NIE Energy Electricity Price Announcement Q and As

Q.1 Why is NIE Energy Supply announcing a decrease in electricity bills now?

A. NIE Energy Supply (NIEES) is making this announcement on electricity tariffs as part of the annual tariff review that it undertakes in consultation with the Utility Regulator.

The announcement today is the second decrease to take place this year. In January a 10.8% decrease to electricity bills was announced.

Q.2 What has caused the decrease in bills?

A. The main reason for the decrease in electricity bills is due to the fall in wholesale energy costs.

NIEES purchased a large proportion (79%) of its wholesale energy during the summer months, allowing total generation costs to be 31% cheaper than the previous tariff year.

Q.3 If wholesale costs have fallen by 31% since 2008 why does the decrease in bills not reflect the full extent of the fall?

A. While wholesale and generation costs have been reduced by 31%, this does not equate to a similar reduction in consumer electricity bills as the generation costs only made up 72% of the typical electricity bill in October 2008. Therefore the generation cost decrease equates to 22%[1] reduction in tariff terms which is made up as follows:

- 10.8% reduction passed to consumers in January 2009;
- 5% reduction to come into effect 1st October 2009; and
- 6.2% offset attributable to additional factors.

The additional factors are:

1. Network costs have increased relative to last tariff year. This is attributable to a forecast drop in demand from 08/09 tariff year to 09/10 for NIE networks (total

[1] 31% * 72% = 22%

system demand) which has therefore pushed up unit rates, and also an under recovery in the previous tariff year.

2. Costs were under-recovered in the tariff year 2008/9 due to the following reasons:

   - Under recovery of NIEES carried forward £6.8m of 'k' under-recovery from the prior year. K is an amount of revenue recovered in a year that either exceeds or does not meet the amount stated in the tariff setting formula. As is the case for this year's tariff review, the amount fell short and therefore a correction factor is included to recover the deficit with interest.

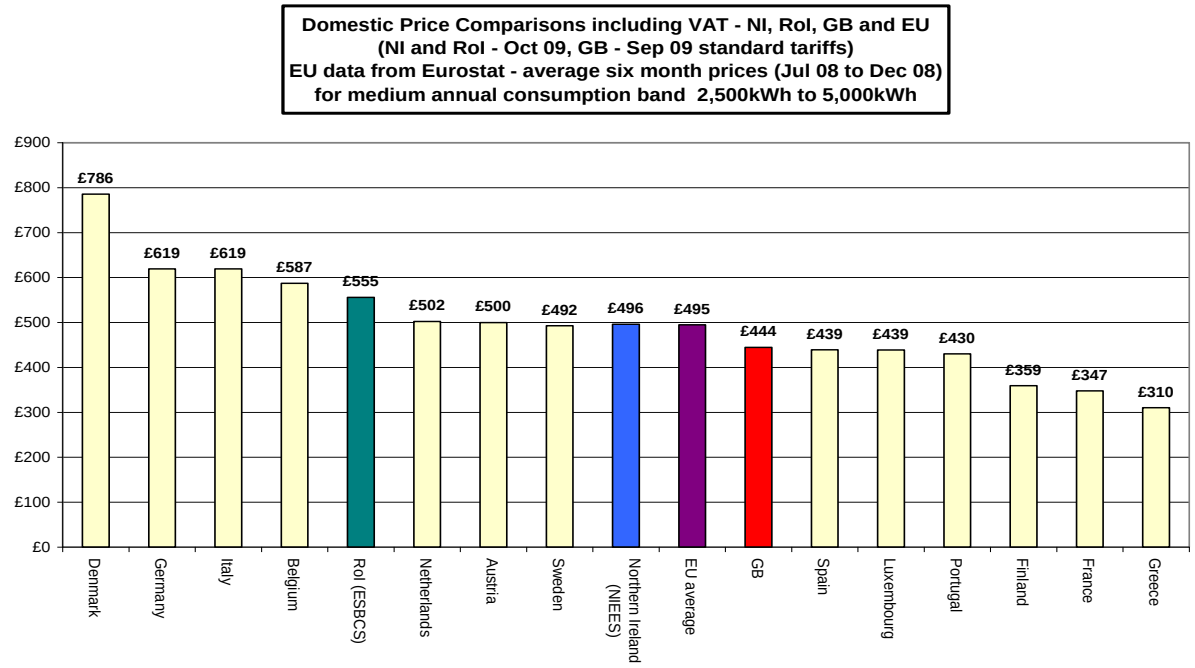
   - Unprecedented fall in demand – 2008-09 saw the biggest fall in electricity demand since records began. This was mainly due to the mild weather and the economic downturn, which has reduced consumption by SME's and increased the number of vacant properties. The result was that NIEES's sales were lower than predicted, which has increased costs.

   - Weakening of sterling – An exchange rate of 1:1.16 was assumed for the NIESS' euro denominated energy hedges/costs that represented a significant input into the January 2009 tariff review. Whilst NIEES secured hedges at the earliest opportunity following agreement to do so with the Utility Regulator, sterling weakened a further 7% from the rate assumed in early December 2008 when the 1 January 2009 tariff reduction was announced.

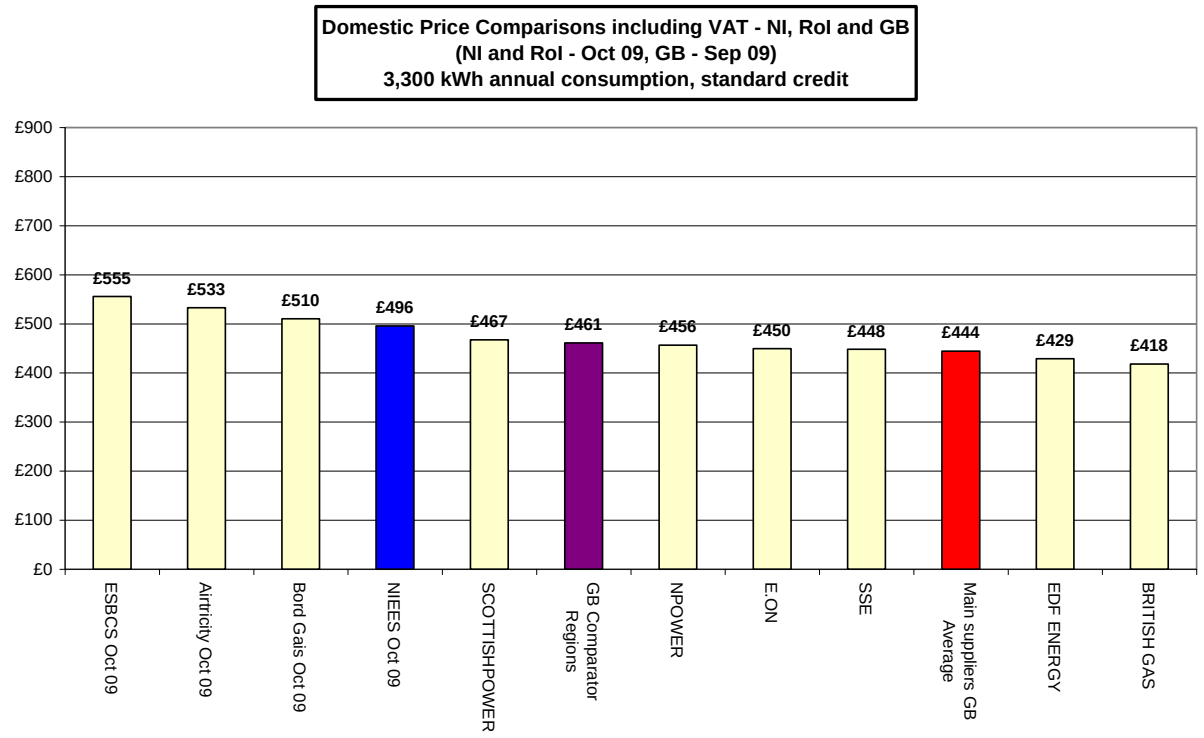
Q.4 Do we pay more for our electricity in Northern Ireland than other parts of the UK or the Republic of Ireland? If so, why?

A. Based on an average standard credit customer using 3,300 kWh of electricity per annum, the average bill is now £496 per annum which is a decrease in their bill by £26 (from January 2009 tariffs).

This is 11.9% lower than RoI (ESBCS) and equal to the European average as depicted in the following graph (note we recognise the need to caveat these figures as the EU data is relatively old):



In comparison to the main suppliers in GB the NI tariffs are 12% higher, and 7.6% higher than the GB comparator regions [2]as depicted in the graph below:



Historically electricity prices in Northern Ireland have tended to be higher than Great Britain. Key disadvantages that have led to higher prices in Northern Ireland are:

- higher energy transport costs;
- economies of scale in Great Britain owing to the relative magnitude of the market there compared to Northern Ireland;
- the additional cost of long term legacy generation and associated contracts (not present in GB markets) although this does not apply this year; and
- the different fuel mix in Great Britain (i.e. Northern Ireland has a reliance on gas, Great Britain's generation mix is mainly nuclear and coal)

[2] The three GB comparator regions are: Sweb, Swalec and Scottish Hydro Electric. These are the normal comparator regions when assessing domestic electricity prices vis-à-vis Northern Ireland, due to similarities in the distribution and scarcity of the population.

Q.5 What did the Utility Regulator do to make sure that electricity bills are as low as possible?

A. The Regulator acts on behalf of consumers to ensure prices are as low as they can be, while still making the necessary investment for the future. The 5% decrease is the second fall in electricity bills this year.

The process of setting tariffs for electricity and gas is rigorously scrutinised by the Utility Regulator. The Utility Regulator has carefully reviewed each of the cost elements within NIEES tariff and is satisfied that the decrease is appropriate.

Moreover, the tariff setting process undertaken this year built in an unprecedented level of transparency. For instance, during the contracting window (when the wholesale energy is purchased for the coming year) the Utility Regulator also published three contracting updates (detailing the total aggregated volumes purchased) alongside updates on progress to the published tariff review timetable.

We have also taken steps to make sure that both the profits of NIEES are constrained and that the company is run efficiently through our price controls. Our recent price control decision decreased the allowed profit margin of NIEES from 1.8% to 1.68% net margin (which is extremely low compared to other energy supply companies in the UK). This profit is not guaranteed and the company needs to run an efficient business to realise the profit margin.

Q.6 Why do we not have a choice of electricity suppliers and what is the Utility Regulation doing to promote competition?

A. The Utility Regulator is strongly committed to encouraging competition for electricity customers.

Effective competition is already being seen by business customers.

Although the market is fully open, no competitors have yet emerged in the domestic sector. However, the NIEES price control carried out by the Utility Regulator acts as a proxy for competition, serving to keep costs and the suppliers' profit margin low.

Internally, a dedicated retail team has been established to drive forward work on encouraging competition. We have also pro-actively looking at how we can further develop switching systems to make entry into the Northern Ireland more attractive.

Q.7 The gas prices have decreased by 19%, why have electricity prices only decreased by 5%

A. The wholesale gas price is the main driver of retail prices, but only one among many drivers of electricity.

60-70% of our electricity is generated from gas, but the prices of coal, carbon and generation equipment also all affect power costs. In addition, in the current tariff year, over 40% of electricity bills relate to items other than wholesale power. In the previous tariff year, non wholesale costs accounted for only 28% of total costs. This was due to higher wholesale costs driven by higher commodity costs.

The following graph shows cumulative changes in domestic gas and electricity tariffs since 2002. Points to take from this graph are:

- gas prices are clearly more volatile than electricity prices, probably explained by the fact that gas prices are much less hedged to underlying wholesale prices
- while the electricity and gas prices will move in a related way because of the importance of wholesale gas prices to both retail electricity and gas tariffs, there are many other cost factors that will also impact on the electricity prices (as mentioned above) so the fluctuations will never exactly correlate
- however the graph would indicate that in the medium term the prices tend to move together.