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

October 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

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 scrutinises Power NI submissions in relation to price changes, 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 efficient costs of purchasing and supplying the electricity plus an agreed profit margin set by the UR.

Audience

Consumers and consumer groups; industry; and statutory bodies.

Consumer impact

The direct consumer impact of this review will be a change to the regulated electricity tariff. This change will affect domestic customers only. Those domestic users who are currently customers of Power NI will see a change to their tariff rates from 1st October 2019. The tariff will increase by 6.1%.

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

Summary

1.1 In July 2019 the Utility Regulator, in consultation with Power NI, DfE and the Consumer Council began a review of the Power NI maximum average charge for domestic customers. The current maximum average price has been effective from 1 October 2018. This review has been triggered (as part of ongoing monthly monitoring) due to a number of reasons (which will be discussed in greater detail later in the paper):

- Increase in network charges;
- Changing wholesale costs, and an increase in imperfections charges which make up part of the wholesale costs suppliers must pay;
- Existence of an under recovery for Power NI due to energy prices out-turning higher than forecast at the last tariff change in October 2018, especially in the 2018/19 winter period.

Therefore, a review was initiated to establish the new maximum average charge to become effective from 1 October 2019.

1.2 The new price for tariff customers on the Standard Home Energy tariff will increase to 17.85 pence per kWh (ex VAT) or 18.74 pence per kWh (inc VAT) from 1 October 2019. This represents an increase of 6.1%. 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 future actual costs and revenues. The tariff would then need to be adjusted upwards or downwards to align costs and revenues.

Background

1.3 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. There are now five suppliers in the domestic market. However, whilst facing competition from other suppliers, Power NI is still dominant in this sector of the market.

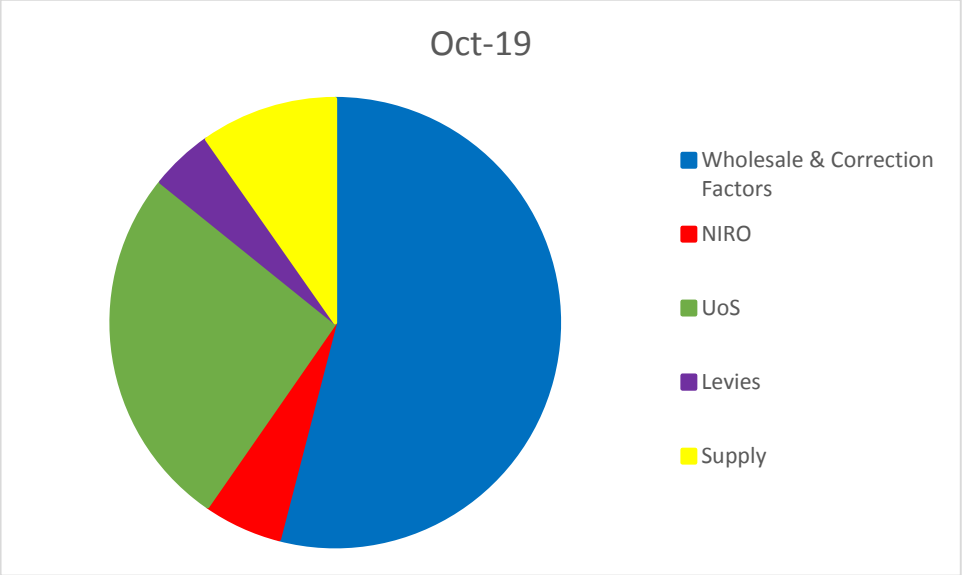
1.4 Under the terms of Power NI's licence to supply electricity, the Utility Regulator ("the Authority" or "UR") has the power to control the maximum amount that Power NI can charge for Electricity to domestic customers.

2. Elements of the Maximum Average Charge

2.1 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 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).

2.2 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



These elements are further discussed in the sections below.

Levies and Use of System Charges

2.3 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 subject to regulatory review and approval:

- Levies - SSS charges (System Support Service)/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.

2.4 These costs are regulated because they are levied to recover the costs of those 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.

2.5 For the purpose of setting a 1 October 2019 tariff, the published Levy and UoS rates have been used where available and, where they haven't yet been published, forecast estimates for these network components have been used to derive the Power NI revenue requirement for them over the next 24 months. Generally speaking, an increase for RPI has been assumed for these elements in the absence of using actual published tariff rates from October 2019 onwards. In addition to this, if other information is available e.g. from consultation papers this will also be used to inform a best estimate of the rates if they have yet to be finalised. It is important to note that Power NI's tariffs will be adjusted in future depending on the actual cost out-turns that materialise, the forecasts used at this time are simply for initial tariff setting purposes.

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

Wholesale Energy Cost and Over/Under recovery

2.7 The all island Integrated Single Electricity Market (I-SEM) is both a competitive and regulated wholesale energy market on the island of Ireland. It is an all island market encompassing the generation plants of both Northern Ireland and Ireland (RoI). Whilst in the previous SEM market there was one "pool" and timeframe which all suppliers would have purchase from on a half hourly basis, as well as the potential to enter into a hedge with generators to help limit exposure to price fluctuations, the new market has different markets and different timeframes which the supplier can purchase energy from. These include:

- Day Ahead Market;
- Intra Day Market;
- Balancing Market (difference between the suppliers demand and what they have already purchased); and

- Forwards Market (same principle as a hedge in the previous SEM).

2.8 Hedges effectively mean that the supplier is purchasing power on a forward basis at a fixed price based on forecast market prices plus a premium. The approval of the Power NI hedging methodology is given by the UR, as well as the approval of the forecast of the total of Power NI wholesale costs for their estimated demand for the tariff period. Due to the fact that 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. Over recoveries that occur in any given tariff period are handed back to customers in the subsequent tariff period and under recoveries are added to the total cost forecast of the subsequent tariff period.

Supplier charge

2.9 The supplier charge is made up of the efficient costs of Power NI's own supply business and are approved by the UR. These costs are assessed and implemented through the application of the Power NI Supply Price Control 2019 – 2021 and any other costs approved on a pass through basis (after thorough regulatory scrutiny). This latest Supply Price Control was an extension of the 2014-17 control due to the delay in 'go-live' of I-SEM to take account of the uncertainty with subsequent costs. The allowance set in the price control is for Power NI own operating costs e.g. salaries, IT systems, rent and rates, legal fees, bad debt costs, keypad meter transaction costs and a 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

2.10 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 increasing?

2.11 The maximum average charge for domestic customers will increase by 6.1% from 1 October 2019. Table 1 below shows the movement in the regulated tariff from April 2015 to date.

Table 1 - Historic tariff (exc VAT)

Effective from date	1 April 2015	1 April 2016	1 October 2017	1 October 2018	1 October 2019
Approved Tariff (pence per kWh)	15.6	13.99	14.78	16.82	17.85
% Change	-9.2%	-10.3%	+5.6%	+13.8%	+6.1%

Wholesale Energy Cost and Power NI Over/Under recovery element

2.12 Since the last tariff was set the actual outturn of wholesale costs during the period from October 2018 has been higher (than those forecast for October 2018 onwards) and this has led to an under recovery for Power NI (estimated up until October 1 2019).

2.13 Reasons for the higher prices include demand out turning differently to that which was forecast as well as an energy cost 'spike' caused by a sharp rise in gas prices, less wind on the system than usual for the time of year and two power plants having unplanned outages. These events occurred around the same time and caused an energy cost spike during the winter 18/19 period.

2.14 This under recovery will now need to be collected in the new tariff. This is a contributing factor to the increase in the tariff.

2.15 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.

2.16 Looking at the forward fuel prices they are down slightly when compared with last year. However there is an increase in the price of carbon. This is in line

with EU policy to decrease emissions by 2020 by 40%. In this context the price of carbon has increased from circa 10 euro to circa 24 euro per tonne and this feeds into the costs incurred by generators pushing up the price of energy. For this current tariff review, this increase in carbon price goes some way to negating the benefit of lower forward fuel prices in respect of the energy cost component of tariffs.

2.17 Imperfections also forms part of the overall wholesale cost Power NI will incur. This element has increased substantially. There are a number of reasons for this

- Substantial under recovery of imperfections revenue last year i.e. the charge for imperfections in 18/19 wasn't high enough and therefore has to be collected this year. In addition to this, the base amount for the coming year has to be recalibrated i.e. now in line with what it should have been last year;
- There is an increase of the amount of wind generation on the system meaning that less efficient generators are not used but still require a payment to be made to them for their availability; and
- Overall demand is down which leads to the amount of money being collected for imperfections being spread across less units thereby increasing the unit rate;

Use of System Costs

2.18 The Distribution Use of System (DUoS) costs have increased substantially this year. Again, there are a number of contributing factors to this:

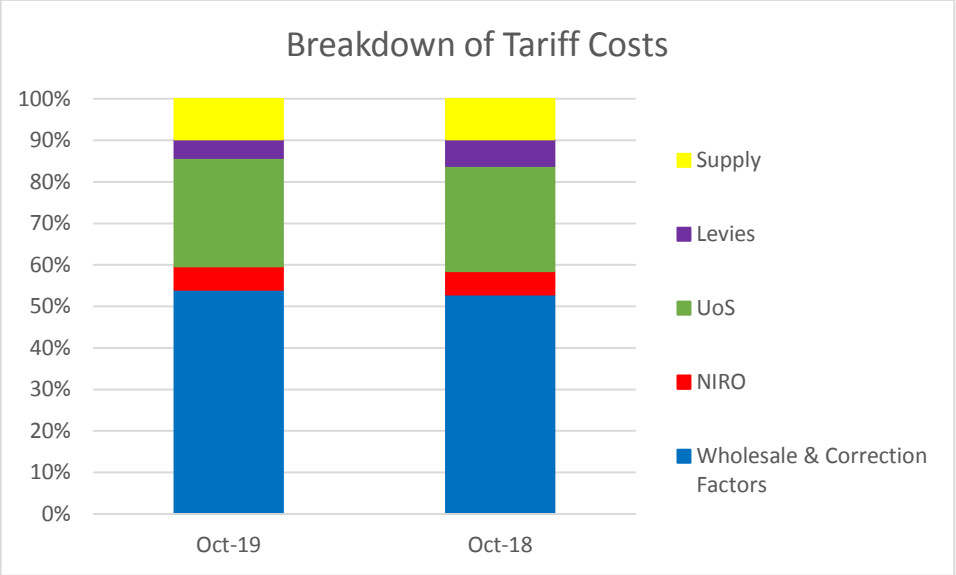
- Substantial under recovery last year of DUoS revenue i.e. the charge for DUoS in 18/19 wasn't high enough and therefore has to be collected this year;
- RPI increase in the NIEN allowance for DUoS charges; and
- Fall in overall demand for energy from domestic and small businesses due to increase of PV panels and other energy efficiency measures. This decrease in demand results in the NIEN fixed costs being spread across less units, increasing the DUoS unit rate which forms part of the overall Power NI unit rate.

Breakdown of Tariff

2.19 The graph shown in Figure 2 below compares the breakdown of the October 2019 tariff with the breakdown of the previous tariff set at October 2018.

This demonstrates that the wholesale element and the UoS make up a slightly increased proportion of the tariff costs when compared with last year.

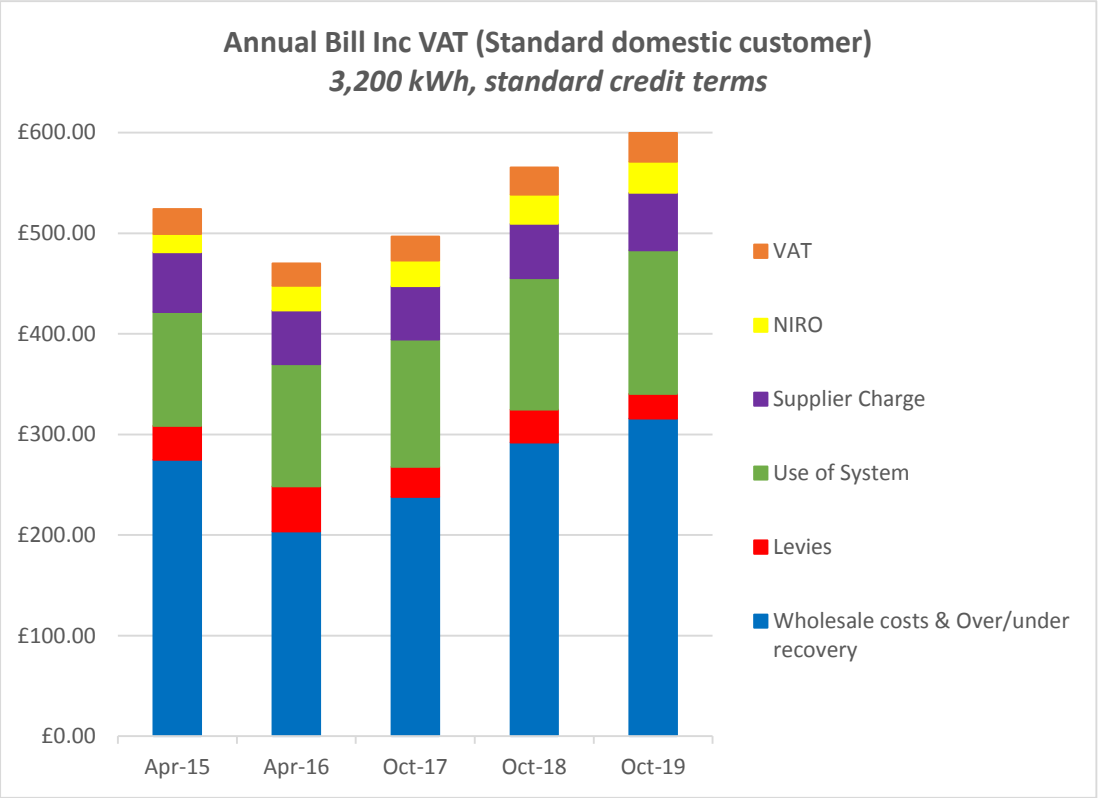
Figure 2 – Breakdown of October 2018 tariff costs compared with a breakdown of the previous tariff costs



2.20 Figure 3 below shows the breakdown in the average annual domestic bill for Power NI consumers for the last five years and illustrates the variation caused by various components of the tariff. Generally, it can be seen that the variations in the tariffs are largely driven by variations in the wholesale cost component of Power NI costs. It also demonstrates that the UoS element is more this year when compared to last year.

2.21 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 as has been used in previous years. Figure 3 shows that the annual bill based on a usage of 3,200 based on a credit customer (non direct debit) on the standard tariff will be £600 inclusive of VAT. This compares with a previous equivalent annual bill (based on the tariff set at October 2018) of £565. On this basis, customers will pay on average £35 more per annum.

Figure 3 - Graph to show breakdown of average annual bill

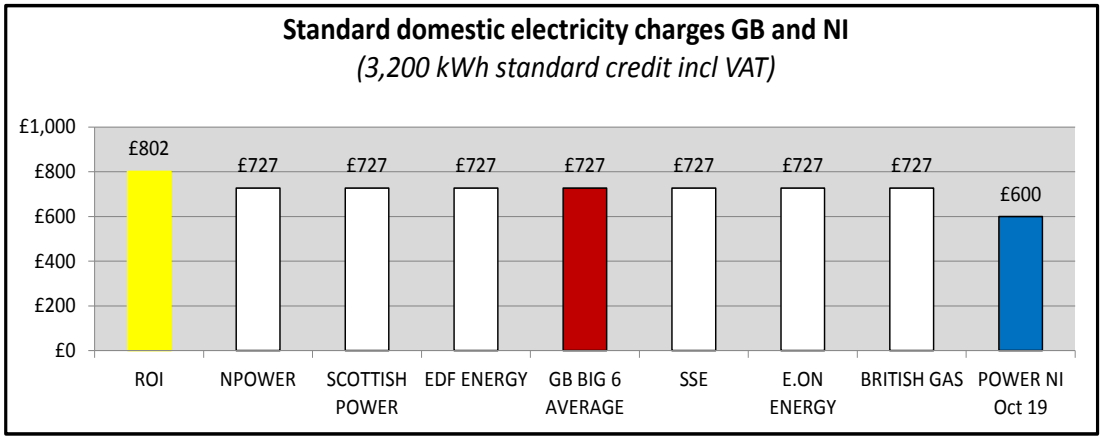


Comparison with GB and RoI

2.22 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.

2.23 Figure 4 illustrates that the Power NI tariff for an average domestic credit customer will be circa 18% cheaper than the GB average standard tariff, and will be circa 25% cheaper than ROI average standard tariff (NB if VAT was removed from the bill comparison between ROI and NI the difference would be NI is circa 20% cheaper – ROI has a higher VAT rate of 13% than NI which is 5%) 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 has been used in previous years for tariff comparison

Outcome

2.24 The Utility Regulator has reviewed the Maximum Average Price submission provided by Power NI and reviewed the Power NI forecasts against its own market analysis. The Utility Regulator is satisfied that this increase is appropriate and therefore agrees the new standard domestic tariff of 17.85 (excluding VAT) pence per kWh from 1 October 2019 (18.74 pence per kWh including VAT). This represents an increase of 6.1% from the previous tariff which became effective on 1 October 2018 of 16.82 (excluding VAT) pence per kWh (17.66 pence per kWh including VAT).