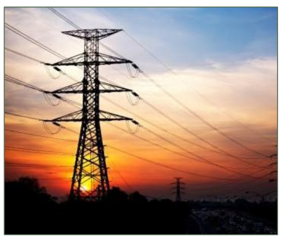
Modifications to Payment Security Policy between NIE and Energy Suppliers

Utility Regulator Decision
28 Aug 2014


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

The level of payment security credit cover under NIE’s Payment Security Policy was set by the Utility Regulator in 2006, to strike a balance between the costs to customers of bad debts and the cost to suppliers for the provision of security cover.

The UR consulted on NIE’s proposal to increase the payment security cover. The consultation highlighted the potential customer impact of NIE’s proposals and sought stakeholder views on these proposals. This decision paper details the UR’s final decision in respect the proposal by NIE to increase the payment security cover.

Audience

Electricity customers, consumer groups, electricity suppliers, electricity industry participants, statutory bodies and other stakeholders.

Consumer impact

The decision paper is designed to promote transparency and provide customers and suppliers with clarity on the decision reached by the UR on the proposals put forward by NIE.

Contents

1. Payment Security Policy Background

1.1. Electricity suppliers (Supplier(s)) use the NIE T&D network to supply their customers' properties. Suppliers pay NIE T&D for their services via Distribution Use of System charges and a Public Service Obligation (PSO) charge.

1.2. NIE T&D's licence obliges them to have in place a Payment Security Plan (PSP). The PSP requires Suppliers to have 'security cover' in place for payments that would be due to NIE T&D. In a situation where a Supplier is unable to pay its bills, for example if they go out of business, the security cover can be called upon. NIE T&D is able to 'claim' from the security cover that the Supplier has put in place and recoup monies owed. In this way security cover acts like an insurance policy eliminating or reducing the amount NIE T&D have to recover directly from customers if a Supplier defaults on its payments.

1.3. On the 29th August 2013 NIE T&D wrote to us with a proposal to increase the payment security cover Suppliers are required to provide.

1.4. The level of payment security cover has not been reviewed since it was set in 2006 and there have since been two significant changes to the circumstances in Northern Ireland:

- The potential level of bad debt has increased with the introduction of quarterly DUoS, rather than monthly, billing cycles for all domestic and small commercial customers; and
- The potential risk of customer and ultimately Supplier default on payments has increased with the economic downturn in Northern Ireland.

1.5. Under condition 24[1] of their distribution licence, NIE T&D are required to develop a Payment Security Policy, which describes its security cover and debt recovery procedures.

1.6. Condition 24 also requires that NIE T&D shall submit a payment security policy and any amendments thereto, to us for approval. Further, NIE T&D may amend the policy, in which case, any proposed changes are also subject to our approval.

1.7. The payment security policy is applied by NIE T&D when it collects revenue under:

- Distribution Use of System (DUoS) tariff; and
- Public Service Obligation (PSO) tariff.

[1] **Error! Reference source not found.**- http://www.uregni.gov.uk/publications/nie_distribution_licence_effective_28_march_2014

1.8. The level of security cover required under NIE T&D's current Payment Security Policy is 5 weeks[2] DUoS and PSO charges in the year.

1.9. NIE issued a public consultation on the 30 October 2013 requesting feedback on the following four options for Payment Security:

- **Option 1 –** Maintain the status quo;
- **Option 2** – Payment security cover based on estimated DUoS and PSO charges accrued by Suppliers;
- **Option 3** - Payment Security Cover in line with levels required in Republic of Ireland; and
- **Option 4** - Payment Security Cover Equal to 2 average months DUoS and PSO charges.

1.10. NIE believes that it is necessary to increase the payment security cover provided by Suppliers for their network charges in order to protect customers from increased costs associated with exposure to bad debt.

1.11. NIE in its recommendation report to the Regulator in January 2014 selected Option 3 - Payment Security Cover in Line with Levels Required in Republic of Ireland.

1.12. This option is based on 2 winter months cover as NIE have indicated that potential customer exposure to bad debt is more significant in the winter months and therefore it is reasonable to base the payment security cover on charges in the winter months.

1.13. We have reviewed the NIE T&D recommendation and noted the potential impact of the proposed changes could have on customers' bills. We were also concerned that there was no representation received from consumer representative groups and limited response from Suppliers.

1.14. In light of our concerns and being keen to ensure arrangements take account of best practice we decided to issue our own public consultation[3]. We sought to gain feedback from consumer representatives and other stakeholders on the options put forward by NIE T&D to increase payment security cover within the Payment Security Policy.

[2] Based on an average 5 weeks.

[3] http://www.uregni.gov.uk/news/view/ur_consults_on_nie_payment_security_policy_arrangements_with_suppliers/

2. Consultation responses

2.1. The UR public consultation posed six questions:-

i. What is the realistic security cover shortfall that should be considered when reviewing the current Payment Security Cover policy?

ii. What is the likelihood of a Supplier/Suppliers defaulting and NIE being unable to recover the debt within 6 months or earlier?

iii. Do Suppliers consider that the 1% charge is a 'typical rate' for them to provide additional cover?

iv. Will an increase in Supplier cover be seen as a barrier to entry to new Suppliers?

v. Which of NIE's options strikes the best balance between the risk and the cost to the consumer?

vi. Should any other options / risk cost recovery mechanisms be investigated?

2.2. We received 7 responses from the following companies and organisations:-

- Power NI
- SSE Airtricity
- Firmus Energy
- Vayu
- Energia
- Manufacturing NI
- Consumer Council NI

2.3. <u>Question (i): realistic security cover shortfall</u>

2.3.1. Power NI stated "The change to NIE's billing arrangements was as a result of the implementation of the Enduring Solution Project. The project facilitated the IT separation of NIE and Power NI and implemented the 'continuous billing' DUoS arrangement noted in the paper. It is important to recognise however that while the DUoS billing did change for most suppliers it did not change in relation to Power NI (as the legacy billing arrangement was 'continuous') nor did it change in relation to interval metered customers. Based upon the latest UR Quarterly Transparency Report therefore 72% of the DUoS market by consumption was unaffected by the implementation of the Enduring Solution." Energia and Vayu indicated that it would be highly unlikely that an event of this nature would occur. Firmus and Vayu also considered the methodology of how any shortfall should be calculated. SSE Airtricity offered no comment,

2.4. Question (ii): consideration of likelihood of default and unrecovery of debt

2.4.1. Power NI, Energia and Vayu all considered a default to be unlikely. SSE Airtricity and Firmus did not comment on likelihood of default. The suggestion that a business in this position is likely to be sold was made by Power NI, Energia and Vayu.

2.5. Question (iii): consideration of proposed charge

2.5.1. Power NI, Firmus Energy, Energia and Vayu all stated that the proposal was not sufficient. SSE Airtricity agreed that the proposed rate was a 'typical rate' for them to provide additional cover.

2.6. Question (iv): barrier to enter

2.6.1. Power NI, Firmus Energy, Energia and Vayu considered the increase in cover a barrier to entry, with SSE Airtricity expressing no view.

2.7. Question (v): respondents preferred option

2.7.1. SSE Airtricity would not support Option 3. Power NI, Firmus Energy, Energia and Vayu all supported Option 1.

2.8. Question (vi): alternative options

2.8.1. Power NI and Energia proposed extending the period of recovery. SSE Airtricity did not provide alternative proposals. Firmus Energy put forward an option involving pre-payment and Vayu suggested alternative billing and improved information.

3. Analysis

3.1. Evidence was not provided that the value of payment security shortfall is £50M; however, assuming the figure is accurate, the maximum shortfall in cover would only occur in the event that the three main Suppliers default on DUoS and PSO payments simultaneously; the risk of this happening is extremely low.

3.2. Furthermore, Power NI currently has a market share of approximately 71% (by volume of customers[4]), the company is price controlled and extremely unlikely to default on DUoS and PSO payments.

3.3. The remaining potential shortfall of cover is related to the remaining seven supply companies. Of the these companies, SSE Airtricity makes up approx 20.5% and Budget approx 6.5% of the market, the remaining five supply mainly

[4] http://www.uregni.gov.uk/publications/qtrs_2014

industrial customers (many on an interval metered basis) which means bills are produced monthly as opposed to quarterly.

3.4. The effect of this is that these non domestic revenues are collected monthly whilst DUoS/PSO charges are paid quarterly, which further reduces NIE’s exposure to the risk of bad debt.

3.5. The general consensus from the suppliers is that the ‘typical’ cost of credit is greater than 1% and is probably in the region of 1.5%. Any additional cover proposed may create financial difficulties for smaller companies should they be unable to source credit at an appropriate rate.

3.6. It should also be noted that any shortfall between payment security held by NIE and the amount owed by the supplier can be deemed bad debt and passed on to customers through network charges if NIE is unable to recover the debt within 6 months or earlier in the case of administration, receivership or liquidation of the supplier.

3.7. NIE therefore has the ability to increase DUoS charges to recover any losses incurred in the event that a supplier defaults on payments and has insufficient security in place. Recovery of debt using this method may take longer than 6 months depending on the amounts in question and the impact on consumers.

4. Response to Other Issues Raised

4.1. Manufacturing NI noted that they felt this was a hidden charge to domestic and business customers, and that customers should not be expected to carry the cost of a risk which they have no control.

4.2. The Consumer Council (NI) expressed a similar view to Manufacturing NI in that they did not feel customers should be expected to carry the cost of a risk which they have no control and that this was a hidden charge to domestic and business consumers.

4.3. UR Response - within any supply activity, it is good practice to have in place various credit cover arrangements which are designed to mitigate risk of exposure to bad debt, these must not be unduly discriminatory, or prevent the promotion of competition and should provide a secure and stable business environment.

4.4. The credit cover ensures that NIE has sufficient collateral to cover DUoS/PSO charges if Suppliers default on payments. This is a known charge to Suppliers who factor this into their own costs.

4.5. Manufacturing Northern Ireland also raised a number of issues in their response to the public consultation paper. In this section we provide answers to 2 of the questions.

4.6. Question 1: How much has been collected historically and what had been done with this money.

4.7. UR Response: The sums of money related to providing payment securities are in the form of banking charges payable by the Supply companies in order to implement Letters of Credit. This is similar to paying insurance premiums.

4.8. Question 2: What claims have been made against the money already collected for this fund/policy?

4.9. UR Response: To date, NIE have not drawn down on any payment securities issued to cover defaulted DUoS/PSO payments by Suppliers.

4.10. Several other questions were raised in these responses but these are beyond the scope of this decision paper.

5. Utility Regulator Decision

5.1. The level of payment security credit cover under NIE's Payment Security Policy was set by the Utility Regulator in 2006, to strike a balance between the costs to customers of bad debts and the cost to Suppliers for the provision of security cover.

5.2. As part of the Enduring Solution changes[5], all domestic and commercial customers were moved from monthly to quarterly billing cycles. While this benefited Suppliers in terms of increased credit, it also increased the potential level of bad debt to be recovered from customers in the event of a supplier defaulting on its DUoS and / or PSO payments or becoming insolvent.

5.3. After consideration of the responses and analysis it is the decision of the Utility Regulator that NIE's additional exposure to the risk of bad debt has not increased by a significant enough amount since the last review to warrant an increase in cover.

5.4. The Utility Regulator has determined that the balance between the costs to customers of bad debts (domestic and non domestic) and the cost to Suppliers for the provision of security cover is currently appropriate and, therefore, will not approve an increase in payment security cover at this time, as was requested by NIE under Condition 24 of their Distribution Licence.

5.5. Option 1 - Maintain the status quo, is the option that the Utility Regulator has decided upon at this time.

[5] Enduring Solution is the name given to a Power NI and NIE IT system upgrade. Among other things the upgrade allowed for all customers to switch their electricity supplier.

Annex 1 [6]

Condition 24. Payment Security Policy

1 The Licensee shall develop, and may from time to time amend, a payment security policy describing its security cover and debt recovery procedures in respect of each of the regulated distribution revenue and the PSO Charges (including details of what is to be considered reasonable recovery costs and reasonable interest for the purposes of calculating uncollected revenue).

2 The Licensee shall submit the payment security policy, and any amendments thereto, to the Authority for its approval. No policy or amendment shall be effective until approved by the Authority.

3 In this Condition: "**regulated distribution revenue**"	means the transmission and distribution revenue (as defined in Annex 2) but excluding any revenue to be collected from the Transmission System Operator.
"PSO Charges"	has the meaning given to that expression in Condition 24A.

[6] http://www.uregni.gov.uk/publications/nie_distribution_licence_effective_28_march_2014 (Page 71)