figure 2 below compares the breakdown of the April 2015 tariff with the breakdown of the previous tariff set at July 2013 and demonstrates that the wholesale gas costs element of the tariff has decreased as a result of forecast energy prices being lower than those forecast at July 2013. In addition to this, the under recovery position in the last tariff, which had to be included in the overall tariff revenue requirement and recovered from customers, has moved to an over recovery amount which is being returned to customers in this tariff, which reduces the overall tariff revenue requirement.

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

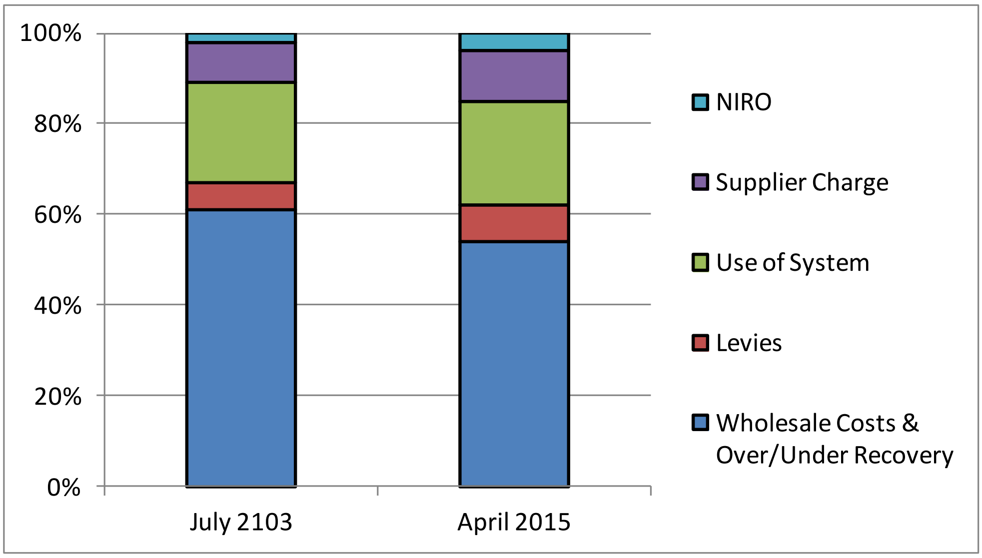


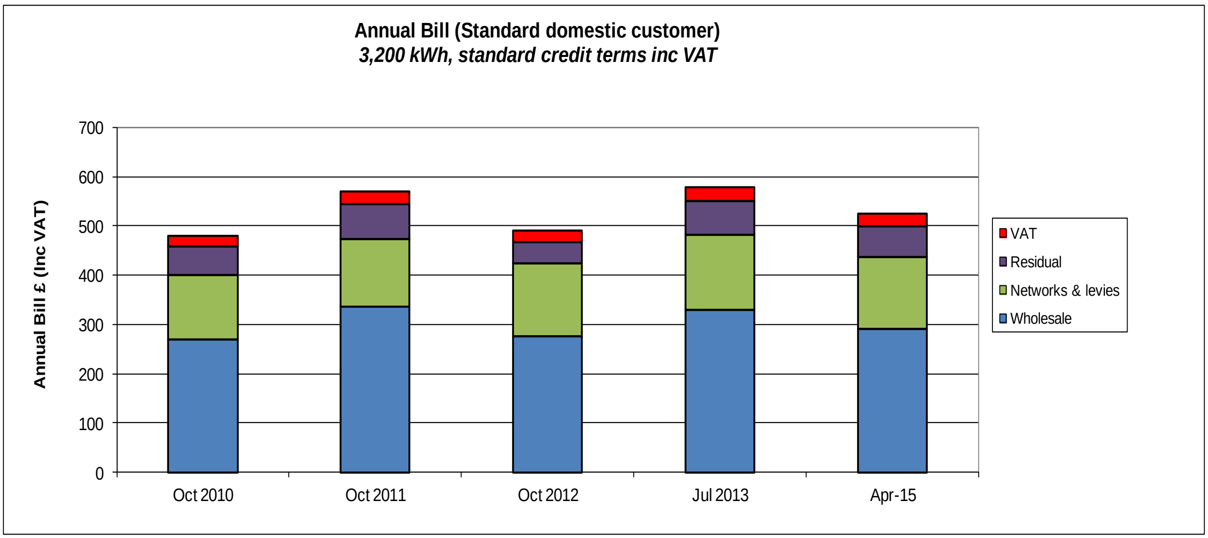
Figure 3 below shows the breakdown in the average annual domestic bill for Power NI consumers over the past few years and illustrates the variation caused by various components of the tariff. As expected, it can be seen that the variations in the tariffs are largely driven by variations in the wholesale cost component of Power NI costs and resulting over/under recovery positions.

The average annual bill amounts have been calculated based on the standard domestic tariff set at each tariff review (including VAT) and are based on an average annual consumption of 3,200 kWh[2] (this is a GB standard usage figure for tariff comparisons). Figure 3 shows that the annual bill based on a usage of 3,200 based on a credit customer (no direct debit) on the standard tariff will be £524 inclusive of VAT. This compares with a previous equivalent annual bill (based on the tariff set at July 2013) of £577. Customers will save on average over £50 per annum.

[2] https://www.ofgem.gov.uk/sites/default/files/docs/decisions/tdcv_decision_letter_final_2.pdf

3,200 kWh represents typical medium consumption which is used as the GB standard usage figure for tariff comparison

Figure 3 - Graph to show breakdown of average annual bill

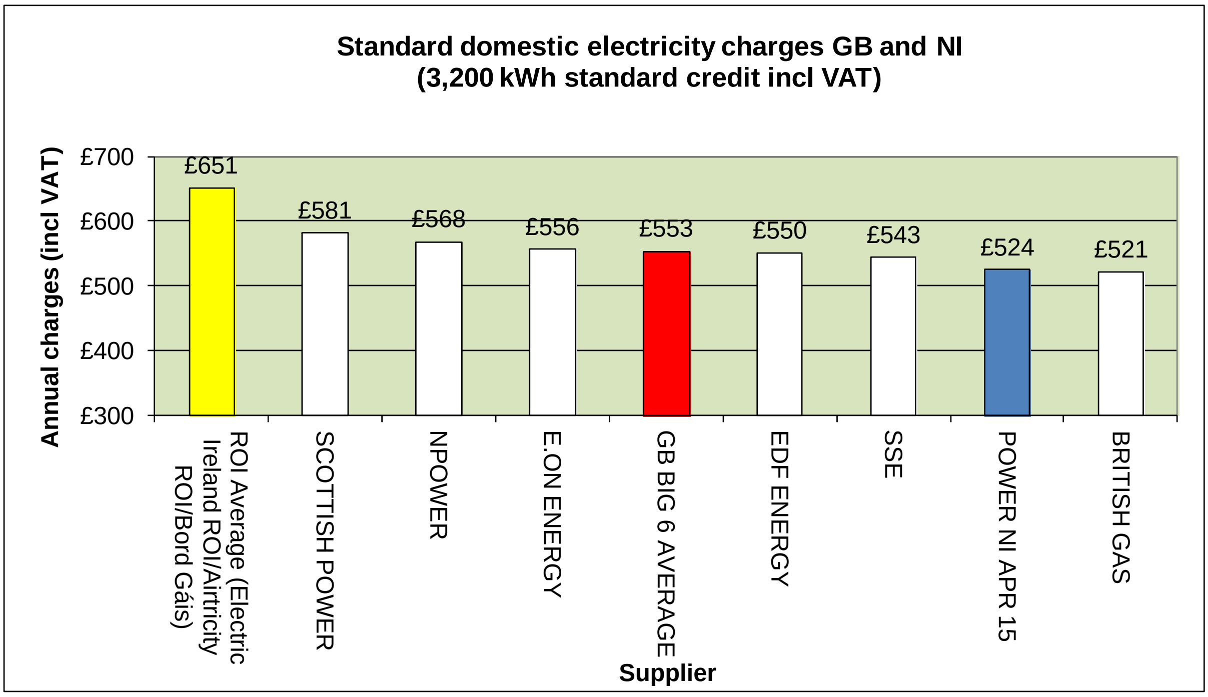


Comparison with GB and RoI

Figure 4 below shows the average annual bill for a Power NI domestic credit customer compared to the "Big 6" Supply companies in GB and the average of the three biggest suppliers in the ROI (Electric Ireland, Airtricity ROI and Bord Gais). This comparison is based on the latest available information on the standard domestic credit (non direct debit) tariffs of each company and is based on average annual consumption of 3,200 kWh. This graph takes account of any tariff changes which have been published to date in each jurisdiction.

Figure 4 illustrates that the Power NI tariff for an average domestic credit customer will be 5% cheaper than the GB average standard tariff, and will be more than 19% cheaper than ROI average (NB if VAT was removed from the bill comparison for ROI and NI the difference would be NI circa 13% cheaper – ROI has a higher VAT rate than NI) based on the three largest suppliers.

Figure 4 - Comparison of average annual bill in GB and ROI (based on estimated usage 3,200 kWh pa including VAT)



NB the ROI comparison is the average of the 3 largest suppliers in ROI - ***standard tariff*** *average of urban and rural.*

3,200 kWh represents typical medium consumption which is used as the GB standard usage figure for tariff comparison[3]

Outcome

The Utility Regulator has reviewed the Maximum Average Price Charge submission provided by Power NI and reviewed the Power NI forecasts against its own market analysis. The Utility Regulator is satisfied that this decrease is appropriate and therefore approves the new standard domestic tariff of 15.6 (excluding VAT) pence per kWh from 1 April 2015 (16.38 pence per kWh including VAT). This represents a decrease of 9.2% from the previous tariff which became effective on 1 July 2013 of 17.18 (excluding VAT) pence per kWh (18.039 pence per kWh including VAT).

[3] https://www.ofgem.gov.uk/sites/default/files/docs/decisions/tdcv_decision_letter_final_2.pdf