Conclusion of the Utility Regulator's Review of the SSE Airtricity Gas Supply (NI) Ltd Maximum Average Price in the Greater Belfast area

March 2018



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 SSE Airtricity Gas Supply (NI) Limited (**SSE Airtricity**) is a core part of our work.

We commenced a review of the maximum average price with SSE Airtricity in January 2018. We have scrutinised the submission provided by SSE Airtricity 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 SSE Airtricity's domestic and small business customers in Greater Belfast will increase to 118.25 pence per therm from 1 April 2018. This equates to an increase of 7.8% to the bills of domestic and small business customers.

SSE Airtricity are the commissioning/default supplier within the West area and as such the UR applies a supply price control to SSE Airtricity in the West area for domestic and small business customers. The review includes the West area in the maximum average price.

Audience

Customers and customer groups, industry and statutory bodies.

Consumer impact

For SSE Airtricity customers in the Greater Belfast area the cost of gas they use will be 7.8% higher. This change will affect all domestic and small business customers using less than 2,500 therms per annum. The change will take effect from 1 April 2018. This follows no change in October 2017.

The impact of the tariff change on a domestic customer on a standard credit tariff with average consumption of 12,500 kWh per annum will be an increase of £39 per annum (including VAT) on their gas bill.

Approval by the Utility Regulator of the SSE Airtricity Gas Supply (NI) Limited Maximum Average Price in the Greater Belfast area

Summary

On 19th January 2018 the Utility Regulator, in consultation with SSE Airtricity Gas Supply (NI) Limited (**SSE Airtricity**), the Department for the Economy (**DfE**) and the Consumer Council began a review of the SSE Airtricity maximum average price for domestic and small business customers using less than 2,500 therms per annum. The current maximum average price has been effective from 1 April 2017 and covers approximately 148,000 customers within the Greater Belfast Area.

We carry out formal reviews of the SSE Airtricity maximum average price on a bi-annual basis (in advance of April and October). The Utility Regulator can also initiate a further review of the maximum average price 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. On an ongoing basis we analyse the cost of wholesale gas on the forward curve, along with the forward purchases that SSE Airtricity has made to date.

We initiated the formal review to establish the new maximum average price to become effective from 1 April 2018. The review is a formal process agreed by SSE Airtricity and the UR, and includes consultation with DfE and the Consumer Council. It is set out within the SSE Airtricity[1] price control.

SSE Airtricity 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. SSE Airtricity cannot charge more than the maximum average price overall.

[1] Price Control for SSE Airtricity Gas Supply (NI) Ltd and firmus energy (Supply) Ltd Final Determination 29th November 2016 https://www.uregni.gov.uk/sites/uregni/files/media-files/SPC%2017%20Final%20Determination%20v1.0.pdf

The maximum average price for domestic and small business customers will be 118.25 pence per therm from 1 April 2018. 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 2018 and will continue to monitor gas prices to identify if an additional review is required.

From 1 April 2018, the unit rates of tariffs for SSE Airtricity's customers in the Greater Belfast area will increase by 7.8%. These unit rates are detailed in Table 5 later in this paper.

Background

In Northern Ireland, there are three distinct distribution areas for natural gas. These are the Greater Belfast area, the Ten Towns area and the West area. Phoenix Natural Gas Limited (PNGL) own and operate the distribution network in the Greater Belfast area, firmus energy (Distribution) Limited own and operate the distribution network in the Ten Towns area while Scotia Gas Networks (SGN) own and operate the distribution network in the West area.

In the Greater Belfast area SSE Airtricity[2] has operated as the incumbent gas supplier since 1996. One competing supplier has been active in the domestic gas market since 2010.

The previous SSE Airtricity price controls applied to customers using less than 25,000 therms (732,000 kWh) per annum (typically domestic properties and small to medium sized businesses). This scope included two customer categories, those using less than 2,500 therms (73,200 kWh), known as End User Category (EUC) 1, typically domestic and small commercial properties and those using between 2,500

2 In June 2012, Airtricity Energy Supply (Northern Ireland) Ltd purchased the entire issued share capital of Phoenix Supply Ltd and was subsequently renamed SSE Airtricity Gas Supply (NI) Limited (SSE Airtricity).

and 25,000 therms (73,200 and 732,000 kWh) per annum known as EUC 2, typically small to medium sized industrial and commercial properties.

As part of the Electricity and Gas Retail Supply Price Controls 2017 (SPC17) UR Approach Consultation published in October 2015[3] we stated that we would review whether it was appropriate for the scope to remain at this level.

Following consultation we determined that the scope of the price control for SSE Airtricity will be limited to those customers using less that 2,500 therms per annum (73,200 kWh per annum), known as the EUC 1 category. This came into effect on 1 April 2017. Therefore, this tariff review only applies to EUC1 customers. This represents around 148,000 tariff customers or around 73% of the EUC1 market in Greater Belfast.

Also in the new gas West area, which covers amongst others the areas around Strabane and Enniskillen , SSE Airtricity are the commissioning/default supplier and as such the UR applies a supply price control to SSE Airtricity in the West area for domestic and small business customers. It is expected that domestic and small business customers will connect in the West area in the coming months.

Under the terms of SSE Airtricity's licence to supply gas, the Utility Regulator ("**the Authority**") has the power to control the maximum amount that SSE Airtricity can charge for gas. This price control is included in SSE Airtricity's licence. Below is an extract from the SSE Airtricity licence:

Control over charges

> The Licensee shall take all reasonable steps to secure that in any Relevant Year the average price per unit of gas supplied by it to Regulated Premises shall not exceed the maximum price calculated in accordance with Condition 2.4.2[4].

[3] https://www.uregni.gov.uk/consultations/consultation-approach-supply-price-controls-energy-companies-launched

[4] SSE Airtricity Licence for the supply of gas: https://www.uregni.gov.uk/sites/uregni/files/media-files/2016-09-01%20SSE%20Airtricity%20Gas%20Supply%20NI%20Ltd%20%28PSL%29%20Supply%20Licence%20v2.pdf

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

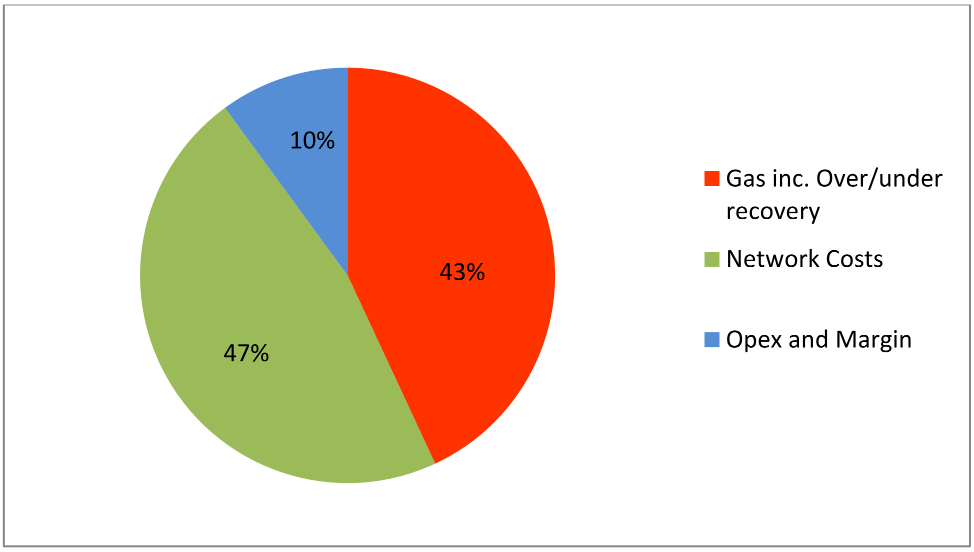
Elements of Maximum Average Price

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

- Operating costs and supply margin;
- Network costs; and
- Wholesale cost of gas and over/under recovery from previous tariff periods.

The breakdown is shown in figure 1 below.

Figure 1 - Makeup of the maximum average price April 2018



The Utility Regulator scrutinises the costs within each of the elements of the maximum average price of SSE Airtricity's submission. SSE Airtricity uses the maximum average price to set the actual tariffs that are charged to customers. SSE Airtricity cannot charge more overall than the maximum average price.

Operating Costs and Supply Margin

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

In November 2016 we published the final determination for the SSE Airtricity price control[5] which indicates the total amount of revenue that the Licensee can recover, in any relevant year, in respect of their gas supply businesses.

The margin refers to the amount of profit SSE Airtricity is allowed to make. The margin is also determined within the new price control and is set at 2% of allowable turnover from tariff customers.

The price control determination[6] runs from 1 April 2017 to 31 March 2020.

Network Costs

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

The SSE Airtricity 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/.

The costs for the distribution system are those costs associated with moving gas throughout the Greater Belfast area and the West area to homes and businesses. On the 15th September 2016, the final determination on the price control for

5 Price Control for SSE Airtricity Gas Supply (NI) Ltd and firmus energy (Supply) Ltd Final Determination 29th November 2016 https://www.uregni.gov.uk/sites/uregni/files/media-files/SPC%2017%20Final%20Determination%20v1.0.pdf

6 Utility Regulator Determination on Phoenix Supply Price Control 2012 – 2016, November 2011: http://www.uregni.gov.uk/uploads/publications/PSL_PC03_Determined_to_Position_Table_26_blanked_for_website2.pdf (Note that SSE Airtricity purchased Phoenix Supply Limited in June 2012)

Northern Ireland's gas distribution networks for the period 2017-2022 (GD17), and associated licence modifications for consultation, were published. GD17 is the distribution price control for Phoenix Natural Gas Limited (PNGL), firmus energy (Distribution) Limited and SGN Natural Gas Limited which will run from 1 January 2017[7]. The distribution price control determines the amounts that PNGL can charge for suppliers to use the Greater Belfast network. These can be found on the Phoenix Natural Gas website at http://www.phoenixnaturalgas.com/help-and-advice/networks/charges/.

Wholesale Gas Costs and Over/Under Recovery from Previous Tariff Periods

This element of the maximum average price includes the forecast cost of wholesale gas and any over/under recovery from the previous tariff period that needs to be deducted/added in the maximum average price. This makes up 43% of the total. Further detail on these costs is provided below.

- ***Wholesale Gas Costs***

As determined within the SSE Airtricity price control, 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 SSE Airtricity 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 over those set in the tariff, the resulting savings or additional costs are passed on to the customer.

SSE Airtricity 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 is known as hedging and limits the exposure to fluctuations in wholesale gas prices and therefore aims to create more stability in the gas price for final customers.

At the time of review, the overall cost of gas for the maximum average price 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

[7] https://www.uregni.gov.uk/news-centre/gas-distribution-networks-price-control-gd17-period-2017-2022-published

that gas which has yet to be bought 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 were included in the maximum average price.

Where the wholesale gas costs out turn less than was forecast in the maximum average price, SSE Airtricity will 'over recover'. This means that they 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, SSE Airtricity will 'under recover', the means they 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 the previous tariff period.

Both SSE Airtricity and the Utility Regulator strive to keep the over/under recovered amount as low as possible in order to avoid distortion of the maximum average price. This is carried out through ongoing monitoring and tariff changes being put through when over or under recoveries are accumulating to such an extent that they would adversely affect the tariff.

The maximum average price effective from 1 April 2017 included an amount of around £2.6m which SSE Airtricity had over recovered previously. This was returned to customers through a 4.5p/therm reduction in the April 2017 tariff i.e. the current tariff. As of 1 April 2018, this over recovery will have reduced to £447k and the return to customers will be much less at 0.75 p/therm. The previous over recovery had a dampening effect on the tariff. The current tariff does not have a large over recovery build into it and is more reflective of current market conditions.

Why is the Maximum Average Price for SSE Airtricity increasing?

The maximum average price for SSE Airtricity's tariff customers in Greater Belfast and now in the West will increase to 118.25 pence per therm from 1 April 2018. Table 1 below shows the movement in the regulated maximum average price from May 2008 to date.

Table 1 - Historic maximum average price

Effective from date	Approved Maximum Average Price (pence per therm)
01-May-08	128.00
01-Oct-08	152.58
08-Jan-09	118.92
01-Oct-09	96.32
01-May-11	133.97
01-Apr-12	122.64
01-Apr-13	133.26
01-Apr-15	125.17
01-Oct-15	112.50
01-Apr-16	101.01
31-Mar-17	109.63
01-Apr-18	118.25

The overall increase in the SSE Airtricity maximum average price is due to:

- the slight increase in the cost of wholesale gas;
- a slight increase in overall network costs;
- A lower wholesale gas over recovery amount in comparison to the previous year.

These are both explained in the section below.

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

The forecast gas costs on the forward curve have increased slightly over the last year. 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 price has increased from 49.69 pence per therm in the 1 April 2017 tariff to 51.68 pence per therm in the April 2018 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. This element is the cost of the gas that has not already be bought (hedged) to date.

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

The maximum average price coming into effect from 1 April 2018 includes an over recovery from the previous year. This acts to offset some of the increase in wholesale gas costs in the maximum average price as SSE Airtricity return this previous over recovery to customers. There was an over-recovery of £2.6m at the setting of the April 2017 maximum average price and for the 1 April 2018 price there is a forecast over recovery position of £447k. This equates to a 0.75 p/therm return to customers. The impact of the change in the over/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	April 2017 (pence per therm)	April 2019 (pence per therm)
Wholesale Gas Cost	49.69	51.68
Over/Under Recovery	-4.53	-0.75
Total Wholesale Gas Cost and Over/Under Recovery from Previous Tariff Periods	45.16	50.93

- ***Network Charges***

Transmission Network charges have decreased slightly over the level set in the April 2017 maximum average price.

The distribution costs contribute an additional 2.5 pence per therm to the overall maximum average price from 1 April 2018. This is attributed to normal inflationary increases and the removal of a previous over recovery which has a dampening effect on the previous distribution charge. These charges are available on the Phoenix Natural Gas website[8].

As a result, there is a small increase of around 3.75% in network costs (transmission and distribution combined). This can be seen in Figure 3.

Breakdown of Maximum Average Price

The graph shown in Figure 3 below compares the breakdown of the April 2018 maximum average price with a breakdown of the previous maximum average price set at April 2017. As explained previously, the increase in the maximum average price is due to slightly increased network costs, a slight increase in wholesale gas prices, and the reduction in the over recovered sum of wholesale gas costs

8 http://www.phoenixnaturalgas.com/fs/doc/Conveyance%20Charge%20Statement%20January%20to%20December%202016.pdf

previously held by SSE. This over recovery had a reducing effect on the 2017 tariff which is not now in the 2018 tariff.

Figure 3 – Breakdown of April 2018 maximum average price compared with the previous maximum average price

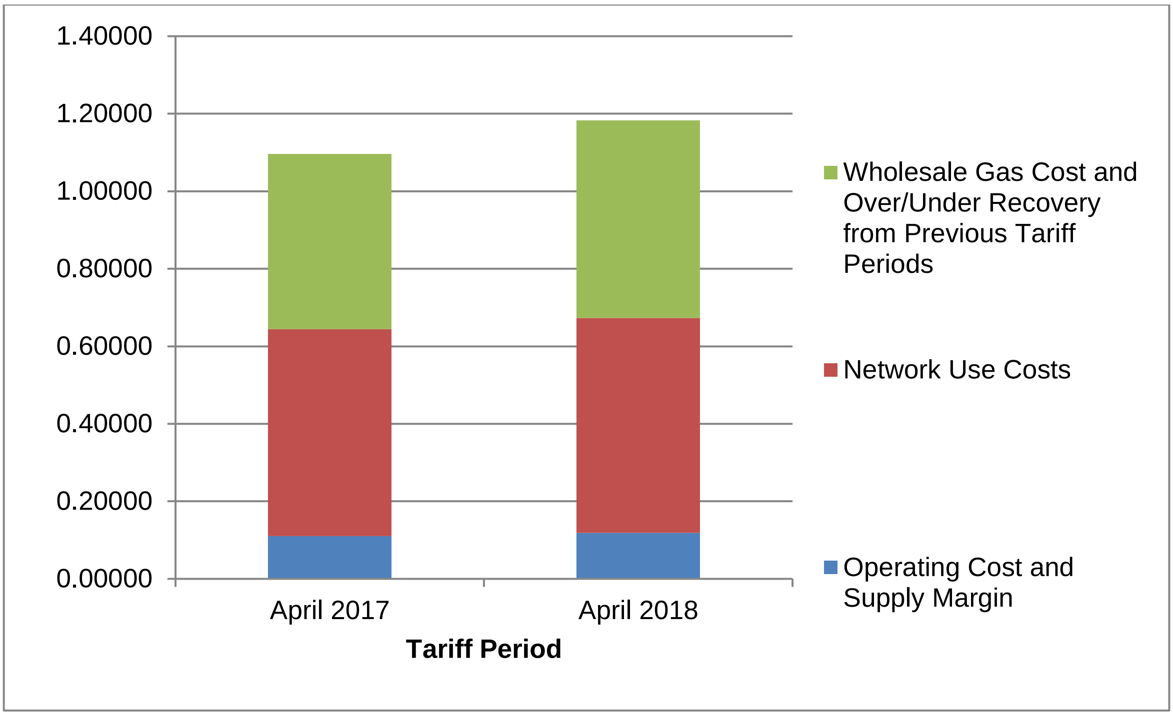
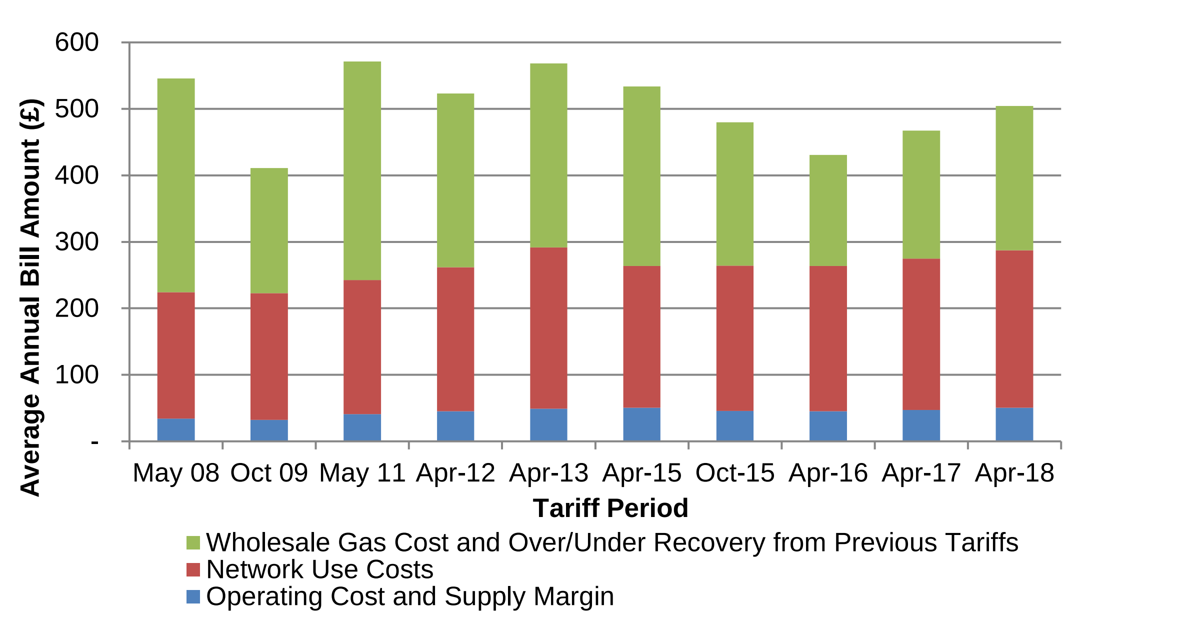


Figure 4 below shows the breakdown in the average annual bill for SSE Airtricity tariff customers over the past few years and illustrates again the variation caused by different components of the maximum average price. Again it can be seen that the variations in the maximum average price are largely driven by changes in the wholesale cost component and resulting over/under recovery positions and network costs.

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[9].

[9] 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 including all domestic customers and IC1 customers.



Impact on Tariff

As stated earlier, SSE Airtricity 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. SSE Airtricity cannot charge more than the maximum average price overall. From 1 April 2018, the unit rates of tariffs for SSE Airtricity's customers in the Greater Belfast area will increase by 7.8%. Table 4 below shows the movement in the tariffs from May 2008 to date.

Table 4 – Historic changes in tariffs

Effective from date	Change
01-May-08	28.00%
01-Oct-08	19.20%
08-Jan-09	-22.10%
01-Oct-09	-19.00%
01-May-11	39.10%
01-Apr-12	-8.50%
01-Apr-13	8.70%
01-Apr-15	-7.8%
01-Oct-15	-10%
01-Apr-16	-10.2%
01-Apr-17	7.6%
01-Apr-18	7.8%

The new unit rates for tariff customers that will apply from 1 April 2018 are shown in Table 5 below. Table 6 shows the percentage increase for each individual unit rate of the domestic and small business tariffs.

Table 5 – SSE Airtricity's tariff unit rates from 1 April 2018 (shown in pence per kWh including VAT)

SSE Airtricity Gas Supply (NI) Tariffs	**Home Energy**	**PAYG**	**IC1**	**Large Home**
Up to 2,000 kWh	5.871	4.271	6.709	5.871
Over 2,000 kWh	4.023	4.271	4.597	4.023
Over 73,200 kWh				3.724
Direct Debit discount	£22.05		£22.05	£22.05

Table 6 – Percentage Increase in SSE Airtricity's tariff unit rates from 1 April 2018

SSE Airtricity Gas Supply (NI) % change	**Home Energy**	**PAYG**	**IC1**	**Large Home**
Up to 2,000 kWh	+7.80%	+7.80%	+7.80%	+7.80%
Over 2,000 kWh	+7.80%	+7.80%	+7.80%	+7.80%
Over 73,200 kWh				+7.80%

The change in the SSE Airtricity maximum average price from 1 April 2018 equates to an increase in domestic customer bills of around £39 per year (including VAT) based on the SSE Airtricity standard domestic credit tariff unit rates using average annual consumption of 12,500 kWh (rounded to nearest pound).

Comparison with GB and Ireland

Figure 5 below, shows the average annual bill of a domestic customer for SSE Airtricity compared to the "Big 6"[10] supply companies in GB and Bord Gais in Ireland.

This comparison is based on the latest available information on the standard domestic credit tariffs[11] of each company and is based on average annual consumption of 12,500 kWh9. 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 12,500kWh9.

This graph shows the SSE Airtricity tariff that will become effective on 1 April 2018 and also takes account of any tariff changes for supply companies in GB and Ireland which have been published.

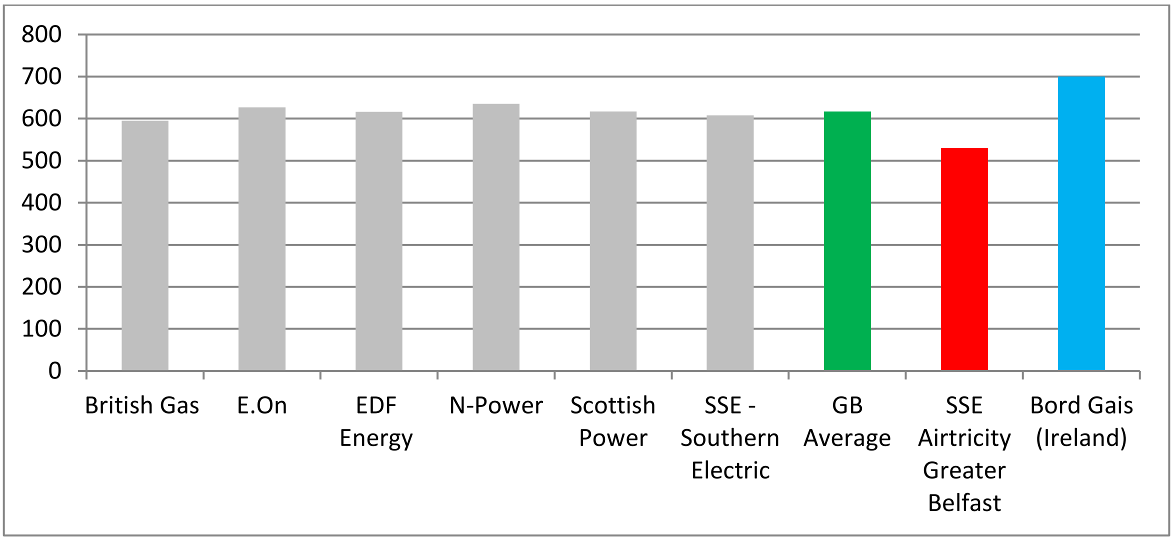
Figure 5 below illustrates that the SSE Airtricity tariff for an average domestic credit customer will be around 14% cheaper than the GB average standard tariff and 24% cheaper than the Bord Gais standard tariff in Ireland (inc VAT)[12].

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

[11] 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. They are based on the West Midlands gas distribution area.

[12] VAT rates in GB and NI are equal. Comparison of RoI and NI exclusive of VAT shows that NI is 20% cheaper that Bord Gais in RoI. Exchange rates as of 20/02/18.

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



Outcome

The Utility Regulator has reviewed the maximum average price submission provided by SSE Airtricity and reviewed SSE Airtricity's forecasts against its own market analysis. The Utility Regulator is satisfied that this increase is appropriate and therefore approves the new maximum average price of 118.25 pence per therm for SSE Airtricity's tariff customers in Greater Belfast. This maximum average price will be effective from 1 April 2018. This represents an increase of 7.8% in the actual tariff unit rates that SSE Airtricity uses to charge customers.

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