Price Control for firmus energy (Supply) Ltd 2020-2022

Final Determination

27 September 2019

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, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.

Our vision

To ensure value and sustainability in energy and water.

Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.

Abstract

This document sets out the UR's final determination for the price control on firmus energy (Supply) Ltd (FES) in the Ten Towns gas supply market. The FES control will come into effect on 1 January 2020 and will run until 31 December 2022.

This paper outlines our decisions in relation to the main areas within the FES control: structure and form; scope and coverage of regulated tariffs; duration of control; operating costs levels and allocations; and allowed margin.

Audience

Industry, consumers, and their representative bodies and statutory bodies.

Consumer impact

The price control will protect customers by setting a maximum limit on the average price that FES can charge its price regulated customers for gas in the Ten Towns area. This ensures that customers only pay for the efficient cost of the gas they receive and a fair profit margin.

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Glossary

Name	Definition
CAPEX	Capital Expenditure
CCNI	Consumer Council for Northern Ireland
CMA	Competition and Markets Authority
DfE	Department for the Economy
EUC	End User Category
FES	firmus energy (Supply) Ltd
firmus distribution	firmus energy (Distribution) Ltd
FTE	Full Time Equivalent
GB	Great Britain
HMRC	Her Majesty's Revenue & Customers
IT	Information Technology
LBE	Latest Best Estimates
NBP	National Balancing Point
NI	Northern Ireland
OPEX	Operating Expenditure
PAYG	Pay As You Go
PNGL	Phoenix Natural Gas Ltd
PSL	Phoenix Supply Limited
Power NI	Power NI Energy Ltd
RPI	Retail Price Index
SGN	SGN Natural Gas Limited
SNIP	Scotland to Northern Ireland Pipeline
SSE Airtricity	SSE Airtricity Gas Supply (NI) Ltd
UR	Utility Regulator

1. Introduction

1.1 The principal objective of the Utility Regulator (UR) in relation to gas is “to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland” while having regard to “the need to ensure a high level of protection of consumers of gas”. To help meet this objective we retain price controls on dominant, former monopoly, gas and electricity suppliers.

1.2 The control will apply for the three year period of 1 January 2020 to 31 December 2022.

1.3 This document sets out the decisions and principles that form the basis of the price control and provides background information on the Ten Towns gas market.

1.4 This final determination follows the UR’s FES Consultation Paper published in May 2019 which set out our high level proposals for supply price control 2020 – 2022 (SPC20). We received three responses to this consultation which are published alongside this final determination and addressed where relevant within this consultation.

1.5 We consider that our approach has been consistent with the principles of better regulation[1] which the UR continues to apply: transparent, consistent, proportionate, accountable, and targeted.

1.6 All costs presented are in October 2018 prices. These prices will be adjusted within the tariff for inflation as discussed in Section 9.

[1] Department for Business Innovation & Skills, *Principles for Economic Regulation,* April 2011: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31623/11-795-principles-for-economic-regulation.pdf

2. Background

2.1 In Northern Ireland (NI) there are three distinct distribution areas for natural gas. These are the Greater Belfast area, the West area, and the Ten Towns area. The Greater Belfast area is served by Phoenix Natural Gas Ltd (PNGL) and the price regulated supplier is SSE Airtricity. The West area is served by SGN Natural Gas Ltd (SGN) and the price regulated supplier is also SSE Airtricity. The Ten Towns area is served by firmus energy (Distribution) Ltd (firmus distribution) and the price regulated supplier is FES.

2.2 The Ten Towns area covers a geographical region that includes Londonderry, Limavady, Coleraine (including Portstewart and Bushmills), Ballymoney, Ballymena (Broughshane), Antrim (including Ballyclare and Templepatrick), Craigavon (including Portadown and Lurgan), Banbridge, Newry (Warrenpoint) and Armagh (Tandragee).

2.3 The Ten Towns area is a relatively small market, and there are currently approximately 42,265 gas connections (comprising of 2,688 I&C connections and 39,557 domestic connections)[2].

2.4 This market opened to supply competition in two stages with the market for large I&C users (those using above 25,000 therms per annum) opening in October 2012 and the market for domestic and small I&C customers opening in April 2015. Currently there are four active suppliers in the market, though FES remains the monopoly supplier to domestic properties.

2.5 The current FES price control applies for the period from 1 January 2017 to 31 December 2019.

2.6 firmus energy is an integrated business that includes firmus energy (Distribution) Ltd which operates the distribution network in the Ten Towns area. The distribution company is also subject to price control. The current control, GD17, ends on 31 December 2022.

[2] Quarterly Transparency Report (Q119) - https://www.uregni.gov.uk/sites/uregni/files/media-files/2019-06-13%20Transparency%20Report%20Q1%202019%20final%20for%20review%20UPDATED.pdf

3. Scope and Duration

Scope

3.1 The SPC17 Final Determination stated that the control would apply to two distinct End User Categories (EUC):

- EUC1 – all domestic customers and those small businesses using less than 2,500 therms (73,200 kWh); and
- EUC2 – those businesses using between 2,500 and 25,000 therms (73,200 and 732,000 kWh) per annum.

3.2 However, following that determination the UR issued a further consultation in October 2017. The result of that consultation was a decision to reduce the scope of the FES price control to exclude EUC2 customers. This was due to the reduction in FES market share in the EUC2 sector, meaning that it no longer held a dominant position. Thereafter, as of 1 April 2018 non-domestic customers consuming between 2,500 and 25,000 therms (73,200 and 732,000 kWh) per annum were no longer to be covered by the price control.

3.3 Due to the continued dominance of FES in the EUC1 category, for SPC20 we proposed to retain the scope of the control at domestic and small business customers using up to 2,500 therms (73,200kWh) per annum.

Duration

3.4 In the November 2018 Information Paper we stated that we considered a three year period to be the most appropriate duration for the price controls as it balances the resource implications of carrying out a control with the ability to forecast accurately over the medium term.

3.5 Therefore, it was our proposal in the consultation to apply the control for a period of three years; from 1 January 2020 to 31 December 2022.

Response to Consultation

3.6 FES made no comment on scope or duration in its response to the consultation.

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3.7 It is the decision of the UR that the scope and duration of SPC20 for FES will remain structured as it was in SPC17; as is laid out in the consultation.

4. The Regulated Tariff

4.1 The gas supply licence confers on the UR the power to control charges if deemed necessary:

2.4.1 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*[3] *shall not exceed the maximum price calculated*"

4.2 A price control is the mechanism that the UR uses to determine the costs which make up the maximum average price per therm that a price regulated gas supply company can charge.

4.3 In granting consent we review the maximum average price to ensure that it is constructed in line with the provisions within the price control.

4.4 This price control sets out the treatment of each cost element which makes up the maximum average price. These are:

- Network Costs;
- Wholesale Gas Costs;
- Supply Operating Costs; and
- Margin

K Factor

4.5 In addition to the costs outlined above the maximum average price will also include a k factor adjustment.

4.6 Within the consultation we proposed that some costs should be treated as retrospective costs. Some of the retrospective costs will be pass through costs, meaning that the company is allowed to recover the actual levels of costs incurred; whereas other retrospective costs will be subject to a retrospective adjustment to calculate the level of allowed cost based on pre-determined factors.

4.7 The costs which we proposed in this price control to treat as retrospective costs are listed in the table below along with our proposal for determination basis of each cost.

[3] Regulated Premises means premises supplied by the Licensee in the Ten Towns Area at which the normal annual consumption of gas is reasonably expected not to exceed 73,200 kilowatt hours.

Retrospective cost line	Determination Basis
Network costs	Pass through cost
Wholesale gas costs	Pass through cost
Prepayment transaction costs (within Billing costs)	Retrospective adjustment
Bad debt (within Billing costs)	Retrospective adjustment
Meter reading costs (within Billing costs)	Retrospective adjustment
Customer information (processing & postage (within Billing costs)	Retrospective adjustment
Safety inspections and meter exchanges (within Operations Costs)	Retrospective adjustment

4.8 Within the tariff we will include a forecast for these retrospective costs based on historical performance and latest best estimates. Each year a reconciliation is carried out to calculate the actual allowed costs based on pass through cost, or the retrospective adjustment as appropriate.

4.9 The k factor is the difference—whether positive or negative—between all of the pass through and retrospectively adjusted actual costs incurred, and what was forecast for them. This difference will then be taken off or added to the next tariff revenue requirement respectively at the next tariff change.

4.10 It is our intention to maintain the k factor at a minimum level through the use of regular tariff reviews and a trigger mechanism to monitor the tariff closely and thus minimise the impact of the k factor on the tariff.

4.11 At each tariff change the UR will publish the k factor to allow for transparency.

Tariff Review

4.12 A tariff review is the process of analysis and discussion of the tariff to consider if a change to the tariff is needed, and to decide the magnitude and timing of any change.

4.13 We review the gas tariffs on a bi-annual basis. In addition we will be able to initiate a tariff review under the trigger mechanism as discussed below. We consider that regular reviews minimise the impact of k factor on the tariff and can help mitigate tariff volatility for consumers.

4.14 We have established a process in consultation with the FES, the Consumer Council NI (CCNI), and the Department for the Economy (DfE) which sets out the timescales and information required in setting the tariff.

4.15 The tariff review process is a consultative one where all parties bring their expertise and opinion in relation to the needs of the gas supplier, the needs of the consumer, and the wider impact on the economy. Therefore, it is important that all parties are aware of and in agreement with the formal process.

4.16 This process provides a robust procedure, which is in line with the requirements of the licence to ensure that all parties are consulted in a timely, prescribed, and comprehensive manner for both anticipated and unanticipated tariff reviews.

Trigger Mechanism

4.17 In addition to the bi-annual tariff reviews we establish a trigger mechanism within the price control. The aim of this trigger mechanism is to initiate a tariff review should the cost of wholesale gas purchased by the gas supplier vary significantly from the cost forecast within the tariff.

4.18 The trigger mechanism will operate to allow the UR to initiate a tariff review should the tariff costs change between review periods, either increase or decrease, so as to change the tariff by 5%.

4.19 We consider the 5% level to be an appropriate level, any level under this and volatility in the wholesale market could necessitate a number of tariff reviews in a year. Tariff reviews can be costly and complex for the company.

4.20 Where a review is initiated by the trigger mechanism, the tariff review group will look at a number of factors including:

- Volatility in the wholesale gas market
- Time since last tariff review
- Level of k factor
- Amount of gas purchased by the supplier

4.21 The UR also retains the flexibility to initiate a review at any stage it considers is in the interest of customers.

Tariff Structure

4.22 The domestic credit tariff for FES is made up of two charges; a higher charge for the first 2,000 kWh used per annum and a second charge for any usage above 2,000 kWh per annum[4].

4.23 Pay as You Go (PAYG) customers pay a flat tariff for each unit used[5].

4.24 Industrial and commercial customers using less than 73,200 kWh (2,500 therms) are charged a two tiered tariff; with different charges for usage up to 2,000 kWh per annum, and between 2,001 kWh and 73,200 kWh per annum.

4.25 At each tariff review we will require the supplier to demonstrate the assumptions used to create the tariff structure in order to ensure that the average weighted price charged to customers is equal to or less than the maximum average tariff.

Response to Consultation

4.26 FES made no comment on the structure of the regulated tariff in its response to the consultation.

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4.27 It is the decision of the UR that the regulated tariff will remain structured as it was in SPC17; as is laid out in the consultation.

4 FES domestic tariff https://www.firmusenergy.co.uk/home/tariffs-offers/all-tariffs
5 FES PAYG tariff https://www.firmusenergy.co.uk/home/tariffs-offers/all-tariffs

5. Network Costs

5.1 Network costs are the charges incurred by FES for their use of the NI gas transmission and distribution systems. These charges are reviewed and approved by the UR.

5.2 The costs for the transmission system are those costs involved in bringing gas from Scotland to NI, via the Scotland to NI Pipeline (SNIP), and all the transmission pipelines within NI. These costs are published on the Gas Market Operator for NI (GMO NI) website[6].

5.3 The costs for the distribution system are those costs associated with moving gas throughout the distribution networks area to homes and businesses. These can be found on the firmus website[7].

5.4 Distribution costs are also subject to price control by the UR. The current price control, GD17, runs from the period of January 2017 for to 31 December 2022.

5.5 Within the previous controls for FES, the network costs have been treated as pass through costs. This means that the customer pays for the actual cost of the network charges that FES incur, and no more than that.

5.6 In the consultation we therefore proposed that network costs remain as pass through costs as these are costs which are outside the control of the supplier.

Response to Consultation

5.7 FES made no comment on the structure of the regulated tariff in its response to the consultation.

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5.8 It is the decision of the UR that network costs will remain pass through costs for SPC20.

[6] GMO NI charges: http://gmo-ni.com/tariffs/explanatory-notes

[7] FES conveyance charge statement: https://www.firmusenergy.co.uk/publications/category/conveyance-charges/specific/conveyance-charge-statement-2019

6. Supply Operating Costs

6.1 Supply operating costs are those costs which relate to the day to day operating of the FES supply business; and include among other things salaries, IT costs, metering costs, rent and rates, consultancy/legal fees and bad debt.

6.2 In November 2018 the UR provided FES with an initial information request for the operating costs wholly incurred by the supply business in the provision of gas to customers within the Ten Towns. This included the total operating costs for serving both price controlled and non-price controlled customers using more than 73,200 kWh per annum.

6.3 The submission requested historical actual costs, Latest Best Estimates (LBE) of current costs (2018), and a forecast of costs for 2019 and the three years of the price control period 2020-2022. We stated that we would welcome any evidence to support the figures given in the submission. Additionally, the information request was clear that the burden of proof rests with FES to justify the cost base set out in the submission.

6.4 In January 2019 the supplier presented its initial submission to the UR. Over the next four months we engaged with FES to understand this submission through meetings and various additional information requests. We have analysed the forecast cost figures against historical costs and previous determinations and benchmarked information against other companies where appropriate. We have also engaged consultants to review specific elements of the submissions (e.g. IT required spend).

6.5 In May 2019 we published the consultation paper which set out our proposals for the price control. FES and other stakeholders submitted responses to the consultation in July 2019

6.6 In the following section we set out our final decisions for the supply operating costs for FES' Ten Towns supply business. These decisions are shown against the requested costs of the companies and the draft determination.

6.7 In reaching our final determination we have considered the responses made by FES and other stakeholders to the consultation, requested additional information and engaged further with FES in order to arrive at our final position.

6.8 The costs shown throughout this paper are the total FES Ten Towns Supply business costs only (i.e. not including the FES Greater Belfast supply business costs). The apportionment allocation of costs determines the appropriate level of costs to the tariff sector (i.e. the price regulated sector of FES). This ensures there is no cross-subsidisation between the tariff and non-tariff businesses. In order to calculate the apportionment, each cost line is apportioned on the basis of the most appropriate cost driver and these apportionments summed to provide the overall percentage. A list of the apportionment cost drivers can be found in Annex 1.

6.9 We consider that the allowances set is an efficient allowance and as a result determine that an efficiency factor of 0% is appropriate for the duration of the control.

6.10 In setting out how we have reached the allowances we will refer to the submissions and detailed cost lines and discuss in more detail those areas where our proposals vary significantly from the FES' submissions or consultation.

6.11 Table 1 below shows the total (price regulated and non-price regulated) costs for the FES Ten Towns supply business. We present here the costs summarised into three main cost categories; **Manpower**, **Operations**, and **Billing**. It is not our intention to provide a line-by-line budget for the supplier to spend, but rather to provide an efficient overall allowance, derived from a reasonable assessment of the various cost requirements, for it to spend running the price regulated supply business.

Table 1 SPC20 Final Decisions (£000)

Tariff Costs	FES Submission			UR Consultation			UR Decision		
	2020	2021	2022	2020	2021	2022	2020	2021	2022
Manpower Costs	892	914	936	882	903	925	887	909	931
Operations Costs	572	569	574	463	441	427	639	657	683
Billing Costs	1,103	1,221	1,345	895	990	1,088	895	990	1,088
Total Costs	**2,567**	**2,704**	**2,855**	**2,240**	**2,334**	**2,440**	**2,422**	**2,556**	**2,702**

6.12 The following section discusses each of these three main cost headings above in greater detail to explain the basis for the finals decisions.

Manpower Costs

Table 2 Manpower Costs (£000)

Tariff Costs	FES Submission			UR Consultation			UR Decision		
	2020	**2021**	**2022**	**2020**	**2021**	**2022**	**2020**	**2021**	**2022**
Salaries	828	848	868	828	848	868	828	848	868
Entertainment	3	3	3	3	3	3	3	3	3
Training	11	11	11	11	11	11	11	11	11
Travel and subsistence	21	21	22	21	21	22	21	21	22
Recruitment Costs Contract staff	30	31	31	19	20	20	25	26	26
Total	**892**	**914**	**936**	**882**	**903**	**925**	**887**	**909**	**931**

Salaries

6.13 Salaries make up the vast majority (93%) of the manpower cost submission along with some other smaller items of manpower cost. The submission for manpower costs for FES' Ten Towns gas supply company reflects an increase of 0.5 Full Time Equivalents (FTE) for each year until the end of the 2022. FES has stated that this FTE increase is a direct result of the additional c.20k tariff customers forecast over the next 4 years (overall a 50% increase in current customer numbers). The extra 0.5 FTEs per year was said to be needed to cover the additional billing resource and customer service staff necessary to facilitate this customer growth.

6.14 The additional FTEs requested for customer service and billing appear commensurate with the expected level of customer growth and therefore we proposed allowing the increase in costs that FES has requested.

Response to Consultation

6.15 FES accepted this allowance in its response to the consultation.

6.16 CCNI stated that its main concern was ensuring FES's FTE allowance per customer was benchmarked against SSE Airtricity and other relevant companies.

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6.17 It is the decision of the UR that the allowance will remain at the levels outlined in the consultation, as detailed in Table 2.

6.18 In response to CCNI's concern, the UR can provide assurance that we used all relevant benchmarks available, including SSE Airtricity, when setting the allowance for FES' manpower in SPC20.

Recruitment Costs Contract staff

6.19 In its initial submission, FES has acknowledged it is now operating at its anticipated manpower levels. It also had to recruit for numerous key roles in SPC17, which caused an increase in costs in that period. Therefore in the consultation we proposed to forecast the 2019 recruitment costs based on what was achieved in 2017.

Response to Consultation

6.20 FES argued that 2017 was an unsuitable year for determining the SPC20 forecast, specifically due to the number of unfilled positions in that year which resulted in a lower recruitment cost. The supplier provided evidence of unfilled positions as well as employee churn figures which are expected to continue through SPC20.

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6.21 The costs for 2018 still represent a significant increase on typical spend. Therefore, the annual recruitment costs for SPC20 will be determined using an average of 2016-18.

Other Manpower Costs

6.22 Entertainment - We proposed to accept FES' submission as it is in line with HMRC recommendations and SPC17.

6.23 Training - We proposed to allow this cost which is in line with historical spend, and commensurate with training norms.

6.24 Travel and subsistence (including Fleet Costs) - The UR reduced FES' travel allowance for SPC17 which the supplier then exceeded throughout the control. Therefore, as the SPC20 submission is at the same level as was spent previously we assume it necessary and we proposed to accept.

Response to Consultation

6.25 FES made no comment on these allowances in its response to the consultation.

Final Determination

6.26 It is the decision of the UR to allow the costs for entertainment, training and travel as laid out in the consultation.

Operation Costs

Table 3 Operation Costs (£000)

Tariff Costs	FES Submission			UR Consultation			UR Decision		
	2020	2021	2022	2020	2021	2022	2020	2021	2022
Office Costs	52	53	54	48	50	51	48	50	51
Rates	5	5	5	4	4	4	4	4	4
Professional and Legal Fees	78	87	103	54	54	61	54	54	61
Insurance	37	38	40	32	33	34	32	33	34
IT OPEX	166	131	96	166	131	96	204	208	213
IT CAPEX	46	46	46	46	46	46	181	181	181
Licence Fee	2	2	2	2	2	2	2	2	2
Network Maintenance	78	87	97	78	87	97	78	87	97
Call Centre	29	32	36	24	25	26	24	25	26
Advertising and Sales	61	68	76	8	9	10	8	9	10
Supplier of Last Resort	20	20	20	0	0	0	4	4	4
Total	**572**	**569**	**574**	**463**	**441**	**427**	**639**	**657**	**683**

IT OPEX and CAPEX

6.27 As part of FES' submission for the last price control (SPC17), the supplier requested an increase in IT allowance to provide a new billing system and the replacement of the internal system software. FES stated that the existing billing system used an obsolete language and that the software was not fit for purpose and was in need of replacement. Furthermore, the supplier stated that its present system was not flexible enough and too expensive for their future needs. The new billing platform would result in enhanced accuracy in regulatory and internal reporting. It would also improve productivity via improved billing operations, meter reading, and customer service.

6.28 Given the technical nature of these requests we engaged Gemserv to perform an assessment of, and provide an opinion on, the IT requirements of the supplier. Gemserv stated that the information received indicated that a new billing system was required and recommended that we allow the costs and the associated operational costs.

6.29 The upgrade to its existing billing system was planned for implementation in 2018; however, FES states it had to prioritise GDPR preparations. As a result the upgrade project did not take place within SPC17 and the allowance went unspent.

6.30 For its initial SPC20 submission in January 2019, FES informed the UR that it was scoping a separate new billing system upgrade project, which is now due to happen in SPC20. At the time of submission, FES was in the process of undertaking a full procurement for the new project. FES stated that accurate capital and operational costs would not become available until the tender process got underway and tender bids were submitted. However, placeholder values for OPEX were provided.

Response to Consultation

6.31 In July 2019, FES informed the UR that its procurement was complete and a provider had been selected. In its consultation response FES included the CAPEX cost provided by the chosen provider.

6.32 Consequently, FES requested that the UR considers the approved allowances for its IT CAPEX and OPEX requirements.

6.33 CCNI stated that it was concerned over the delayed implementation of the new billing system, and how its eventual implementation will make its operations and billing processes more efficient and cost effective.

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6.34 Gemserv has performed an assessment of the new IT CAPEX and OPEX, and found them to be reasonable and offering customer’s value for money when compared with many other utility companies.

6.35 In response to CCNI, we understand concerns over the delayed implementation. However, Gemserv’s advice to the UR was based primarily on the cost effectiveness of the project as well as the expected improvements to FES’ overall business and processes.

6.36 Therefore, having reviewed the additional information provided as well as Gemserv’s assessment, we accept the outcome of the FES procurement exercise and our decision is to allow the costs for the billing system upgrade.

6.37 We consider the SPC17 IT CAPEX allowance outlined above as an unspent allowance, and the newly scoped and tendered SPC20 cost to be a separate project. Therefore for the SPC20 CAPEX, FES will only be allowed the net of the CAPEX amount agreed for SPC20 and the unspent SPC17 CAPEX allowance. The allowance shown in Table 3 above reflects this net amount.

Professional and Legal Fees

6.38 In both its SPC17 and SPC20 submissions, FES has forecasted costs for Professional and Legal fees to be driven by the forecast increase in customer numbers. After review, we stated this methodology does not accurately reflect how Professional and Legal spend will change. In reality, this spend decreased YoY from 2016 to 2018 despite rising customer numbers. Therefore, for the three years of SPC20 we proposed that an average of 2017 and 2018 be used to set a fixed allowance, with an additional £7k allowed in 2022 for consultancy spend for the next price control process.

6.39 Beyond the typical forecast spend for professional and legal fees, FES also included an amount of £20k annually to deal with unforeseen GDPR issues. The supplier stated that it envisaged legal, IT and specialist consultancy fees relating to GDPR issues and Subject Access Requests. However, the supplier was unable to suitably justify or quantify this spend on GDPR (beyond what has already been spent in preparation for GDPR implementation) and we herefore excluded it from our consultation proposal.

Response to Consultation

6.40 FES stated the £20k per annum will cover ad hoc additional IT, legal, and training fees; and the supplier outlined some further aspects of its business which will be impacted by GDPR.

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6.41 Whilst FES has identified certain aspects of GDPR which may have a cost impact on the business, the supplier has still not sufficiently quantified these additional costs. Also many of the costs FES has identified are associated potential data breaches, and we consider it inappropriate for consumers to bear the cost for the potential future misuse of their data.

6.42 We expect that any costs associated with GDPR should be managed within the existing or new allowances for IT, training and legal costs, etc. which are provided. Therefore, we will not provide any additional allowance for GDPR. This decision is consistent with the UR treatment of other regulated companies in the NI energy market.

Advertising, Website and Sales

6.43 FES included a fixed amount in its submission of £50k for each year from 2020-2022 in anticipation of entry into the Ten Towns market by other domestic gas suppliers. The supplier stated that if this entry were to occur FES would have to adopt a new competitive operational strategy.

6.44 In the consultation, we stated that the customers of a regulated company—which is also the commissioning supplier and in a dominant position in the market and a monopoly position in the domestic sector—should not bear the costs of advertising.

6.45 Therefore, we proposed that FES be provided no additional advertising and marketing allowance. This would be consistent with the treatment of both Power NI and SSE Airtricity, neither of which were provided a marketing allowance under their respective price controls when their regulated businesses first faced competition in the early years after new entry by competitors. FES is still the monopoly domestic supplier and faces no competition in the Ten Towns market, and we cannot envisage that there will be sufficient erosion of market share during the 3 year horizon of this new control to move them from a dominant position in the domestic sector. However, we committed to keep this under review as the market develops and observe whether FES' domestic market share deteriorates should significant competition emerge.

Response to Consultation

6.46 FES stated that it remains of the view that advertising and marketing costs are necessary even for a regulated business; however, the supplier welcomed the UR's commitment to keep this under review as the market develops.

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6.47 It is the decision of the UR to maintain the allowance for Advertising, Website and Sales that was outlined in the consultation.

Call Centre

6.48 FES' initial submission had forecasts of call centre costs driven by customer numbers. However, UR analysis indicated that the costs do not rise proportionally with customer numbers. Therefore we proposed basing the SPC20 forecasts on the actual historical correlation between customer number increases and cost increases.

Response to Consultation

6.49 FES agreed with the UR's comment that costs wouldn't necessarily increase at the same rate as customer numbers. However, the supplier stated that it did not believe it was appropriate to use a single year on year movement (2017 to 2018) as a 'historical trend'. Subsequently, the supplier provided a new proposal that is based on a historic (2 year) call centre 'cost per customer' basis.

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6.50 The new methodology FES proposed actually produced higher costs than its original submission. As the costs in the original submission were deemed to be rising excessively we do not accept this new methodology. In the consultation, the UR chose the difference in costs between 2017 and 2018 as this appeared to reflect a typical increase. Had we included the movement between costs in 2016 and 2017 then FES would receive a smaller allowance than proposed by the UR in the consultation, as costs actually fell between 2016 and 2017 despite rising customers. Therefore, it is the decision of the UR to maintain the allowance outlined in the consultation.

Supplier of Last Resort

6.51 FES submitted costs of £20k for each year of the price control to cover Supplier of Last Resort (SoLR) costs. We proposed to exclude this as SoLR costs are captured as part of the SoLR process.

FES Consultation Response

6.52 FES stated that due to a recent focus from the UR at industry forums to ensure suppliers are "SoLR-Ready", it was requesting an allowance for £3,800 per annum. This would cover the costs of system development, annual testing, training, consultancy costs.

UR Final Determination

6.53 We agree that nominated suppliers should be SoLR ready and that systems and processes should be implemented and tested. Therefore, we have approved this allowance; however, we will request annual reports on the outcomes of the SoLR testing.

Other Operations Costs

6.54 Office Costs (including stationery, telephone and postage) - The submitted 2019 forecast is based on the average of 2016-18. For consistency throughout SPC20 regarding items that can vary YoY, we proposed forecasting based on the average of 2017 and 2018 where appropriate, as these relate to the most recent observable costs and, in the absence of any reliable trend pattern, give a reasonable forecast of what the future yearly costs might be.

6.55 Rates - FES submitted costs for Rates which increase with FTEs. We believed this as an inappropriate driver for rates as they will not be impacted by additional FTEs, but rather the size of Land and Property Services (LPS) increases. We therefore proposed that Rates forecasts are set at the 2018 level, as per SPC17 (i.e. the cost observed in the most recent LBE).

6.56 Insurance - We proposed that the driver of the forecasts be changed from customer numbers to FTEs, which is a more appropriate driver for insurance and consistent with SPC17. FES also requested £10k for cyber security insurance (to be split 50/50 between supply businesses). We assessed the need for this as well as several quotes FES has received and determined it a reasonable cost. Therefore we proposed to accept the request.

6.57 Licence Fee – We proposed to allow the costs for licence fees.

6.58 Network Maintenance (including safety inspections) - We proposed to accept the FES submission as the unit rates for maintenance items and safety inspections are set by the network company and the volumes are retrospectively adjusted.

FES Consultation Response

6.59 For Office costs, FES support the UR's methodology and agreed that FTEs are the most appropriate driver for calculating future allowances in years 2020 to 2022.

6.60 FES made no comment on the other Operations allowances in its response to the consultation.

6.61 CCNI asked for justification around the 50/50 split for the new cyber security insurance between supply and distribution (as was incorrectly stated in the text of the consultation).

UR Final Determination

6.62 To clarify CCNI's point, this cost is actually being split 50/50 between the supply businesses of FES; Greater Belfast and Ten Towns.

6.63 It is the decision of the UR to maintain the allowance for Office Costs, Rates, Insurance, Licence Fee and Network Maintenance as outlined in the consultation.

Billing Costs

Table 4 Billing Costs (£000)

Tariff Costs	FES Submission			UR Consultation			UR Decision		
	2020	2021	2022	2020	2021	2022	2020	2021	2022
Bad debt	88	92	97	88	92	97	88	92	97
Paypoint costs incl PAYG cards	545	605	668	545	605	668	545	605	668
Credit Check Costs	7	8	9	4	5	5	4	5	5
Bank and Interest Charges	9	10	10	5	5	5	5	5	5
Meter reading	187	208	231	187	208	231	187	208	231
Customer Billing and Postage	266	297	329	66	73	81	66	73	81
Total	**1,103**	**1,221**	**1,345**	**895**	**990**	**1,088**	**895**	**990**	**1,088**

Bad Debt

6.64 Bad debt costs are calculated in the current price control as 0.25% of total credit revenue (i.e. the total of regulated business and unregulated business credit revenue). SPC17 approved the amount of 0.25% and FES historic performance supports this percentage.

6.65 However, FES stated that subsequent internal analysis showed that larger unregulated I&C customers are less likely to default on payments, and that regulated customers (EUC1) are more likely to do so. So whereas the overall businesses bad debt amount is approximately 0.25%, FES stated that its analysis indicated that the bad debt of regulated customers is closer to 1% whilst bad debt of the unregulated business is approximately 0.15%.

6.66 Therefore the supplier’s submission detailed an overall 0.25% debt provision, as per SPC17, but FES then proposed a weighting of 1% allowance on tariff revenue with the remainder (approximately 0.15%) applied to non-tariff revenue.

6.67 From analysis of the supplier’s financial accounts and responses to numerous UR Information Requests, we determined that FES’ calculation of 1% bad debt for the regulated business was not reflective of actual performance. We estimate an actual bad debt level for regulated customers of 0.45% of credit revenue. This figure is comparable with the level of bad debt for SSE Airtricity's regulated gas business in Greater Belfast.

6.68 In our consultation, we proposed to accept the overall 0.25% debt provision for the total business (regulated and unregulated combined), as per SPC17, but apply a weighting of 0.45% allowance on tariff revenue with the remainder applied to non-tariff revenue.

Response to Consultation

6.69 FES made no comment on Bad Debt in its response to the consultation.

6.70 CCNI asked that the UR ensure that FES' Bad Debt be cost reflective and based off historical data.

UR Final Determination

6.71 In response to CCNI's comment, we can provide assurance that rigorous analysis has been performed on FES' actual levels of historical bad debt, and the level we have determined is cost reflective and benchmarks well against other energy suppliers.

6.72 It is the decision of the UR to maintain the allowance for Bad Debt as laid out in the consultation.

Bill Processing and Postage

6.73 Bill processing is a cost that is subject to retrospective adjustment relating to actual bills, invoices, PAYG statements and other literature sent out to tariff customers (such as direct debit confirmations, tariff changes, debt reminders, property handover letters). The rates are set by the UR for the control period and the costs adjusted for the volumes of letters sent.

6.74 In its initial submission FES detailed the expected mailing requirements for 2019 (i.e. number of tariff changes; number of bills sent; etc). FES then based its forecasts on increasing this cost with customer growth.

6.75 Whilst this cost is retrospectively adjusted, we stated in the consultation that any up front allowance should as closely as possible reflect what the actual spend will be. In 2017 and 2018 combined, FES only spent c.30% of its allowance. Therefore, the assumptions being made for mailing requirements were demonstrably too high and we believe required adjustment.

6.76 Therefore, rather than making assumptions on anticipated mailing activity, we proposed the allowance be set based on the 2018 actual spend and that forecasts be then driven by customer numbers. FES would not lose financially from this arrangement as the cost is retrospectively adjusted, but the amount going into the tariff should be closer to the actual spend and hence k factor volatility will be reduced.

Response to Consultation

6.77 FES requested confirmation that the rates submitted are approved. The supplier also asked that any Royal Mail increases or decreases in postage costs would also be applied to our annual amendments.

Final Determination

6.78 It is the decision of the UR to maintain the allowance for Bill Processing and Postage at the level outlined in the consultation. We accept the rates as submitted by FES and that Royal Mail increases or decreases in postage costs would also be applied to its annual amendments.

Credit Check Costs

6.79 The submitted 2019 forecast is based on the average of 2016-18. For consistency throughout SPC20 on items that can vary YoY, we proposed forecasting based on the average of 2017 and 2018, as these are the most recent observable costs and, in the absence of any reliable trend pattern, give a reasonable forecast of what the future yearly costs might be.

Response to Consultation

6.80 FES proposed an alternative methodology using a cost per customer basis.

Final Determination

6.81 For consistency, an average of 2017 and 2018 was used to forecast the majority of cost lines in SPC20. We see no reason to deviate from this methodology for these cost lines, and the monetary difference between the different methodologies is minimal. Therefore, we have determined to maintain the allowance outlined in the consultation document.

Bank and Interest Charges

6.82 The submitted 2019 forecast is based on the average of 2016-18. For consistency throughout SPC20 on items that can vary YoY, we propose forecasting based on the average of 2017and 2018 as these are the most recent observable costs and, in the absence of any reliable trend pattern, give a reasonable forecast of what the future yearly costs might be.

Response to Consultation

6.83 FES proposed an alternative methodology using a cost per customer basis.

Final Determination

6.84 For consistency, an average of 2017 and 2018 was used to forecast the majority of cost lines in SPC20. We see no reason to deviate from this methodology for these cost lines, and the monetary difference between the different methodologies is minimal. Therefore, we have determined to maintain the allowance outlined in the consultation document.

Other Billing Costs

6.85 Paypoint Costs (including PAYG cards) - We proposed to accept the FES submission as the rates are agreed and numbers are retrospectively adjusted.

6.86 Meter reading - We proposed to accept the FES submission as the rates are set and numbers are retrospectively adjusted.

Response to Consultation

6.87 FES made no comment on these costs in its response to the consultation.

UR Final Determination

6.88 It is the decision of the UR to maintain the allowance for Paypoint and Meter Reading outlined in the consultation.

7. Gas Costs

7.1 Gas Costs relate to the cost of wholesale gas as well as the costs for transporting gas through Great Britain (GB) to the SNIP. These transportation costs are published by National Grid[8]. Previous controls have determined that these costs are pass through which means that FES is allowed to recover the actual cost of gas. Therefore, where wholesale gas costs increase or decrease, the difference in costs is passed on to customers.

7.2 In the Information Paper, we proposed to allow wholesale gas costs and the related transportation costs as pass through costs. Wholesale gas costs will be allowed as pass through at the level purchased at the National Balancing Point (NBP).

Energy Balancing

7.3 In reviewing the gas costs we consider it appropriate to set an additional allowance for energy balancing. The energy balancing amount is a figure included within the tariffs to account for the cost of buying gas within the month as opposed to on the forward curve. The actual wholesale cost of the gas remains pass through, this figure is to ensure the tariff reflects the impact of the timing of purchasing the gas. FES will hedge the majority of their purchases before the month but some gas will remain to be purchased within the month to match the actual consumption profile.

7.4 We will set the energy balancing figure in the tariff as follows:

Where FES has 40% or less of their gas requirements for the month remaining to be secured, there will be a 10% premium applied to the remaining gas to be purchased.

Where FES has more than 40% of their gas requirements for the month remaining to be secured, there will be a 10% premium on 40% of the total purchases for the month.

7.5 This is in line with the energy balancing figures currently within the FES tariff.

Credit Support

7.6 FES submitted details of credit arrangements in place to cover transmission, distribution, and gas costs and other relevant costs. Currently credit cover costs are allowed at an agreed pence per KWh.

7.7 The submission for the supplier's credit costs are reasonable when

[8] http://www2.nationalgrid.com/uk/Industry-information/System-charges/Gas-transmission/Current-charges/

benchmarked to other suppliers in the energy supply industry. We therefore propose to allow these costs.

Response to Consultation

7.8 FES made no comment on gas costs in its response to the consultation.

Final Determination

7.9 We determine that gas costs will remain as pass through costs.

8. Margin

8.1 During SPC17, we conducted a complete review of margin in line with the methodology used for the previous Power NI supply price control using a notional supply business capital base and the cost of capital to calculate an appropriate margin.

8.2 The SPC17 Final Determination approved a margin of 2% of allowable turnover. This was determined to strike an appropriate balance between the calculations of the CMA, UR external consultants and both FES and SSE Airtricity and their advisors, whilst at the same time taking account of other benchmarks in the energy industry.

8.3 We do not believe that market conditions have changed sufficiently to warrant any amendment to this level of margin. FES retains a dominant position in supply to price regulated customers (and is the monopoly supplier to domestic customers) in the Ten Towns area and has associated market power. This is one of the principal reasons for the continuance of the price control, and FES still has more market share and fewer competitors than Power NI had when the 2.2% was set for that supplier.

8.4 Given all the above and after due consideration, we are satisfied that the calibration of the margin still reflects the appropriate benchmarks. We informed FES that the UR has no specific intentions to modify this or put in place an alternative level of allowed margin. FES responded with a paper stating that it was "broadly supportive of the UR's initial proposition not to put in place an alternative level of allowed margin".

Response to Consultation

8.5 FES made no further comment on margin in its response to the consultation.

UR Final Determination

8.6 The UR therefore has decided that, consistent with SPC17 and the consultation proposal, the margin will remain at 2% of allowable turnover.

9. Reconciliation

9.1 This section sets out how the price control will be reconciled to actual allowed costs on an annual basis.

Reconciliation

9.2 On an annual basis we will reconcile the forecast costs that are allowed in the price control with the actual allowed costs (i.e. the retrospectively adjusted allowed costs) to determine a reconciliation amount. This amount will then form part of the k factor.

9.3 The reconciliation will take into account:

- Billing costs which are retrospectively adjusted
- Ring-fenced allowances (if any)
- Inflation
- Rate of interest applicable
- Possible other items (to be confirmed)

9.4 In addition to the information required to complete this reconciliation, we will also require from FES annual cost reporting to show their actual costs on a line-by-line basis reconciled with regulatory accounts.

Inflation

9.5 All costs presented in this paper are in October 2018 prices. These costs will be adjusted to account for inflation where appropriate. Inflation will be treated as a pass through. The costs used to make up the tariff at each tariff period will be adjusted to reflect the current price base. For reconciliation purposes the inflation figure will be the average figure for the year being reconciled. The inflation index used will be Retail Price Index (RPI).

Rate of Interest

9.6 We propose that any reconciled amounts, whether under or over recovered, will be rolled forward at an interest rate of LIBOR plus 1.5%. The proposed rate of interest reflects the cost to the suppliers of financing the under recovery or the benefits to them of holding any over recovery.

Response to Consultation

9.7 FES made no comment on reconciliation in its response to the consultation.

Final Determination

9.8 It is the decision of the UR that reconciliation will remain structured as it was in SPC17; as is laid out in the consultation.

Annex 1

Apportionment Cost Drivers

Cost	Driver
Manpower	FTEs
Entertainment	FTEs
Training	FTEs
Travel and subsistence including Fleet Costs	FTEs
Recruitment Costs Contract staff	FTEs
Office Costs including stationery, telephone and postage	FTEs
Rates	FTEs
Professional and Legal Fees	Load in therms
Insurance	FTEs
IT OPEX	Customer bills
IT CAPEX	Customer bills
Licence Fee	Load in therms
Network Maintenance including safety inspections	firmus care customers[9]
Call Centre	Customer number
Advertising, Website and Sales Development	Customer number
Supplier of Last Resort	Customer number
Bad debt	Credit Revenue[9]
Paypoint costs incl PAYG cards	PAYG customers[9]
Credit Check Costs	Customer number
Bank and Interest Charges	Load in therms
Meter reading	Customer numbers[9]
Customer Information Bill Processing and Postage	Customer numbers[9]

[9] This is how this cost line is apportioned for this decision paper. This cost is then retrospectively adjusted to actual numbers.