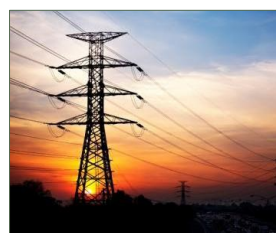


# Price Control for SSE Airtricity Gas Supply (NI) Ltd and firmus energy (Supply) Ltd

Final Determination  
29th November 2016



# 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, proportionate, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

## Abstract

This document sets out our final determination for price controls on SSE Airtricity Gas Supply (NI) Ltd (SSE Airtricity) in the Greater Belfast market and firmus energy (Supply) Ltd (firmus) in the Ten Towns gas supply market. The SSE Airtricity price control will come into effect on 1 April 2017. The firmus energy control will come into effect on 1 January 2017. This consultation also sets out our final decisions with regard to implementing a supply price control in the West area.

This consultation follows our Approach to Supply Price Controls consultation published in October 2015 and the Supply Price Control Draft Determination published in June 2016. This paper outlines the final decisions in relation to the main areas within the controls: 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 in terms of price by setting a maximum limit on the average price that the regulated gas suppliers can charge for gas in their relevant markets. It also acts as a benchmark against which domestic and business customers can compare the tariff offerings of other competing suppliers in all three gas network areas.

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## Glossary

<b>Name</b>	<b>Definition</b>
Capex	Capital Expenditure
CCNI	Consumer Council for Northern Ireland
CMA	Competition and Markets Authority
EED	Energy Efficiency Directive
EUC	End User Category
firmus	firmus energy (Supply)Ltd
firmus distribution	firmus energy (Distribution) Ltd
FTE	Full Time Employee
GB	Great Britain
HMRC	Her Majesty's Revenue & Customers
IT	Information Technology
I&C	Industrial and Commercial
LBE	Latest best estimates
LTNA	Long Term No Access properties
NI	Northern Ireland
PNGL	Phoenix Natural Gas Ltd
PSL	Phoenix Supply Limited
Power NI	Power NI Energy Ltd
Q	Quarter
REMM	Retail Energy Market Monitoring
SEM	Single Electricity Market
SGN	SGN Natural Gas Limited
SSE Airtricity	SSE Airtricity Gas Supply (NI) Ltd
TSO	Transmission System Operator
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*”.
- 1.2. To help meet this objective we retain price controls on dominant, former monopoly, gas suppliers. This paper sets out our final decisions for the price control for the two price-regulated gas supply companies.
  - SSE Airtricity Gas Supply (NI) Ltd (SSE Airtricity) in the Greater Belfast area
  - firmus energy (Supply) Ltd (firmus) in the Ten Towns area
- 1.3. This paper also sets out our final decisions for a supply price control in the West gas distribution area for SSE Airtricity as Commissioning Supplier in that new area.
- 1.4. The controls will apply from 1 April 2017 for SSE Airtricity and 1 January 2017 for firmus. The discrepancy in dates is due to different accounting periods for the two companies.
- 1.5. This document sets out the final decisions and principles that will form the basis for the price control and provides background information on the gas markets in Northern Ireland.
- 1.6. This final determination follows the Price Control for SSE Airtricity Gas Supply (NI) Ltd and firmus energy (Supply) Ltd Draft Determination published in June 2016<sup>1</sup> which set out our proposals for the price controls. We received four responses to this consultation which are published alongside this final determination and addressed where relevant within this consultation.
- 1.7. We consider that our approach has been consistent with the principles of better regulation<sup>2</sup> which the Utility Regulator continues to apply: transparent, consistent, proportionate, accountable and targeted only where needed.
- 1.8. All costs presented are in October 2015 prices. These prices will be adjusted within the tariff for inflation as discussed in section 11.2.

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1 Price Control for SSE Airtricity Gas Supply (NI) and firmus energy (Supply) Ltd Draft Determination: <https://www.uregni.gov.uk/consultations/consultation-draft-determination-sse-airtricity-and-firmus-energy-supply-price>

2 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](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 there are three distinct distribution areas for natural gas. These are the Greater Belfast area, the Ten Towns area and the West area. The Greater Belfast area is served by Phoenix Natural Gas Ltd (PNGL) and the price-regulated supplier is SSE Airtricity. The Ten Towns area is served by firmus energy (Distribution) Ltd (firmus distribution) and the price-regulated supplier is firmus. The West area is served by SGN Natural Gas Ltd (SGN). This is a new gas area where development is currently underway. As yet there are no connections to the SGN gas network. SSE Airtricity is the price regulated supplier in this area, this is discussed further in section 8.

### SSE Airtricity

2.2. The Greater Belfast market includes Belfast, Newtownabbey, Carrickfergus, Larne, Carryduff, Newtownards, North Down and East Down. There are approximately 189,000 connections to the network (comprising of around 178,000 domestic and 11,000 I&C connections) in this area.

2.3. Currently there are six active suppliers in the market. Only two of these companies supply to domestic customers; SSE Airtricity and firmus.

2.4. SSE Airtricity, as the incumbent dominant supplier (having purchased Phoenix Supply Limited), is subject to a price control. The current SSE Airtricity price control lasts for a period of five years from January 2012 to December 2016. This price control can be found on our website<sup>3</sup>.

2.5. During 2015 SSE Airtricity formally wrote to the UR to request a change in accounting period from January to December, to April to March. This change was approved and came into force on 1 April 2016.

2.6. The new control will therefore be effective from 1 April 2017.

2.7. Following consultation within the draft determination we determine that the existing SSE Airtricity control will be rolled over for a period of three months from 1 January 2017 to 31 March 2017... Section 4 sets out the allowances for this roll

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3 Utility Regulator Determination on Phoenix Supply Price Control 2012-2016, November 2011: <https://www.uregni.gov.uk/news-centre/utility-regulator-publishes-phoenix-supply-ltd-price-control-determination>

over.

## **firmus**

- 2.8. 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).
- 2.9. The Ten Towns Market is a relatively small market, there are currently approximately 29,000 gas connections (comprising of around 2,500 I&C connections and 26,500 domestic connections).
- 2.10. This market opened 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 firmus remains the sole supplier to domestic properties.
- 2.11. The current firmus price control runs from April 2015 to December 2016. This control can be found on our website<sup>4</sup>.
- 2.12. firmus 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 most recent control GD17 was published in September 2016<sup>5</sup>.
- 2.13. Where relevant, decisions are in line with UR treatment of costs within GD17.
- 2.14. We note that the GD17 final determination imposes upon firmus distribution projected connections and volume which differ from those included within the firmus submission. Within the final determination for consistency we have used the GD17 determined targets. Where relevant, the firmus submission has also been updated to reflect the new target.

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4 Final Determination on Price Control for firmus energy (Supply) Ltd 1 April 2015 – 31 December 2016, 15 December 2014: <https://www.uregni.gov.uk/publications/firmus-energy-supply-ltd-price-control-final-determination>

5 Price Control for Northern Ireland's Gas Distribution Networks GD17: <https://www.uregni.gov.uk/publications/gd17-final-determination-final>



## 3. Scope and Duration

### Scope

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

As part of the Electricity and Gas Retail Supply Price Controls 2017 (SPC 17) UR Approach Consultation published in October 2015<sup>6</sup> we stated that we would review whether it was appropriate for the scope to remain at this level.

### SSE Airtricity Scope

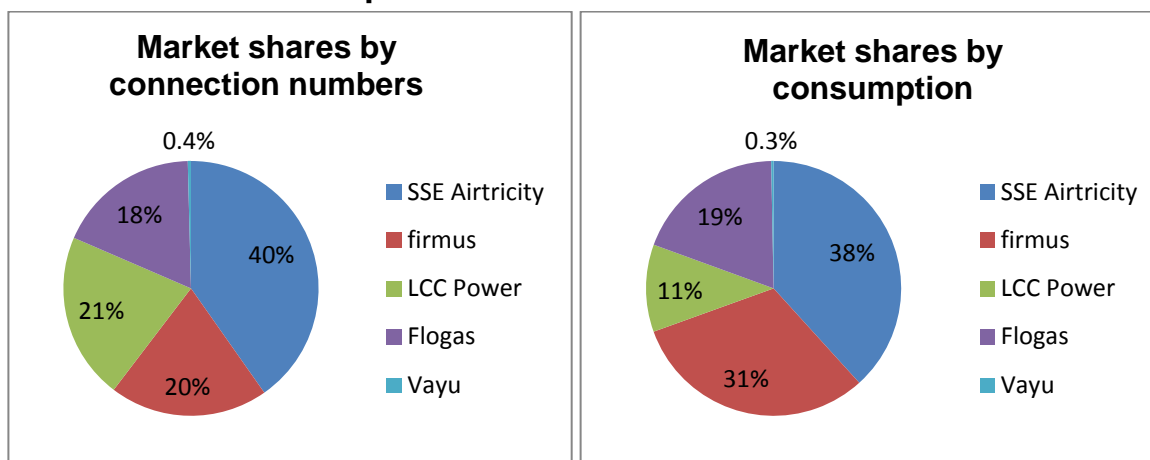
#### Draft Determination

- 3.3. Within the draft determination we proposed reducing the scope of the price control to exclude EUC 2 customers in within the Greater Belfast area, those customers using between 2,500 and 25,000 therms per annum (73,200 to 732,000 kWh per annum). This proposal was on the basis of the level of competition and customer engagement within the market, and based on the evidence that SSE Airtricity no longer held a dominant position in this market, as shown in Chart 1 below.

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<sup>6</sup> Electricity and Gas Retail Supply Price Controls 2017 (SPC 17) UR Approach Consultation: <https://www.uregni.gov.uk/consultations/consultation-approach-supply-price-controls-energy-companies-launched>

**Chart 1: Market share in Greater Belfast EUC2 category by connection numbers and consumption**



3.4. There are approximately 2,600 customers within this market. As this chart shows, SSE Airtricity holds around 40% of the market by connection numbers with three of the other suppliers holding around 20% each. By consumption SSE Airtricity hold 38% of the market, with firmus holding 31%.

### Response to Draft Determination

- 3.5. The Consumer Council in its reply agreed with removing EUC2 from the scope but also suggested that the market sector still requires support and education about the availability and benefits of competition.
- 3.6. Other respondents broadly welcomed the removal of the EUC2 customers from the scope for the SSE Airtricity price control.

### Final Determination

- 3.7. Following consultation we now determine that the scope of the price control for SSE Airtricity will be limited to those customers using less than 2,500 therms per annum (73,200 kWh per annum), known as the EUC 1 category.
- 3.8. This decision is consistent with the treatment of Power NI, as the UR removed the price control on that business in the 50-150MWh segment of the electricity market as it was no longer in a dominant position in that segment.

### firmus Scope

#### Draft Determination

- 3.9. Within the draft determination we evidenced that firmus remain dominant in the

EUC1 category, holding almost 100% of the overall market of both domestic and small I&C properties, nearly 28,000 connections in total.

- 3.10. Within the EUC2 category firmus are also dominant holding 78% of market share by connection numbers. Flogas is the only other competitor with significant market share. There are approximately 900 connections in this market.
- 3.11. Due to the dominance of firmus in both the EUC1 and EUC2 categories, and the fact that, with the exception of Flogas, other competitors do not hold appear to be very active in this market we proposed to retain the scope of the control at customers using up to 25,000 therms per annum. This includes both the EUC1 and EUC2 categories.

### **Response to Draft Determination**

- 3.12. The Consumer Council and Flogas both supported the proposal to retain the existing scope for the firmus supply price control.

### **Final Determination**

- 3.13. Following consultation, we determine that the scope for the firmus control will remain at those consumers using less than 25,000 therms per annum.

### **Duration**

#### **Draft Determination**

- 3.14. In the draft determination we proposed to apply the control for a period of three years for both price-regulated gas suppliers; from 1 April 2017 to 31 March 2020 for SSE Airtricity and from 1 January 2017 to 31 December 2019 for firmus.

#### **Response to Draft Determination**

- 3.15. Respondents to the draft determination consultation paper broadly supported the duration of this price control for three years.

#### **Final Determination**

- 3.16. Following consultation we determine that the control will last for three years from 1 April 2017 to 31 March 2020 for SSE Airtricity and from 1 January 2017 to 31 December 2019 for firmus.

## 4. Rollover of Existing SSE Airtricity Price Control

- 4.1. The existing SSE Airtricity price control ends on 31 December 2016.
- 4.2. During 2015 SSE Airtricity formally wrote to the UR and requested a change in financial year in order to align with the financial year of the SSE group.
- 4.3. In October 2015, following a consultation period we issued a decision paper<sup>7</sup> which stated that the SSE Airtricity financial year would change from a January to December financial year to an April to March financial year. This change came into effect on 1 April 2016.
- 4.4. As a result of this change the price control will now commence on 1 April 2017 and run until 31 March 2020.
- 4.5. In the draft determination we proposed to extend the existing control for a period of three months from 1 January 2017 to 31 March 2017, until the new control begins.

### **Response to Draft Determination**

- 4.6. Respondents to the control were in support of the rollover of the SSE Airtricity control.

### **Final Determination**

- 4.7. Following consultation it is our decision that the existing control<sup>8</sup> will apply in its entirety to the price-regulated business of SSE Airtricity as it applies in 2016.
- 4.8. The control will apply to all customers using less than 25,000 therms per annum (both EUC1 and EUC2 categories).
- 4.9. Network costs and relevant wholesale gas costs will continue to be treated as pass through costs. Operating costs will be allocated on a pro rated basis from 1 January 2017 to 31 March 2017. The table below shows the operating cost allowance for this period in October 2015 prices.
- 4.10. The ring fenced allowance for bad debt will be allowed at a pro rated amount, the conditions for the allowance as set out in the determination must be met.

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7 Decision paper on change in SSE financial year: <https://www.uregni.gov.uk/publications/decision-modificaiton-sse-airtricitys-gas-supply-licence>

8 PSL Final Determination [https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/2011-11-22\\_PSL\\_PC03\\_Determined\\_to\\_Position\\_Table\\_26\\_blanked\\_for\\_website2.pdf](https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/2011-11-22_PSL_PC03_Determined_to_Position_Table_26_blanked_for_website2.pdf)

*This allowance is ring fenced solely for debt management and prevention and PSL will have to evidence to the Utility Regulator how this money has been spent and the benefits achieved from it.*

4.11. The efficiency factor of 1% will apply on all operating costs up to 31 March 2017.

**Table 1: Operating costs allocation from 1 January to 31 March 2017**

	Allowance for 2016		Pro Rated Allowance 2017
	2010 prices (£000)	2015 prices (£000)	2015 prices (£000)
Manpower	1,534	1,780	445
Human Resources	27	31	8
Fleet Costs	56	64	16
Travel and Subsistence	15	18	4
Office Costs	218	253	63
Rates	44	51	13
Telephone & Postage	35	41	10
Stationery	38	45	11
Advertising, Marketing and PR	119	138	35
Licence Fee	65	75	19
Professional and Legal Fees	123	142	36
Insurance	57	66	16
IT	178	207	52
Capex	13	15	4
Network Maintenance	147	171	43
Billing	2,121	2,461	615
<b>Total</b>	<b>4,789</b>	<b>5,558</b>	<b>1,390</b>
Efficiency factor	1%	1%	1%
<b>Determination</b>	<b>4,742</b>	<b>5503</b>	<b>1376</b>

4.12. The following costs will be treated as retrospective costs as per the control. The allowance will be adjusted on a retrospective basis for the actual costs and cost drivers.

- Licence Fee
- Inflation
- Apportionment of cost

4.13. Billing costs will also be adjusted on a retrospective basis at the rates as agreed in the 2012-2016 final determination, section 6.14 based on the actual level of

activity

- Bad Debt at 1% of credit revenue (adjusted for actual credit revenue)
- Transaction costs (adjusted for actual number of transactions)
- Meter reading costs (adjusted for actual number of meter reads)
- Bill printing costs (adjusted for actual number of bills)

4.14. The rate of interest on any amounts to be returned to or collected from the customer will be rolled forward at an interest of LIBOR plus 1.5% as per section 11.3 of the 2012-2016 final determination.

4.15. The correction mechanism as set out in section 11.4 of the 2012-2016 final determination will apply to costs and volumes up to 31 March 2017.

## 5. The Regulated Tariff

- 5.1. In order to apply this price control the UR will issue licence modifications for the gas supply licences of both SSE Airtricity and firmus. The licence modifications are published alongside this document.
- 5.2. The licence modifications include a formula which will set out how the maximum average price will be calculated and through which the price control elements discussed or set out in this document will be brought into force.
- 5.3. These modifications will provide the companies with the opportunity to challenge the control at the time of the modifications to give effect to any new price control and bring the gas supply licence in line with other licences of price regulated market participants.
- 5.4. The licence modifications will also include a disapplication process equivalent to that contained within other licences to afford the price regulated gas supply companies the same rights as other price regulated companies.
- 5.5. These modifications will be published during November, on the same date as the publication of this document, for a 28 calendar day consultation period during which representations may be made by the companies or other interested parties.
- 5.6. Following this consultation period, and the time taken for the UR to consider any representations made, the final modifications will be issued with a 56 calendar day notice period after which, they will come into force on 1 April 2017.
- 5.7. Due to the time periods involved the licence modifications will not be made in time for the commencement of the control for firmus. In this case the existing licence condition, condition 2.4, will apply from 1 January 2017 until 31 March 2017. The licence modifications will then include pro rated amounts for the remainder of 2017 and the full allowances for 2018 and 2019. This document acts as our determination by which firmus energy must calculate its maximum average price for any period from January 2017 to December 2019 and as such includes the period 1 January 2017 until 31 March 2017 when the current licence condition 2.4 will apply. The table below shows the total  $S_t$  allowance for the period 1 January 2017 to 31 March 2017 and the  $S_t$  allowance for the rest of 2017 (that amount being included in the licence modification). Both are in 2015 prices. The cost of credit allowance for 1 January 2017 to 31 March 2017 will be consistent with the rest of the year at 0.0181 p/kWh. In like manner the margin allowance for the first 3 months of 2017 will be set as 2% of allowable turnover consistent with the calculation which will go into the licence modification.

	Period 1 1 January 2017 – 31 March 2017	Period 2 1 April 2017 – 31 December 2017
S <sub>t</sub> Allowance	£536K	£1608k

## K Factor

- 5.8. The price control formula as set out in the licence modifications includes a k factor calculation. The intent of the k factor is to ensure that the companies do not recover any more or any less than they are allowed to under the price control.
- 5.9. In addition we have determined, following consultation, that a number of costs will be treated as retrospective costs. This means that the companies are allowed to recover the actual levels of costs incurred, based on the relevant cost drivers.
- 5.10. These retrospective costs are listed in the table below along with the determined driver of each cost.

Retrospective cost line	Determination Basis
Network costs	Pass through cost (see section 6 of this final determination)
Wholesale gas costs	Pass through cost (see section 9 of this final determination)
Prepayment transaction costs (within Billing costs)	Retrospective adjustment (see section 7.4 of this final determination)
Bad debt (within Billing costs)	Retrospective adjustment (see section 7.4 of this final determination)
Meter reading costs (within Billing costs)	Retrospective adjustment (see section 7.4 of this final determination)
Customer information (processing & postage (within Billing costs)	Retrospective adjustment (see section 7.4 of this final determination)
Safety inspections and meter exchanges (within Network Maintenance cost line in Operations Costs)	Retrospective adjustment (see section 7.3 of this final determination)

- 5.11. Within the tariff we will include a forecast for these retrospective costs based on the latest estimates. Each year a reconciliation is carried out to calculate the actual allowed costs based on the pass through cost, or the retrospective adjustment as appropriate.
- 5.12. The k factor is the term for the difference between actual allowed costs and



forecasts for those costs. If the company over recovers revenue in any given tariff period that over recovery is passed back to customers at the next tariff change. Under recoveries are treated in the same way but vice versa.

- 5.13. It is our intention to maintain the k factor at a minimum level though the use of regular tariff reviews and a trigger mechanism to monitor the tariff closely and thus minimise the impact of k factor on the tariff.
- 5.14. At each tariff change the Utility Regulator will publish the k factor to allow for transparency.

## **Tariff Review**

- 5.15. 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.
- 5.16. We will review the gas tariffs on a bi annual basis; additionally 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 guard against tariff volatility for consumers.
- 5.17. We have established a process in consultation with the gas suppliers, CCNI and the Department for the Economy<sup>9</sup> which sets out the timescales and information required in setting the tariff.
- 5.18. 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. It is important, therefore, that all parties are aware of and in agreement with a formal process.
- 5.19. 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**

- 5.20. In addition to the bi annual tariff reviews we will 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.
- 5.21. The trigger mechanism will operate to allow the UR to initiate a tariff review should the wholesale cost of gas change, either increase or decrease, so as to change the tariff by 5%.

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<sup>9</sup> Previously the Department of Enterprise, Trade and Investment

- 5.22. 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.
- 5.23. Where a review is initiated by the trigger mechanism the tariff review group will look at not only the wholesale cost of gas but 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
- 5.24. The UR also retains the flexibility to initiate a review at any stage it considers is in the interest of customers.

## Tariff Structure

- 5.25. The domestic credit tariff for both price-regulated suppliers is made up of two charges, a higher charge for the first 2,000kWh used per annum and a second charge for any usage above 2,000kWh per annum<sup>10</sup>.
- 5.26. Pay as You Go customers pay a flat tariff for each unit used<sup>11</sup>.
- 5.27. Industrial and commercial customers using less than 73,200 kWh (2,500 therms) per annum are charged a tariff with the same structure as the domestic credit tariff.
- 5.28. Those I&C customers using between 73,200 and 732,000 kWh (2,500 and 25,000 therms) per annum are charged a three tiered tariff, with different charges for usage up to 2,000kWh per annum, between 2,001kWh and 73,200kWh per annum and above 73,200kWh per annum<sup>12</sup>. This will apply only to firmus customers.
- 5.29. 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.
- 5.30. For SSE Airtricity the maximum average price will be calculated based upon the tariffs applied to EUC 1 customers in Greater Belfast and those applied to EUC 1

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10 SSE domestic tariff [http://www.airtricitygasni.com/fs/doc/Domestic\\_Tariff.pdf](http://www.airtricitygasni.com/fs/doc/Domestic_Tariff.pdf)  
firmus domestic tariff <https://www.firmusenergy.co.uk/home/tariffs-offers/all-tariffs>

11 SSE PAYG tariff [http://www.airtricitygasni.com/fs/doc/PAYG\\_Tariff.pdf](http://www.airtricitygasni.com/fs/doc/PAYG_Tariff.pdf)  
firmus PAYG tariff <https://www.firmusenergy.co.uk/home/tariffs-offers/all-tariffs>

12  
firmus business tariff <https://www.firmusenergy.co.uk/home/tariffs-offers/all-tariffs>

customers within the West area.

### **Response to Draft Determination**

- 5.31. firmus stated in their response that they were supportive of the proposals set out in the draft determination. firmus sought the opportunity to work with the Utility Regulator to reduce the timeline for a review to 6 weeks in the eventuality of a review resultant from use of the trigger mechanism. We will continue to engage with suppliers on this issue.
- 5.32. The Consumer Council stated its strong support for proposals for regular tariff reviews and a trigger mechanism to closely monitor the tariff.
- 5.33. Flogas was also broadly supportive of tariff proposals.

### **Final Determination**

- 5.34. It is our decision that the tariff review and trigger mechanisms will operate in the method as set out above.

## 6. Network Costs

- 6.1. Network costs are the charges incurred by each supplier for their use of the Northern Ireland transmission and distribution systems. These charges are reviewed and approved by the Utility Regulator.
- 6.2. The costs for the transmission system are those costs involved in bringing gas from Scotland to Northern Ireland, via the Scotland to Northern Ireland Pipeline, and all the transmission pipelines within Northern Ireland. These costs are published on the Premier Transmission website<sup>13</sup>.
- 6.3. 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 distribution company websites<sup>14</sup>.
- 6.4. Distribution costs are also subject to price control by the Utility Regulator. The current price control, GD14, ends on 31 December 2016. The new control, GD17 will take effect from 1 January 2017. The final determination can be found on our website<sup>15</sup>.
- 6.5. Within the previous controls for SSE Airtricity and firmus, the network costs have been treated as pass through costs. This means that the companies are allowed to recover all the network costs as identified above associated with the supply of gas to regulated premises, meaning that the customer pays for the actual cost of the network charges.
- 6.6. Within the approach consultation we proposed that network costs remained as pass through costs as these are costs which are outside the control of the supplier. This proposed treatment was welcomed by respondents.
- 6.7. We therefore determine that network costs will be treated as pass through costs.

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13 PTL transmission charges: <http://www.premier-transmission.com/>

14 PNGL conveyance charge statement: <http://phoenixnaturalgas.com/help-and-advice/networks/charges/> firmus conveyance charge statement: <https://www.firmusenergy.co.uk/home/firmus-energy-network/publications/conveyance-charge-statement-2016>

15 GD17 final determination: <https://www.uregni.gov.uk/publications/gd17-final-determination-final>

# 7. Supply Operating Costs

## 7.1 Background

- 7.1.1 Supply operating costs are those costs which relate to the day to day operating of the supply business.
- 7.1.2 In October 2015 the UR provided both gas supply companies with an initial information request, requiring a detailed submission of the operating costs wholly and necessarily incurred by the regulated supply business in the provision of gas to customers within their respective network areas.
- 7.1.3 The information request required historical actual costs, latest best estimates of current costs and a forecast of costs for the next three years. We stated that we would welcome any evidence to support the submission. Additionally the information request was clear that the burden of proof rests with the companies to justify the costs set out in the submission.
- 7.1.4 The costs shown throughout this paper are the total SSE Airtricity Supply costs and the firmus Ten Towns Supply business costs (not including the firmus Belfast supply business costs). Section 7.5 details the cost apportionment which ensures no cross subsidisation between the price regulated and non-price regulated businesses of both SSE Airtricity and firmus.
- 7.1.5 In January 2016 the supply companies presented their initial submissions to the UR.
- 7.1.6 We engaged with the companies to understand these submissions through meetings and additional information requests, analysed the figures against historical costs and previous determinations, benchmarked information against other companies where appropriate and engaged consultants to review specific elements of the submissions.
- 7.1.7 In June 2016 we published the draft determination which set out our proposals for the price controls for SSE Airtricity and firmus. The companies and other stakeholders submitted responses to the draft determination by 9th August 2016.
- 7.1.8 In the following section we set out our final decisions for the supply operating costs for SSE Airtricity and firmus Ten Towns regulated supply business. These decisions are shown against the requested costs of the companies and the draft determination.
- 7.1.9 In reaching our final determination we have considered the response made by the regulated companies to the draft determination, requested additional information and engaged further with the companies in order to arrive at our final position.
- 7.1.10 In their submissions the companies presented their costs broken down into

detailed costs lines. 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 companies but rather to provide an efficient allowance for them to finance their regulatory activities. Our intention is that the companies will decide how to efficiently spend this allowance in conducting their regulated activities and meeting their gas supply licence requirements.

- 7.1.11 In setting out how we have reached our final decisions on allowances we will refer to the submissions and detailed cost lines and discuss those areas where our decisions vary from the draft determination.
- 7.1.12 We consider that the allowances set for both companies are efficient allowances and as a result determine that an efficiency factor of 0% is appropriate for the duration of the control.
- 7.1.13 firmus figures have been updated for the original submission and draft determination to reflect the volumes and customer numbers indicated in GD17 Final Determination.
- 7.1.14 The two tables below show the overall operating cost allowances for both SSE Airtricity and firmus.

**Table 2: Total Operating Cost Allowances for SSE Airtricity (£000)s**

	Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Total Manpower Costs	2,507	2,575	2,708	1,743	1,782	1,822	2,031	2,064	2,102
Total Operations Cost	2,130	1,677	1,676	1,212	1,303	1,360	1,325	1,364	1,391
Total Billing Costs	2,142	2,136	2,205	2,009	2,077	2,145	2,048	2,116	2,185
<b>Total</b>	<b>6,779</b>	<b>6,389</b>	<b>6,588</b>	<b>4,965</b>	<b>5,162</b>	<b>5,327</b>	<b>5,404</b>	<b>5,544</b>	<b>5,679</b>

**Table 3: Total Operating Cost Allowances for firmus (£000s)**

	firmus Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Total Manpower Costs	923	922	921	778	777	777	811	811	811
Total Operations Cost	877	590	552	543	493	508	543	502	517
Total Billing Costs	788	858	992	768	780	898	790	801	919
<b>Total</b>	<b>2,588</b>	<b>2,371</b>	<b>2,466</b>	<b>2,088</b>	<b>2,051</b>	<b>2,183</b>	<b>2,144</b>	<b>2,114</b>	<b>2,247</b>

7.1.15 Discussed below are the reasons and rationale for the UR decisions in the three separate areas of manpower, operations and billing.

## 7.2 Manpower Costs

**Table 4: Manpower costs for SSE Airtricity (£000s)**

	Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
<b>Manpower Costs</b>	1,870	1,930	2,052	1,258	1,293	1,329	1512	1546	1585
<b>Staff Engagement</b>	26	25	26	9	9	9	10	10	10
<b>Travel and Subsistence</b>	51	50	51	45	45	45	46	46	45
<b>Training</b>	44	46	47	39	39	39	40	39	39
<b>Recharges</b>	470	475	480	376	380	384	423	423	423
<b>Recruitment Costs</b>	47	49	53	16	16	16	0	0	0
<b>Total</b>	<b>2,507</b>	<b>2,575</b>	<b>2,708</b>	<b>1,743</b>	<b>1,782</b>	<b>1,822</b>	<b>2031</b>	<b>2064</b>	<b>2102</b>
<b>Total FTE</b>	<b>73.3</b>	<b>72.3</b>	<b>74.3</b>	<b>63.0</b>	<b>63.0</b>	<b>63.0</b>	<b>65.0</b>	<b>64.5</b>	<b>64.0</b>
<b>Cost per FTE</b>	<b>34</b>	<b>36</b>	<b>36</b>	<b>28</b>	<b>28</b>	<b>29</b>	<b>31</b>	<b>32</b>	<b>33</b>

### SSE Airtricity Headcount

#### Draft Determination

7.2.1. SSE Airtricity currently operate with 56 full time staff (FTE). In addition there are six temporary staff employed to carry out reconciliations on prepayment systems. These staff are funded under a mechanism in the current control know as the bad debt management allowance (part of billing costs) and therefore are not reported in the most recent actual manpower costs for 2015.

7.2.2. This level does not include the regulation team or corporate services manpower costs such as finance, HR, payroll etc which are recharged separately.

7.2.3. In its initial submission SSE Airtricity requested an increase of 17 staff members to 73 FTE from 2017 onwards.

7.2.4. This increase was made up of:

- 6 staff to reconcile prepayment system – transferred to manpower costs from billing costs
- 5 staff to support increased opening hours and Energy Efficiency Directive support
- 1 training/quality monitoring
- 2 complex complaint handlers
- 1 field operative
- 1 credit controller
- 0.5 SSE rewards administrator
- 0.5 central services return from career break

7.2.5 During our analysis for the draft determination we considered that SSE Airtricity currently has a high staff level in comparison with the other regulated companies.

7.2.6 In our draft determination we supported SSE Airtricity's request to increase the opening hours from 8.30am to 5pm to 8am to 8pm, however we considered the request for additional staffing level of five staff to be excessive. Therefore, we proposed that the increased manpower requirement for increased opening hours could be met with three additional staff alongside changes to shift patterns etc within the existing workforce. This increased staffing level will also provide EED and other support.

7.2.7 In the draft determination we considered the work undertaken by SSE Airtricity in relation to prepayment account reconciliation. We considered much of the work already undertaken to be legacy work which has reduced backlog and as such proposed allowing four staff for prepayment reconciliation.

7.2.8 Of the remaining staff, including the request for a field operative and a credit controller, we decided not to provide allowance as there was insufficient evidence on the requirement for the additional headcount.

### **Response to Draft Determination**

7.2.9 In their response to the draft determination, SSE Airtricity welcomed the additional seven headcount allowed, however, stated that the roles not provided for are essential to the efficient and effective operation of the business over the next price control period.

7.2.10 With regard to staffing the extended opening hours, SSE stated in



correspondence with the UR that they could accept three additional headcount for this if IT investments were made and if Gas to the West was resourced properly.

- 7.2.11 As part of their response to the draft determination, SSE Airtricity provided further information on the benefits of the roles of a Field Operative and a Credit Controller for Long Term No Access (LTNA), properties bad debt management, revenue protection and associated debt issues.
- 7.2.12 SSE Airtricity stated that LTNA properties may be masking a degree of meter tampering which would have revenue protection implications. The benefits of a field operative and credit controller would include prevention of build-up of debt, improved safety for all through early identification of tampered meters, more accurate bills for LTNA properties and more timely identification of faulty meters.
- 7.2.13 In response to the draft determination, the Consumer Council welcomed SSE's intention to extend opening hours and encouraged SSE and the UR to engage to reach a suitable outcome.

### **Final Determination**

- 7.2.14 Having reviewed SSE Airtricity's response on headcount we maintain our position on additional staff for prepayment reconciliation, opening hours and other ongoing requirements such as REMM and EED.
- 7.2.15 Following further engagement and additional information from SSE Airtricity, we have decided to allow SSE Airtricity the two additional headcount for the Field Operative and the Credit Controller. It is our understanding that these roles will assist in the management of revenue protection and bad debt and the allowance of additional staff here is reflected in our final decision on bad debt. The final decision for SSE Airtricity is to allow a manpower headcount of 65 staff in total:
- 56 current staff
  - 4 staff to reconcile prepayment accounts
  - 3 staff to support increased opening hours and Energy Efficiency Directive support
  - 1 field operative
  - 1 credit controller
- 7.2.16 We are allowing significant IT investment during the period of the price control, including system improvements and new systems to allow SSE Airtricity improved ways of working and communicating with customers. We consider that this investment will result in significant manpower efficiencies. This is discussed

further in Section 7.3 on IT costs. Having reviewed the IT projects in detail we consider it appropriate to apply an efficiency in both 2018 and 2019.

- 7.2.17 In 2018 the headcount will be reduced by 0.5 FTE to 64.5 and then to 64 FTEs in 2019.
- 7.2.18 The manpower costs also include a small allowance in year one of the control to complete a project on settling credit remaining in closed customer accounts.
- 7.2.19 We consider this to be sufficient headcount for SSE Airtricity to carry out the requirement of the licence.
- 7.2.20 With regard to CCNI comment we consider the process followed and the allowances provided for will facilitate the extended opening hours for SSE.

### **SSE Airtricity Salary**

#### **Draft Determination**

- 7.2.21 In their initial submission, SSE Airtricity showed a significant increase in average salary from £20k p.a. in 2015, the latest best estimate figures to £26k per annum in 2017, a forecasted figure. We considered that there was insufficient information to explain the increase in salaries and therefore we allowed an average salary of £20k per annum in the draft determination and provided for an increase in 5% per annum in grades 8 and 9 to reflect the increase to the national living wage whilst allowing all other grades to increase by inflation only.
- 7.2.22 SSE Airtricity stated in their initial submission that they utilise the Hays methodology to determine salaries at all grades, and aim to be a median employer in Northern Ireland, not paying either the highest or the lowest salary.
- 7.2.23 In addition SSE Airtricity introduced the living wage, which affects the lower salary grades and requested salary increases of 5% for lower grades and 1% for all other grades above inflation.
- 7.2.24 As stated in the draft determination, overall we support the review of salaries undertaken by SSE Airtricity. We agree with the Hays methodology for determining salaries and have benchmarked with other companies and find the salaries to be broadly in line with those companies.
- 7.2.25 We also support the introduction of the living wage and note the intention for the minimum wage to be increased to £9 per hour by 2020, thereby requiring an increase in salary levels for these grades.

#### **Response to Draft Determination**

- 7.2.26 In their response to the draft determination, SSE Airtricity expressed concern

with respect to the manpower allowance proposed by the UR claiming that the allowances proposed are insufficient to support existing staff costs.

- 7.2.27 In their response to the draft determination, SSE provided further information on the change in organisational structure which saw some roles move from recharged roles to direct cost.
- 7.2.28 Additionally, SSE Airtricity submitted their actual costs for 2015 which were not available at the time of initial submission in January.
- 7.2.29 SSE also stated that they do not agree with the “average salary” approach taken by the UR and support a bottom up approach to costs.

### **Final Determination**

- 7.2.30 Having reviewed the updated salary and recharge figures submitted by SSE Airtricity following the draft determination we have determined that the average salaries will be based on the 2015 actuals, adjusted to reflect the recharged headcount. Additionally we allow an uplift of 5% for grades 7 to 9 in 2018 and 2019 to account for the increase in living wage. Although the living wage only applies to grades 8 and 9, including grade 7 staff will allow SSE to manage the staff pay differential and staff salary expectations.
- 7.2.31 Salaries will increase at inflation over the period of the control.
- 7.2.32 There is no additional allowance for recruitment costs as these are included in the overall actual 2015 manpower costs provided by SSE Airtricity.
- 7.2.33 We continue to use the average salary approach as this is consistent with the other regulated company supply price controls. Furthermore it is consistent with our approach to price controls that the overall manpower allowance is a budget for SSE Airtricity to use as it deems to be most appropriate in running its regulated supply business, rather than a line by line budget.

### **SSE Airtricity Recharges**

#### **Draft Determination**

- 7.2.34 SSE Airtricity submitted costs of £0.5m for recharged salaries. These costs relate to services provided by the SSE business as a whole and include regulation, corporate affairs, human resources, finance etc.
- 7.2.35 In our draft determination we stated that SSE had not provided sufficient explanation of these costs, or demonstrated how they are allocated between the various SSE companies. Therefore we proposed to reduce the level of recharges by 20% pending a more detailed explanation.

## **Response to Draft Determination**

- 7.2.36 In response to the draft determination, SSE submitted further, confidential information on the breakdown of the manpower recharges.

## **Final Determination**

- 7.2.37 We do not consider that SSE Airtricity evidenced the requirement for the full amount of recharges requested.
- 7.2.38 We consider some of the apportionment in the recharges between the various businesses of SSE Airtricity to be inappropriate. Furthermore, we consider the annual increase applied to all line items to be inconsistent with our decision on salaries to maintain increases at inflation, therefore we have decided to reduce the level of manpower recharges by 10% and propose to keep this allowance flat across each of the three years of the price control.

## **Other Manpower Costs**

### **Draft Determination**

- 7.2.39 SSE Airtricity requested costs for staff engagement which they intend to spend on staff motivation and training and initiatives such as the Great Place to Work scheme.
- 7.2.40 While we support these endeavours in the draft determination we considered that these activities will provide efficiencies within the business through staff retention and morale. We therefore proposed to allow costs for staff engagement at the HMRC allowance of £150 per employee.
- 7.2.41 SSE Airtricity submitted travel and subsistence costs of approximately £710 per FTE per annum. We considered these costs to be high as they include the costs of travel and accommodation to and from SSE Airtricity head offices in Dublin. However we recognised that SSE Airtricity benefits in some cost areas due to being part of the larger SSE group and therefore proposed to allow these costs at £710 per person.
- 7.2.42 Training costs were requested at £612 per FTE per annum. For the draft determination we benchmarked these costs against other companies and considered this to be a reasonable level for training costs. Therefore, we proposed to allow these costs.

## Response to Draft Determination

7.2.43 SSE Airtricity made no comment on these allowances in their response to the draft determination.

## Final Determination

7.2.44 As no further comment or evidence was submitted by SSE Airtricity we have decided to implement the allowances as proposed in the draft determination for Travel and Subsistence, Staff Engagement and Training.

7.2.45 Therefore

- Staff Engagement costs are allowed at £150 per employee.
- Travel and subsistence costs are allowed at £710 per employee.
- Training and subsistence costs are allowed at £610 per employee

**Table 5: Manpower costs for firmus (£000s)**

	firmus Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Manpower Costs	822	821	821	739	739	738	771	771	771
Entertainment	23	23	23	3	3	3	3	3	3
Travel and Subsistence	25	25	25	13	13	13	13	13	13
Training	40	40	40	11	11	11	12	12	12
Recruitment Costs	12	12	12	12	12	12	12	12	12
<b>Total Manpower Costs</b>	<b>923</b>	<b>922</b>	<b>921</b>	<b>778</b>	<b>777</b>	<b>777</b>	<b>811</b>	<b>811</b>	<b>811</b>
<b>Number FTE</b>	<b>19.3</b>	<b>19.3</b>	<b>19.3</b>	<b>18.3</b>	<b>18.3</b>	<b>18.3</b>	<b>18.9</b>	<b>18.9</b>	<b>18.9</b>
<b>Cost/FTE</b>	<b>48</b>	<b>48</b>	<b>48</b>	<b>42</b>	<b>42</b>	<b>42</b>	<b>43</b>	<b>43</b>	<b>43</b>

## firmus Headcount

### Draft Determination

7.2.46 firmus currently operate with 108 FTE in the overall business, allocated between

the distribution business, the Greater Belfast supply business and the Ten Towns supply business. 19 staff are allocated to the Ten Towns supply business, with 12.7 of these currently allocated to the price-regulated sector of the Ten Towns supply business.

- 7.2.47 firmus did not request any increase in staff as part of their initial price control submission even though volumes and connections are forecast to increase at a significant rate over the period of the control.
- 7.2.48 Having reviewed the allocations of staff between the businesses for the draft determination, we considered that some staff were disproportionately weighted towards the price-regulated Ten Towns supply business, particularly in relation to marketing staff and proposed to allow 11.7 staff for the period of the control.

### **Response to Draft Determination**

- 7.2.49 In response to the draft determination, firmus stated that the reduction in staff numbers was not justified and that the submission contained in-built productivity gains and provided further information on the staff roles and time allocation.

### **Final Determination**

- 7.2.50 Following a review of the additional information and engagement with firmus, we have adjusted the total FTE to reflect some of the additional information on roles and allocation. We allow 12.3 staff for the period of the control. We have not allowed the full FTE count originally requested as we consider the evidence provided does not fully illustrate appropriate allocation of some sales and marketing roles.

### **firmus Salaries**

#### **Draft Determination**

- 7.2.51 In the draft determination we used the 2014 actual salaries as these were the last actual costs provided as part of the submission. firmus increased their salary level to include costs for Executive and Non Executive directors and we considered that these costs should have been separately identified and apportioned.

### **Response to Draft Determination**

- 7.2.52 As part of the engagement process after the draft determination, firmus provided the UR with actual figures for 2015.

### **Final Determination**

- 7.2.53 Having considered the additional information submitted by firmus, we have decided to base the average salary on the actual costs for 2015 submitted by firmus after the draft determination for the duration of the price control.
- 7.2.54 Salary levels for firmus and SSE Airtricity are comparable at the relevant grades. However the lower number of staff in firmus leads to a higher proportion of high grade staff to the overall amount, hence the average staff cost is higher than SSE Airtricity.

### **Client Entertainment**

#### **Draft Determination**

- 7.2.55 In their initial submission, firmus included client entertainment costs of £20k within manpower costs. These costs are not appropriately included within manpower costs and should have formed part of advertising costs within the submission.
- 7.2.56 The costs relate to the entertainment of I&C customers due to increased competition within the sector. In the draft determination we proposed that these costs were not allowed as we considered that advertising costs should be borne by the company as retaining customers provides a reward to the company in terms of the margin from each customer.
- 7.2.57 We proposed that staff entertainment be set at the level allowed by HMRC at £150 per FTE. This approach is consistent with SSE Airtricity allowance and the treatment of costs for GD17.

#### **Response to Draft Determination**

- 7.2.58 firmus welcomed the allowance of £150 per FTE as per HMRC allowance. With regard to client entertainment, firmus responded stating that client entertainment is an essential part of operating in a competitive retail market.

## **Final Determination**

- 7.2.59 We do not consider that regulated customers should have to bear the cost for client entertainment and therefore these costs are disallowed.

## **Training**

### **Draft Determination**

- 7.2.60 firmus initially requested a training allowance of around £2k per employee per annum. Having benchmarked the training costs we considered this cost to be high. In the draft determination we noted that there were a number of cost lines included within the training line which should have been included within the professional and legal fees cost line. These include Heron Report data, Met office data and professional subscriptions. We proposed to allow the same training costs as SSE Airtricity at £600 per FTE and moved £25k for report data, Met Office data and professional subscriptions from training into professional and legal costs as we considered this the appropriate cost line. This is consistent with other suppliers

### **Response to Draft Determination**

- 7.2.61 firmus accepted the reallocation of some of the costs to professional and legal fees and accepted the training cost allowance.

### **Final Determination**

- 7.2.62 We determine a training allowance of £612 per FTE for the period of the control.

## **Travel and Subsistence**

### **Draft Determination**

- 7.2.63 Travel and subsistence costs submitted by firmus were deemed high given that a small proportion of their staff travel. In the draft determination, we proposed allowing firmus the same travel and subsistence costs as SSE Airtricity.

### **Response to Draft Determination**

- 7.2.64 In their response to the draft determination, firmus challenged this allowance stating that the geographical spread of the Ten Towns networks means that



firmus requires higher travel and subsistence costs. firmus stated that the travel costs should reflect the different geographical spread of the Ten Towns network as compared to SSE Airtricity in Greater Belfast.

### **Final Determination**

- 7.2.65 Given that the majority of staff in the supply business are office based, including the customer services staff, HR, finance, billing and IT staff we consider that geographical spread is not a relevant factor in this decision. We would also note that the geographic spread for the Greater Belfast area is not insubstantial as it includes Larne, North Down, Lisburn and will soon incorporate East Down. Furthermore as noted above we consider the travel costs for SSE Airtricity to be high as they include costs for travelling to and from Dublin.
- 7.2.66 Therefore we determine a travel and subsistence allowance of £710 per FTE for the period of the control.

### **Recruitment**

#### **Draft Determination**

- 7.2.67 firmus requested recruitment costs in line with the previous year's figures period and in the draft determination we proposed to allow these costs at the requested level.

#### **Response to Draft Determination**

- 7.2.68 firmus welcomed the recruitment costs allowed in the draft determination.

### **Final Determination**

- 7.2.69 We determine an allowance of £12k per annum for recruitment costs.

## **7.3 Operations Costs**

- 7.3.1 Operations costs include office costs and rates, professional and legal fees, insurance, information technology (IT), capital expenditure (CAPEX), licence fee, network maintenance and customer engagement.

**Table 6: SSE Airtricity operations costs (£000s)**

	SSE Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Office Costs	347	349	353	334	343	347	346	348	352
Rates	39	40	41	39	40	41	39	40	41
Professional and Legal Fees	148	145	174	128	131	160	122	122	122
Insurance	26	22	19	26	22	19	26	22	19
IT	1,030	563	502	484	561	563	569	604	606
Capex	21	21	22	-	-	-	20	20	20
Licence Fee	2	2	2	2	2	2	2	2	2
Network Maintenance	231	244	247	177	181	185	179	183	187
Advertising	288	291	315	23	23	43	23	23	43
<b>Total Operations Costs</b>	<b>2,130</b>	<b>1,677</b>	<b>1,676</b>	<b>1,212</b>	<b>1,303</b>	<b>1,360</b>	<b>1,325</b>	<b>1,364</b>	<b>1,391</b>

7.3.2 In their initial submission on operations costs, SSE Airtricity stated that they have not forecast any significant changes from the previous control period with the exception of IT and customer engagement.

### Office Costs

#### Draft Determination

7.3.3 SSE Airtricity stated in their initial submission that the office costs included the costs associated with landlord lease arrangements, service charges, facilities management and services contracts for their offices at Millennium House. SSE Airtricity also provided more detailed information on stationery costs, telephone and postage, parking and storage and subscription costs. Since the last price control, SSE Airtricity has moved to a city centre location, Millennium House, and now shares premises with the SSE electricity business.

7.3.4 In our draft determination, we noted that office costs were in line with previous years despite the relocation to city centre premises and we proposed to allow these costs.

- 7.3.5 In the draft determination we based the telephone and postage costs on the last actual costs available and included an increase based on increased connections.
- 7.3.6 In the draft determination, the requested costs for storage, subscriptions and the office costs for bad debt management had not been allowed due to insufficient evidence of why these costs are required.

### **Response to Draft Determination**

- 7.3.7 While SSE Airtricity were broadly happy with the allowances provided for in the draft determination, they requested we review those areas where costs had been disallowed and provided more information to clarify their requests.
- 7.3.8 SSE Airtricity provided more information on their telephone and postage costs and further details on storage and subscription subscriptions costs.

### **Final Determination**

- 7.3.9 As a result of the further information provided by SSE Airtricity on telephone, postage and storage and subscription we have decided to allow these costs. Office costs are therefore set as detailed in Table 6.

## **Rates**

### **Draft Determination**

- 7.3.10 In previous price controls, rates have been allowed on a fixed allowance basis. As part of the submission, SSE Airtricity has requested that, as rates can be subject to external factors such as political decisions, they should be retrospectively allowed based on actual costs. We considered that the variance between forecast and actual has not been a material sum in the past and therefore this cost will remain as a fixed allowance.

### **Response to Draft Determination**

- 7.3.11 SSE Airtricity made no comment on the proposal for rates in the draft determination.

### **Final Determination**

- 7.3.12 Rates levels are therefore set as detailed in Table 6.

## **Professional and Legal Fees**

### **Draft Determination**

- 7.3.13 In their initial submission, SSE Airtricity noted that although the level of professional and legal fees requested was in line with the current allowance, they also requested an increase in 2019 to allow for increased costs associated with a future price control review. In analysing the information provided by SSE Airtricity, we noted that a proportion of these costs were recharges for specific professional services through group functions such as corporate legal and taxation. These services are recharged rather than employing individual staff members. For the draft determination consistent with our proposals on manpower recharges we proposed to reduce the recharge aspect of professional and legal fees by 20% pending a more detailed explanation of the makeup of these costs.

### **Response to Draft Determination**

- 7.3.14 In response to the draft determination SSE Airtricity stated that they wanted more information on the reason for the 20% reduction in the recharge. Additionally, they submitted further information on the breakdown of professional and legal fees.

### **Final Determination**

- 7.3.15 From the further information provided by SSE Airtricity, we are satisfied that SSE Group legal charges are appropriate. We do, however, consider the level of external legal fees to be excessive. SSE Airtricity have included estimated costs for large legal cases. If the company wins the case then the fees will be paid by the other party. If SSE Airtricity loses these cases, we feel that it is not acceptable that these costs are borne by the customer.
- 7.3.16 Furthermore, we consider that the additional costs for work on margin in 2015 represent a one-off piece of advice therefore we do not foresee any need for additional resources to complete the next Supply Price Control.

## **IT Costs – Capital**

### **Draft Determination**

- 7.3.17 As part of the 2012-2016 Supply Price Control, the UR determined to allow all IT

costs requested by Phoenix Supply Ltd (PSL)<sup>16</sup>. These requested costs were to support PSL's IT requirements for running their business including customer switching, billing and day to day operational matters.

- 7.3.18 As part of the submission for this price control, SSE Airtricity requested costs for both ongoing requirements to maintain IT systems alongside costs associated with proposals for new and upgraded IT systems. SSE Airtricity stated that underinvestment in their legacy IT systems has resulted in a lack of functionality and therefore the system requires significant upgrading during the 2017-2019 control period.
- 7.3.19 Forecast costs submitted by SSE Airtricity showed a substantial increase from the last price control in terms of both specific projects and ongoing operational costs. SSE Airtricity had submitted funding requests for nine projects, ranging from customer services such as webchat and improved telephone systems to compliance requirements such as those for EED. Given the technical nature of these projects we requested Gemserv to carry out an assessment of, and provide an opinion on, the IT costs submitted.
- 7.3.20 Gemserv reported that the new projects had merit and that the optional projects seemed to have the potential to improve customer service and reduce costs. However, with regard to the reporting project, Gemserv were not able to substantiate whether the outcome of the project was to benefit customers or to align with SSE corporate systems. In the draft determination we proposed therefore to disallow the costs for this project. Furthermore, Gemserv identified that part of the proposed projects, the Hi-Affinity Upgrade<sup>17</sup>, was completed in March 2016 yet the costs were submitted as part of the overall submission. Therefore, we proposed that this should not be allowed in the 2017-2019 price control.
- 7.3.21 Gemserv also advised the UR that implementing the IT projects as one suite of projects should attract substantive economies of scale if procured and delivered efficiently, and in the draft determination we recommended a 20% reduction in implementation costs and a 10% reduction in submitted capital costs.
- 7.3.22 For the draft determination we proposed allowing costs for all the IT projects requested by SSE Airtricity with the exception of the Hi-Affinity Upgrade and the reporting project and applying the savings recommended by Gemserv.
- 7.3.23 In their initial submission, SSE Airtricity requested the IT costs in year one of the control, 2017. In our draft determination we proposed to spread the allowance over the three years of the control in order to avoid having a significant impact on customers in year one and to better match the likely IT roll out profile.

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<sup>16</sup> SSE Airtricity purchased Phoenix Supply Limited in June 2012.

<sup>17</sup> Hi-Affinity is a customer management and billing system

7.3.24 The IT costs also include a small allowance in year one of the control to complete a project on settling customer accounts.

### **Response to Draft Determination**

7.3.25 SSE Airtricity welcomed the allowances for the IT systems seeing it as a positive step towards providing customers with improved services. However, SSE Airtricity was concerned with the efficiencies presented in the draft determination.

7.3.26 In their response to the draft determination, SSE Airtricity provided further information on the IT projects and continued to engage with Gemserv to facilitate further information gathering. SSE Airtricity stated that the reporting project would facilitate more efficient, accurate and transparent systems and information recording and retrieval for a customer focussed business.

7.3.27 Furthermore, in their response to the draft determination, SSE Airtricity stated that given the level of IT investment elsewhere and associated upgrades, an allowance for one upgrade of the Hi-Affinity system in would be satisfactory in place of the three upgrades originally requested...

7.3.28 SSE Airtricity also challenged the efficiencies proposed in the draft determination stating that they would not be achievable and stated that it cannot deliver the projects in question for the capital allowance allowed in the draft determination. SSE also stated in their response that the proposed 20% efficiency for implementation is too high.

7.3.29 In the response to the draft determination, SSE Airtricity submitted an alternative proposal for spreading the costs.

### **Final Determination**

7.3.30 It is important to note that the IT allowances are not fixed allowances but rather are set as “up to” amounts. This means that SSE Airtricity will have to provide evidence of the actual level of costs spent. Any spend below the allowance will be returned to consumers. Any spend above the allowance will be borne by SSE Airtricity.

7.3.31 Gemserv reviewed the information provided by SSE and recommended that the allowance for one upgrade of the Hi-Affinity system in 2018 be allowed. We have allowed for this cost in our final determination.

7.3.32 With regard to the efficiencies proposed in the draft determination, we consulted again with Gemserv who stated that they saw no further evidence to make them change their recommendation efficiencies. Therefore our final decision is to retain the proposed efficiencies from the draft determination.

- 7.3.33 With regard to SSE Airtricity's additional proposal on the spreading of the costs of the IT projects over three years, having fully considered their submission on allocation of IT costs, we consider the proposal in the draft determination to be the most appropriate approach. Therefore our final decision is to retain the proposed cost allocation from the draft determination.
- 7.3.34 It should be noted that the IT projects that will be implemented by SSE Airtricity will move many of the company activities from a manual basis to automated systems. Projects such as IVR, cheque automation and reporting functions will improve the operating efficiency of the business, while other initiatives such as webchat will improve the customer interface and bring the business in line with other service businesses.
- 7.3.35 As a result we consider it appropriate to reduce the overall manpower allowance over the control in order to capture the efficiencies gained as a result of undertaking these projects. Therefore we have reduced manpower by 0.5FTE in 2018 and 1 FTE in 2019. Furthermore we consider that any additional resource required for connections in the West area will be met by efficiencies achieved through these projects,

## **IT Costs – Operational**

### **Draft Determination**

- 7.3.36 SSE Airtricity's submission indicated that IT operational costs would increase to support the new projects. Gemserv reviewed these costs and considered them to be reasonable and suitable for inclusion in the price control. Gemserv recommended that we remove contingency costs of £60k over the control as these costs were not evidenced. Additionally they recommended removing year one costs for three of the proposed projects as they considered that these costs should be included in the overall project development costs. We proposed to disallow the contingency costs and the relevant year one costs in line with Gemserv recommendations.

### **Response to Draft Determination**

- 7.3.37 SSE Airtricity questioned which projects the UR decided not to allow the year one costs for. SSE Airtricity reiterated that the costs would ensure that the systems in place can be maintained and used on an ongoing basis without issue.

## **Final Determination**

- 7.3.38 For clarity, we proposed disallowing year one costs for IT support and maintenance for the following projects; New Support Costs (Enhanced Tariffing), New Support Costs (Ebilling/OSS) and Webchat licences and support. We considered that these maintenance and support costs would not be required in year one as this is the development period for the projects.
- 7.3.39 Our final decision is to retain the proposed reductions described above.

## **Advertising**

### **Draft Determination**

- 7.3.40 SSE Airtricity's submission highlighted specific advertising and customer engagement initiatives that they have requested as part of the 2017–2019 supply price control. In the draft determination, the cost allowance for customer literature was moved to the customer information line in billing costs as a retrospective cost. In the draft determination we proposed that the costs for SSE Rewards are not allowed as we consider that this cost is not wholly and necessarily related to the supply of gas to customers and therefore unjustifiable.
- 7.3.41 In the draft determination we proposed to allow costs for customer research and other publications as these will bring benefits to consumers, however we did not propose allowing costs for public relations (£10k p.a.), sponsorship (£10k p.a.) and brand recharge (£15k p.a.).

### **Response to Draft Determination**

- 7.3.42 In the response to the draft determination, SSE Airtricity challenged the lack of provision for public relations, sponsorship or brand stating that the activities outlined in the submission are normal for any modern business and allow SSE Airtricity representatives to engage with customers.
- 7.3.43 SSE made no reference to SSE Rewards in their response to the draft determination.

### **Final Determination**

- 7.3.44 Although SSE Airtricity has stated in the response that other regulated companies engage in awareness and sponsorship campaigns we would note that SSE Airtricity have the advantage of being commissioning supplier meaning that all customers must connect to them on first receiving a gas supply. We would consider that the commercial benefits of this arrangement far outweigh the requested costs of brand awareness and sponsorship. Additionally this decision



is consistent across the two gas supply companies with regard to allowances for brand, PR and sponsorship.

- 7.3.45 As per the draft determination non licence customer literature is allowed under the customer information line in billing costs. However the UR will require to approve the subject of the literature prior to approving costs, and as stated in the draft determination costs for SSE Rewards will not be allowed. Only costs for literature to existing customers will be allowed, marketing to other properties will not be allowed.

## **Other Operations Costs**

### **Draft Determination**

- 7.3.46 In their initial submission, SSE Airtricity noted that the forecast insurance costs from 2016 onwards are based on SSE group recharge figures and are reduced from previous years. They stated that this is a benefit of being part of the SSE group. We proposed to accept these costs in the draft determination.
- 7.3.47 SSE Airtricity requested an amount for non IT capex as part of their submission however, they had not provided evidence to account for the amount and it was not provided for in the draft determination.
- 7.3.48 In previous price controls licence fees were a pass through cost however this is no longer the case and the licences fee is a set figure from the UR. The costs for the licence fee were allowed in the draft determination.
- 7.3.49 Network maintenance costs relate to metering costs for which the supplier is responsible such as meter exchanges (where the supplier is charged by the Distribution Network Operator for the exchange) and safety inspections for vulnerable customers, tampered meters and disconnections.
- 7.3.50 In their initial submission, SSE Airtricity stated that their forecast network maintenance costs were similar to those in the previous control. They noted the increase in drivers for items driven by an increase in the cost drivers linked to customer growth but also noted how they had been able to reduce overall costs in meter tampering. SSE Airtricity also proposed establishing a Boiler Replacement Scheme for vulnerable households.
- 7.3.51 We proposed in the draft determination to allow the network maintenance costs at the submitted levels which are in line with historic levels. However, we proposed to set safety inspections and meter exchanges as a retrospective cost as these activities are a requirement placed on the company. We proposed to allow the costs for each activity on a retrospective basis, variable by the volume of activity completed at the rate provided by SSE Airtricity. We proposed to disallow costs for the proposed Boiler Replacement Scheme as there are

existing schemes which provide funds for these activities to various categories of customer.

- 7.3.52 In the draft determination we proposed to disallow the warrant access costs citing insufficient evidence on the requirement and benefit of these costs.

### **Response to Draft Determination**

- 7.3.53 SSE Airtricity provided further information on capex costs, but made no comment on the other cost items.

### **Final Determination**

- 7.3.54 We benchmarked the non-IT Capex information provided against Power NI and have decided to allow this amount in the final determination at £300 per FTE...
- 7.3.55 Costs for licence fees and insurance costs will be allowed.
- 7.3.56 For network maintenance we will allow the network maintenance costs proposed in the draft determination. That is to allow costs for disconnection, isolation and other network maintenance costs as requested by SSE Airtricity as these were in line with costs in previous years.
- 7.3.57 Costs for safety inspections for vulnerable customers will be allowed in line with the relevant licence condition and allowed at a set rate as requested by SSE Airtricity and retrospectively adjusted on the basis of the actual number of applicable inspections completed.
- 7.3.58 Costs for meter exchanges for vulnerable customers from prepayment meters to credit meters are allowed at the published rate charged by the distribution company and retrospectively adjusted on the basis of the actual number of exchanges carried out. For the avoidance of doubt, the supplier will not be allowed to recover this rate for any meter exchanges where the supplier did not incur a cost (i.e. where the Distribution Network Operator completes a meter exchange for the supplier that is not chargeable by the Operator then the supplier will not be entitled to recover any costs).
- 7.3.59 Following further discussion with SSE Airtricity and in line with our decision to allow manpower for investigation into LTNA properties we will allow warrant costs of £2k per annum to access LTNA properties.

**Table 7: firmus operations costs (£000s)**

	firmus Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Office Costs	69	69	69	58	58	58	53	53	53
Rates	6	6	6	5	5	5	5	5	5
Professional and Legal Fees	84	84	84	84	84	84	84	84	84
Insurance	31	31	31	31	31	31	31	31	31
Information Technology	138	88	88	206	172	177	229	180	185
CAPEX	303	53	-	-	-	-	6	6	6
Licence Fee	2	2	2	2	2	2	2	2	2
Network Maintenance	110	120	131	111	118	126	111	118	126
Call Centre	27	30	33	13	15	17	13	15	17
Advertising	88	88	88	33	10	10	10	10	10
Supplier of Last Resort	20	20	20				-	-	-
<b>Total Operations Cost</b>	<b>877</b>	<b>590</b>	<b>552</b>	<b>543</b>	<b>493</b>	<b>508</b>	<b>543</b>	<b>502</b>	<b>517</b>

**IT Costs****Draft Determination**

- 7.3.60 As part of their initial submission, firmus requested a substantial increase in IT costs to provide a new billing system and the replacement of the internal system software, IUS. firmus stated that the existing billing system uses an obsolete language and that the software is not fit for purpose and is in urgent need of replacement. Furthermore, firmus stated that their present system is not flexible enough and too expensive for their future needs. firmus stated that a new billing platform will result in enhanced accuracy in regulatory and internal reporting and will improve productivity via improved billing operations, meter reading and customer service.
- 7.3.61 As with SSE Airtricity, given the technical nature of these requests we contracted Gemserv to carry out an assessment of, and provide an opinion on, the IT costs submitted. Initially, Gemserv reported that firmus had not provided sufficient information to agree, or to disagree, with the proposal to replace the existing billing system. However, following substantial engagement with firmus, Gemserv

stated that the information received indicated that a new billing system was required and recommended that we allow the costs for the billing system and the associated operational costs.

7.3.62 In their initial submission firmus allocated the costs for the new system equally between the Belfast and Ten Towns markets. However we considered that this allocation was not reflective of costs and therefore proposed in the draft determination to allocate on the basis of customer numbers.

7.3.63 As with the SSE Airtricity IT spend, we split the IT costs evenly over the three year control period to minimise the impact on customers. We included the requested capex costs within the IT line. This is in line with SSE Airtricity IT costs.

### **Response to Draft Determination**

7.3.64 In their response to the draft determination, firmus welcomed the allowance for IT spend. They also highlighted that website maintenance costs which were initially submitted as part of the advertising cost line should have been part of IT costs as they relate to technical management and administration and requested that we reconsider allowing this cost.

### **Final Determination**

7.3.65 We have accepted the cost for website maintenance and have moved this from the advertising cost line to IT costs. Our final decision is to retain the proposed IT costs from the draft determination with the addition of the website maintenance cost. It is important to note that the IT allowances are not fixed allowances but rather are set as “up to” amounts. This means that firmus will have to provide evidence of the actual level of costs spent. Any spend below the allowance will be returned to consumers. Any spend above the allowance will be borne by firmus.

7.3.66 Furthermore whilst the main purpose of this project is to replace out of date systems we do understand that there will be efficiency gains from the new systems. We expect that these gains will be utilised in meeting the increased connection numbers forecast over the period of the control.

## **Advertising**

### **Draft Determination**

- 7.3.67 firmus submitted costs for advertising, website and sales development stating that they are a key cost for the supply business and are essential to be in line with the UR objective to ensure that suppliers do not use a distribution company as a marketing vehicle. The item comprised website development, advertising, sponsorship, market research and corporate events.
- 7.3.68 In the draft determination we proposed the website development costs be allowed in 2017 only, as firmus failed to evidence why these costs would be ongoing for the duration of the price control. In keeping with our proposal for SSE, we proposed that costs relating to corporate events and sponsorship would not be allowed.

### **Response to Draft Determination**

- 7.3.69 firmus welcomed the allowance for market research as it will ultimately benefit the consumer.
- 7.3.70 firmus challenged the proposal that advertising costs would not be allowed during this price control stating that corporate events and sponsorship opportunities would further develop the gas network and promote natural gas as being an efficient and environmentally friendly energy option.
- 7.3.71 In the response to the draft determination, firmus highlighted that website maintenance costs which relates to technical management of the website, should have been part of IT costs and requested that we reconsider allowing this cost. We have accepted the cost for website maintenance and have moved this from the advertising cost line to IT costs.

### **Final Determination**

- 7.3.72 We would also note that firmus have the advantage of being commissioning supplier in the Ten Towns area meaning that all customers must connect to them on first receiving a gas supply thus reducing the need for advertising and marketing costs. In addition firmus are the only supply for domestic properties in this network area.
- 7.3.73 We remain of the opinion that customers of a price regulated company which is a commissioning supplier and in a dominant position in the market should not bear the costs of advertising. Additionally, it is the distribution company who is responsible for growing connections, not the supply company. Therefore it is our final decision that the costs proposed in the draft determination are implemented.

This decision is consistent across both regulated gas suppliers.

## **Other Operations Costs**

### **Draft Determination**

- 7.3.74 In their submission, firmus forecast their future office costs in line with future tariff FTEs. We proposed to retain costs at the 2014 levels as at the time, these were the most recent actual costs and there was no increase in staffing levels. This is consistent with the treatment of office costs in GD17.
- 7.3.75 firmus submitted costs for rates with an increase based on an increased forecast on FTE numbers. In the draft determination we stated that this is an inappropriate driver for rates as rates will not be affected by extra FTEs but rather the size of buildings/Land & Property Services (LPS) increases. We proposed to retain costs at the 2014 levels again as these were the most recent actual costs at that time. This is consistent with the treatment of costs in GD17.
- 7.3.76 The professional and legal fees initially submitted by firmus were in line with previous years. We proposed to accept these costs in the draft determination. As stated before, we noted that there were a number of cost lines included within the training line which we considered should be included within the professional and legal fees cost line. These included Heron Report data, Met office data and professional subscriptions. We moved £25k from training to professional and legal costs as we considered this the appropriate cost line.
- 7.3.77 The insurance costs submitted by firmus were in line with previous years and we proposed to allow these costs in the draft determination. This was consistent with the treatment of insurance costs in GD17.
- 7.3.78 firmus submitted increased costs for the call centre which they stated was to account for the projected increase in customer phone calls resulting from growth in customer numbers. In the draft determination we proposed to allow these costs at the best estimate of 2015 levels, increasing based on customer numbers.
- 7.3.79 Within the draft determination firmus did not include a request for capital expenditure for fixtures and fittings. The capital expenditure requested was solely related to IT costs.
- 7.3.80 In previous price controls licence fees were a pass through cost however this is no longer the case and the licences fee is a set figure from the UR. The cost for the licence fee was allowed in the draft determination.
- 7.3.81 Network maintenance costs relate to metering costs for which the supplier is responsible such as meter exchanges (where the supplier is charged by the Distribution Network Operator for the exchange) and safety inspections for

vulnerable customers, tampered meters and disconnections.

- 7.3.82 In the draft determination we proposed to allow the firmus costs at the submitted levels which are in line with historic levels. We proposed to set safety checks and meter exchanges as retrospective costs as these activities are a requirement on the company.
- 7.3.83 firmus also requested additional allowance for unrecoverable gas costs relating to tampered and faulty meters. We considered this is a part of bad debt allowance and therefore proposed to disallow this amount.
- 7.3.84 firmus also submitted costs of £20k for each year of the price control to cover Supplier of Last Resort costs. We proposed that these costs would not be allowed.

### **Response to Draft Determination**

- 7.3.85 After the draft determination, firmus submitted actual costs for office costs and rates for 2015 but made no challenges to either of these areas.
- 7.3.86 firmus supported the reallocation of subscription fees from training to professional and legal and accepted the allowance.
- 7.3.87 firmus welcomed the decision to allow insurance costs and stated that they considered that licence fees should be a pass through cost.
- 7.3.88 firmus welcomed the allowance for call centre costs provided in the draft determination.
- 7.3.89 In the response to the draft determination firmus accepted the allowances for network maintenance but also requested that other disconnection costs charged to firmus energy supply by the DNO that cannot be passed on to a specific customer be considered a retrospective cost such as vacant properties where warrants are required and the resident is unknown.
- 7.3.90 firmus accepted the methodology proposed in the Draft Determination and stated that they will continue to engage with industry stakeholders on these matters including finalising the SoLR Retail Development Plan.

### **Final Determination**

- 7.3.91 Having included the actual costs for 2015 in our determination office costs and call centre costs are now based on an average of 2014 and 2015 costs.
- 7.3.92 There is no change to the allowance set for rates from the draft determination.
- 7.3.93 We determine to retain the proposed allowance for professional and legal fees, insurance costs from the draft determination.

- 7.3.94 Costs for licence fees will be allowed at the rate charged by the UR, these costs are no longer treated as a pass through cost as the amount charged to supply companies is now a fixed rate.
- 7.3.95 In relation to the request to treat other disconnection costs as retrospective costs we have reviewed the cost and consider that the level set within the draft determination to be based on historical costs and we do not consider these costs to be significantly material so as to impact on the business should the activity increase. Therefore we will retain the network maintenance costs proposed in the draft determination.
- 7.3.96 We will allow the network maintenance costs proposed in the draft determination. That is to allow costs for disconnection, isolation and other network maintenance costs as requested by firmus energy as these were in line with costs in previous years.
- 7.3.97 Costs for safety inspections for vulnerable customers in line with the relevant licence condition will be allowed at a set rate as requested by SSE Airtricity and retrospectively adjusted on the basis of the actual number of applicable inspections completed.
- 7.3.98 Costs for meter exchanges for vulnerable customers from prepayment meters to credit meters are allowed at the published rate charged by the distribution company and retrospectively adjusted on the basis of the actual number of exchanges carried out. For the avoidance of doubt, the supplier will not be allowed to recover this rate for any meter exchanges where the supplier did not incur a cost (i.e. where the Distribution Network Operator completes a meter exchange for the supplier that is not chargeable by the Operator then the supplier will not be entitled to recover any costs).

## 7.4 Billing Costs

- 7.4.1 For both SSE Airtricity and firmus, the majority of billing costs are treated as retrospective costs as these costs are driven by actual volumes of gas burned and actual customer numbers and can therefore be affected by factors outside of the control of the company (e.g. weather). It is a licence requirement that companies are allowed costs to finance this activity.
- 7.4.2 In the case of retrospective costs we will include a forecast allowance in the price control determination; however the final allowed costs will be calculated based on actual cost drivers.
- 7.4.3 The costs affected are:
- Prepayment transaction costs – rate and number of transactions
  - Bad debt – adjusted for actual credit revenue



- Meter reading – adjusted for actual number of meters read
- Customer information (processing & postage)– adjusted for actual number of bills

**Table 8: SSE Airtricity billing costs (£000)**

	SSE Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Prepayment Transaction/ Commission Costs	437	444	450	437	444	450	437	444	450
Prepayment Cards	9	8	7	9	8	7	9	8	7
Credit Check Charges	10	10	11	10	10	11	10	10	11
Meter Reading	678	703	728	678	703	728	678	703	728
Customer Information Processing & Postage	594	542	565	521	542	565	521	542	565
Bad Debt	254	258	261	195	198	201	234	237	242
Bank Interest	104	112	120	104	112	120	104	112	120
Tracing costs	52	55	56	52	55	56	52	55	56
Text alerts	4	5	6	4	5	6	4	5	6
Bad Debt Management Allowance	0	0	0	0	0	0	0	0	0
<b>Total Billing Costs</b>	<b>2,142</b>	<b>2,136</b>	<b>2,205</b>	<b>2,009</b>	<b>2,077</b>	<b>2,145</b>	<b>2,048</b>	<b>2,116</b>	<b>2,185</b>

## Bad Debt

### Draft Determination

7.4.4 The existing SSE Airtricity price control includes a bad debt level of 1% of credit revenue. This was a challenging target set to Phoenix Supply Ltd (PSL) on the basis of their poor record with debt. PSL's debt levels at this stage were notably higher than 1%. SSE Airtricity has made considerable changes to the processes surrounding debt and has seen significant improvement in the bad debt levels, (bad debt levels in 2014 were 0.81% of credit revenue).

7.4.5 In their initial submission, SSE Airtricity requested a bad debt level of 1% of credit revenue for the three years of the control. We considered that the

changes made by SSE Airtricity would bring further reductions to the bad debt level and proposed a bad debt level of 0.75% of credit revenue.

### **Response to Draft Determination**

- 7.4.6 In their response to the draft determination, SSE Airtricity stated that the bad debt provision of 0.75% of credit revenue is not achievable. The company submitted further information on business processes, and noted the potential issues with Long Term No Access accounts and the recent improvements made in bad debt levels.
- 7.4.7 They stated that revenue protection (RP) debt is at an all time low and that these levels have been achieved through changes in process and also running special projects to target areas of concern. SSE Airtricity stated they do not see how any additional reduction in level is possible. Furthermore, SSE Airtricity stated that it is more likely that levels will rise than fall during the next price.

### **Final Determination**

- 7.4.8 SSE Airtricity have seen a considerable reduction in their bad debt levels through revised policies and procedures. We acknowledge the consistent improvement in bad debt processes. Following further engagement we determine a bad debt level of 0.9% of credit revenue. We consider that the additional funding within this control including two additional FTEs allocated to Long Term No Access and associated credit control roles, allowed credit costs, text messages, tracing costs and warranty costs should assist SSE Airtricity in achieving and maintaining this level.
- 7.4.9 As stated in the draft determination there will be no additional fixed bad debt management allowance in this control, any costs have been included in the appropriate lines.

### **Other Billing Costs**

#### **Draft Determination**

- 7.4.10 Prepayment transaction costs are the transaction and commission costs relating to the pay as you go meters. We proposed that these costs will be retrospectively adjusted based on the actual rate charged to the company and the actual volume of activity.
- 7.4.11 As stated in the draft determination, during the current price control period SSE Airtricity has made considerable improvement in its management of debt and that

credit checks and tracing costs are important in allowing debt to remain at a low and stable level. We proposed the credit checking and tracing costs to be allowed as submitted

- 7.4.12 The meter reading service used by SSE Airtricity is a standalone business operating within the legal entity of SSE Airtricity Gas Supply. We proposed to allow the meter reading rate submitted by SSE Airtricity as this rate was in line with that allowed in the previous control.
- 7.4.13 The customer information processing and postage cost line includes the postage and printing costs for all customer literature, including bills, statements, and any information the company must provide to its customers under licence requirements. We proposed to allow these costs as retrospective costs.
- 7.4.14 SSE Airtricity submitted appropriate information on their bank charges. We proposed to allow this cost as it is in line with previous costs.
- 7.4.15 In the draft determination we proposed that the other billing costs (i.e. prepayment cards, credit check charges, tracing costs and text alerts) be allowed as fixed cost allowances as set out in the table above.
- 7.4.16 The GD17 approach paper<sup>18</sup> indicated that the UR may consider undertaking a meter reading review in the future to establish if it is appropriate for the responsibility for meter reading to remain with gas suppliers, or if the responsibility should it be transferred to the distribution network operators. Any impact of such a review on the supply companies will be considered by the UR through the Et section of the licence modifications

### **Response to Draft Determination**

- 7.4.17 In their response to the draft determination, SSE Airtricity made no comment on the allowances proposed for prepayment costs, meter reading, customer information processing and postage, bank interest and tracing costs.

### **Final Determination**

- 7.4.18 We determine to allow the costs for prepayment costs, meter reading, customer information processing and postage, bank interest and tracing costs as laid out in the draft determination.
- 7.4.19 Costs for prepayment cards, credit check costs, bank interest, tracing costs and text alerts are allowed at the fixed rate as per the table set out above.
- 7.4.20 Prepayment transaction costs are retrospective items where both the rate

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<sup>18</sup> GD17 Update on Our Overall Approach, 17 April 2015: <https://www.uregni.gov.uk/news-centre/approach-gd17-price-control-nis-gas-distribution-networks>

charged and the actual volume of transactions will be adjusted for actual.

- 7.4.21 Meter reading costs will be retrospectively adjusted for the actual number of meters read against the rate per read as stated by SSE Airtricity in their submission.
- 7.4.22 Customer Information costs will be retrospectively at an allowed rate (the rate submitted by SSE Airtricity) for printing and postage adjusted for the actual volume. This cost also includes the non-licence requirement customer literature, moved from advertising and customer engagement under operation. The non licence customer literature must be approved by UR prior to publication and must not include marketing or reference to SSE Rewards.

**Table 9: firmus billing costs (£000)**

	firmus Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Bad debt	108	104	104	87	84	84	109	105	105
Paypoint costs	301	335	370	301	335	370	301	335	370
Prepayment Cards	8	8	8	8	8	8	8	8	8
Credit Check Costs	11	13	16	11	13	16	11	13	16
Bank and Interest Charges	10	10	10	10	10	10	10	10	10
Meter reading	226	252	274	227	194	199	227	194	199
Customer Information	123	135	209	123	135	209	123	135	209
Virtual terminal	1	1	1	1	1	1	1	1	1
<b>Total Billing Costs</b>	<b>788</b>	<b>858</b>	<b>992</b>	<b>768</b>	<b>780</b>	<b>898</b>	<b>790</b>	<b>801</b>	<b>919</b>

### Bad Debt

#### Draft Determination

- 7.4.23 firmus currently operate with a bad debt level within the existing control at 0.2% of credit revenue. This is a comparatively low rate when compared with other supply companies both in Northern Ireland and GB. However, this rate is achievable due to the meter profile within the firmus distribution area as the majority of domestic properties have a prepayment meter and this is a significant tool in preventing bad debt. Moreover, firmus have consistently managed credit debt at a low level due to having proper procedures in place for preventing debt.

- 7.4.24 Bad debt levels for the two suppliers differ due to SSE Airtricity's legacy debt issues. There are currently over 12,000 customers repaying debts on a quantum meter much of which was accrued on credit meters before the customers were then switched to prepayment meters to recover the debt. As the total bad debt is apportioned over credit revenue this leads to a higher percentage for SSE Airtricity. Additionally with no competition in the Ten Towns area customers cannot switch to avoid repaying debt or leave final bill debt when they switch.
- 7.4.25 Initially firmus requested an allowance of 0.25% of credit revenue, however they failed to evidence why the level should be increased therefore based on the historic performance to date and on the high percentage of prepayment meters installed in the Ten Towns area we proposed to retain the current level of bad debt at 0.2% of credit revenue.

### **Response to Draft Determination**

- 7.4.26 In the response to the draft determination, firmus expressed concern at the level of bad debt provision. They stated that due to the small scale of the business, the risk to firmus of a negative financial impact from individual I&C customers defaulting on payments is greater than that of suppliers with a larger customer base and revenue.
- 7.4.27 firmus also stated that the plans for Distribution Network Growth will result in an increase of domestic credit meter connections and an increase in credit meters as a proportion of total meter stock.

### **Final Determination**

- 7.4.28 Having reviewed the additional information provided and considered the implications of GD17 with regard to growing the network in the Ten Towns area, we determine a bad debt provision for firmus of 0.25% of credit revenue.

### **Meter Reading**

#### **Draft Determination**

- 7.4.29 firmus tender with a third party for their meter reading services and have a contract in place until April 2018. Within the draft determination we benchmarked the costs against SSE Airtricity and NIE and found firmus' forecast costs to be high. We considered that firmus should be achieving better meter reading rates from either a supplier or in-house facility. We proposed a glide path from their existing rates in 2017 to reduced rates in 2019. These rates were a blended rate of SSE Airtricity 2019 meter reading rate and the firmus tendered rate. We did consider that meter reading costs may be higher within the Ten Towns area due

to the geographical spread and rurality of the properties and as a result set a proposed rate above that allowed for SSE Airtricity. The allowed rates, however, will decrease over the duration of the control to implement the glide path mentioned above.

### **Response to Draft Determination**

- 7.4.30 In their response to the draft determination firmus stated that the proposed allowance does not account for the “unique nature” of the firmus Ten Towns area citing sparsity and scalability as mitigating factors and reiterated that the tendered costs should be accepted.
- 7.4.31 firmus stated that the failure of the previous meter reading contractor highlights the cost challenges within the Ten Towns and claimed that moving the meter reading activities in-house would result in a 25% increase in meter reading costs.
- 7.4.32 firmus stated that they also undertook an internal benchmarking of independent contractor’s costs which showed that costs in the Ten Towns are 14% higher than those in the Greater Belfast Area as a direct result of increased travel times for meter readers.
- 7.4.33 Both firmus energy and Flogas, who also responded to the draft determination, supported the potential for the UR to undertake a meter reading review in the future to establish if it is appropriate for the responsibility for meter reading to remain with gas suppliers, or if the responsibility should it be transferred to the distribution network operators.

### **Final Determination**

- 7.4.34 We determine to allow meter reading costs for firmus as set out within the draft determination. This allows firmus actual contract rates for 17/18 with a reduction in rates toward the end of the control as a target rate for firmus energy to become more efficient at these activities.
- 7.4.35 In considering the position we compared the meter reading rates for firmus to both SSE Airtricity and NIE meter reading rates and found them to be substantially higher. We have taken into consideration the geographical location and rurality of the properties in the Ten Towns area and determined an allowed rate above that allowed for SSE Airtricity. We note firmus’ comment on the 14% uplift required on meter reading figures in the Ten Towns in comparison to the Greater Belfast. We would note that if we applied the 14% uplift to SSE Airtricity’s meter reading rate this would result in a further reduction to the meter reading rate than that proposed in the draft determination.
- 7.4.36 Furthermore with the increased number of connections over the period of the

control we would expect economies of scale to lead to decreasing meter reading costs.

7.4.37 We therefore determine that meter reading costs will be retrospectively adjusted at the rate set by UR per annum adjusted for the actual number of meter reads.

7.4.38 The GD17 approach paper<sup>19</sup> indicated that the UR may consider undertaking a meter reading review in the future to establish if it is appropriate for the responsibility for meter reading to remain with gas suppliers, or if the responsibility should it be transferred to the distribution network operators. Any impact of such a review will be considered by the UR through the Et section of the licence modifications.

## **Other Billing Costs**

### **Draft Determination**

7.4.39 Prepayment transaction costs are the transaction and commission costs relating to the pay as you go meters. These costs will be retrospectively adjusted based on the actual rate charged to the company and the actual volume of activity.

7.4.40 The customer information (processing and postage) costs are the costs of all customer literature, including bills, statements, and any information the company must provide to its customers under licence requirements. We stated in the draft determination that these costs will be retrospectively adjusted based on the allowed rate for printing and postage adjusted for the actual volume.

7.4.41 In the draft determination we proposed to allow bank and interest costs as a fixed allowance as they are in line with previous costs, to allow credit check and tracing costs as fixed allowances to maintain the excellent bad debt levels that firmus maintains and to allow virtual terminal cost as a fixed allowance. firmus welcomed these allowances therefore these allowances will stay the same as in the draft determination.

### **Response to Draft Determination**

7.4.42 firmus welcomed the UR decisions on prepayment costs, bank charges and credit check costs.

7.4.43 firmus requested that additional allowances for design and amendment of customer engagement materials which were previously submitted as advertising costs be accepted and stated that a similar approach had been taken for SSE

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<sup>19</sup> GD17 Update on Our Overall Approach, 17 April 2015:  
<https://www.uregni.gov.uk/news-centre/approach-gd17-price-control-nis-gas-distribution-networks>

Airtricity.

### **Final Determination**

- 7.4.44 Costs for prepayment cards, credit check costs, bank interest, tracing costs and text alerts are allowed at the fixed rate as per the table set out above.
- 7.4.45 Prepayment transaction costs are retrospective items where both the rate charged and the actual volume of transactions will be adjusted for actual.
- 7.4.46 Customer Information costs will be allowed retrospectively at an allowed rate (the rate submitted by firmus) for printing and postage adjusted for the actual volume.
- 7.4.47 We have reviewed the reference cited by firmus and do not consider this to be the same costing issue as SSE Airtricity therefore there will be no change in this decision.

### **7.5 Apportionment**

- 7.5.1 The apportionment allocation of costs allocates the appropriate level of costs to the tariff sector of each business (i.e. the price regulated sector of each business). This ensures there is no cross-subsidisation between the tariff and non-tariff businesses of firmus and SSE Airtricity. 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 cost drivers can be found in Annex 1. The apportionment figure will be retrospectively adjusted on the basis of actual volumes, customer numbers, credit revenue, number of bills and number of meter reads.



## 8. Gas to the West

- 8.1. The West distribution area covers Strabane, Omagh, Enniskillen, Derrylin, Dungannon, Coalisland, Cookstown and Magherafelt.
- 8.2. SGN Natural Gas Limited (SGN) is the distribution network operator for the West area.
- 8.3. It is intended that the first large I&C customer in the West area will be connected during quarter 4, 2016 with the first domestic connections being made during 2018 (possible end 2017).
- 8.4. SSE Airtricity has been appointed as commissioning/default supplier within the West area. The UR will therefore apply a supply price control to SSE Airtricity in the West area for domestic and small business customers.

### **Scope and Duration**

#### **Draft Determination**

- 8.5. In the draft determination we proposed that the scope of the price control on SSE Airtricity in the West area would align with the scope of the Greater Belfast control. SSE Airtricity is the commissioning/default supplier in both areas.
- 8.6. We proposed to align the duration of the price control on SSE Airtricity in the West area with the duration of the price control on SSE Airtricity in the Greater Belfast area.

#### **Response to the Draft Determination**

- 8.7. Respondents to the draft determination were broadly supportive of the scope and duration of the price control on SSE Airtricity for the West area and aligning it to the Greater Belfast area.

#### **Final Determination**

- 8.8. The control will therefore apply to domestic and small I&C customers using up to 2,500 therms per annum.
- 8.9. The control will commence on 1 April 2017 and will apply for three years from 1 April 2017 to 31 March 2020.

## **Network Costs and Gas Costs**

### **Draft Determination**

- 8.10. In line with our proposal for the treatment of networks costs in the supply price controls for SSE Airtricity in the Greater Belfast area and firmus in the Ten Towns (as set out in section 6 of the draft determination paper), we proposed that network costs will be treated as a pass through cost for the price-regulated supplier, SSE Airtricity, in the West area.
- 8.11. In the draft determination we proposed to align the treatment of gas costs for SSE Airtricity in the West area with the treatment of gas costs in the Greater Belfast and Ten Towns supply price controls as set out in Section 9 below i.e. that gas costs will be treated as a pass through cost.

### **Response to Draft Determination**

- 8.12. No respondents to the draft determination opposed the proposal regarding the treatment of Network Costs and Gas costs to be pass through in alignment with Greater Belfast and Ten Towns areas

### **Final Determination**

- 8.13. Network costs for SSE Airtricity in the West area will be treated as pass through as set out in section 6.
- 8.14. Gas costs for SSE Airtricity in the West area will be treated as pass through as set out in section 9.

## **Supply Operating Costs**

### **Draft Determination**

- 8.15. SSE Airtricity submitted a request for set up and operations costs of £230k for the duration of the three year price control as seen in the table below. SSE Airtricity forecast that by 2019 1,500 domestic and 87 I&C properties will be connected. This is a more conservative forecast of customer numbers than the targets forecast for SGN in their Distribution price control process.

**Table 10: West costs for SSE Airtricity**

	SSE Submission			Draft Determination			Final Determination		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Summary									
Manpower - Meter Reading	4,181	19,392	46,562	4,181	19,392	46,562	4,181	19,392	46,562
- Contact Centre	600	3,000	7,000						
- Back Office	600	3,000	7,000						
Customer Billing and Engagements	224	987	2,425	224	987	2,425	224	987	2,425
Network Maintenance	1,992	2,697	4,025	500	1,000	1,500	500	1000	1500
Geocoding Data	3,543	3,685	3,832	3,543	3,685	3,832	3543	3685	3832
Brand Awareness		15,000	15,000						-
Setup Costs	85,000			25,000			25,000		
<b>Total Costs</b>	<b>96,140</b>	<b>47,761</b>	<b>85,844</b>	<b>33,448</b>	<b>25,064</b>	<b>54,319</b>	<b>33,448</b>	<b>25,064</b>	<b>54,319</b>

- 8.15 Within the draft determination we proposed to allow costs of £113k for the duration of the price control. These costs were total costs for the West area and would be apportioned between tariff and non tariff customers.
- 8.16 SSE Airtricity submitted costs for manpower for contact centre and back office. We accept that new connections may lead to increased manpower costs for SSE Airtricity; however we consider that these costs are funded from the efficiencies gained from the allowed IT projects mentioned in section 7.3
- 8.17 Meter reading costs for SSE Airtricity in the West are treated differently for those in the Greater Belfast area. It is not appropriate to allow this cost at a cost per meter read as the low level of connections over the first few years would lead to a large cost per meter. Instead we have allowed this cost as a manpower cost, this will be reviewed should the level of connections reach a level at which we consider it appropriate to apply a cost per meter read.
- 8.18 The GD17 approach paper<sup>20</sup> indicated that the UR may consider undertaking a meter reading review in the future to establish if it is appropriate for the responsibility for meter reading to remain with gas suppliers, or if the responsibility

<sup>20</sup> GD17 Update on Our Overall Approach, 17 April 2015:  
[http://www.uregni.gov.uk/uploads/publications/2015-04-17\\_GD17\\_-\\_Approach\\_Document\\_-\\_Final.pdf](http://www.uregni.gov.uk/uploads/publications/2015-04-17_GD17_-_Approach_Document_-_Final.pdf)

should it be transferred to the distribution network operators. If the UR does complete this review during this price control period any impact of the review will be included as an Et item in the licence.

- 8.19 Customer engagement costs relate to the postage and printing costs for all customer literature, including bills, statements and any information the company must provide to its customers under licence requirements. These costs will be treated as retrospective costs as per the Greater Belfast control.
- 8.20 Safety inspections and meter exchanges within the network maintenance costs will be treated as retrospective costs as per the Greater Belfast control. As stated in the draft determination, we have reduced the costs for network maintenance as we have not received sufficient evidence to support these costs. While SSE Airtricity state that they have used the same assumptions as for the Greater Belfast area we would question if these assumptions are appropriate in a new gas area with a new network operator.
- 8.21 In the draft determination we proposed disallowing £50k for brand awareness and advertising (£30k as set out above and an additional £20k within set up costs). As commissioning/default supplier, SSE Airtricity will not be required to increase its brand awareness in order to attract customers.
- 8.22 In relation to set up costs, SSE Airtricity presented a list of costs equating to £85k in total.

We consider that some of the activities presented by SSE Airtricity are already covered by existing regulatory activities or do not require the forecast level of costs. For the draft determination, we proposed to allow £25k for set up costs and stated that we would review these costs on the receipt of further information from SSE Airtricity during the consultation period.

### **Response to Draft Determination**

- 8.23 The Consumer Council agree that the costs submitted by SSE Airtricity on brand awareness and advertising are excessive but have noted that they are keen for a discussion on how best to promote natural gas in the West and achieve connections.
- 8.24 SSE Airtricity did not provide any additional information to support their requests for set up costs.

## **Final Determination**

- 8.25 Having received no further information from SSE Airtricity our decisions on supply operating costs for SSE Airtricity in the West area remain as set out in Table 10 above.
- 8.26 Meter reading costs will be set at up to allowance of the costs set out above. This ensures that SSE Airtricity is not rewarded for activity that is not carried out.
- 8.27 Customer engagement costs will be treated as retrospective costs as per the Greater Belfast control.
- 8.28 Safety inspections and meter exchanges within the network maintenance costs will be treated as retrospective costs as per the Greater Belfast control.
- 8.29 Set up costs are capped at £25k in 2017.
- 8.30 All other costs relating to Gas to the West are deemed to be included with the control as a whole.

## 9. Gas Costs

- 9.1. Gas Costs relate to the cost of wholesale gas as well as the costs for transporting gas through Great Britain to the SNIP. These transportation costs are published by National Grid<sup>21</sup>. Previous controls have determined that these costs are pass through which means that the company is allowed to recover the actual cost of gas. Therefore where wholesale gas costs increase or decrease, the additional costs, or resulting saving are passed on to customers.
- 9.2. In the Approach consultation, 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).
- 9.3. Respondents to the consultation welcomed the proposal to treat wholesale gas costs and related transportation costs as pass through, therefore we propose to continue this approach.

### Energy Balancing

- 9.4. 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. SSE Airtricity and firmus 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.
- 9.5. We will set the energy balancing figure in the tariff as follows
  - where SSE Airtricity or firmus 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 SSE Airtricity or firmus 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.

This is in line with the energy balancing figures currently within the SSE Airtricity and firmus tariffs. These costs will form part of the tariff costs.

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21 <http://www2.nationalgrid.com/uk/Industry-information/System-charges/Gas-transmission/Current-charges/>

## **Credit Support**

- 9.6. Both suppliers 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 unit.
- 9.7. The allowed credit costs are included in the licence modification. These credit costs vary by company based on the financial structure and backing of the company and its parent company.

## 10. Margin

10.1. In its consultation paper the UR proposed a margin of 2%. This was based on

- The range of margin for a supply business operating in competitive markets as outlined by the CMA in its recent GB investigation
- The range of margin as calculated by First Economics using the capital base x cost of capital methodology
- The benchmark of Power NI allowed margin
- The benchmark of the current allowed price-regulated gas supply businesses margin

10.2. These four point estimates were discussed in detail in the consultation paper and the UR shared with the companies the confidential analysis carried out by First Economics which calibrated margins for both companies.

10.3. Responses were received from both SSE Airtricity and firmus and also the Consumer Council (CCNI) and Flogas. Flogas welcomed the analysis and felt that 2% was more appropriate in comparison to other Energy company margins in NI.

10.4. CCNI however argued that the UR had set the margin too high and should give consideration to a reduction from the current level of 1.5% following the CMA investigation in GB. The rationale for this was that the CMA had, using its Return on Capital Employed (ROCE), calculated that an appropriate margin for a supply company is 1.25% of turnover.

In addressing the CCNI point in relation to margin, whilst this level of margin (1.25%) was discussed in the CMA report, the final figure which was actually recommended by CMA after the analysis had been carried out was actually in the region of 2%. The CMA report recognises that there is a range of margins earned but states that:

*“We consider that greatest weight should be placed on evidence from the GB energy market itself, i.e. on the margins earned serving I&C customers and on previous GB regulatory determinations (recognising that regulated firms may face fewer risks). On this basis, we consider that an appropriate benchmark EBIT margin is around 2%.”*



The report also went on to state:

*“We note that this figure is higher than the competitive EBIT margin implied by our ROCE analysis (of 1.25%). However, the level of the appropriate EBIT margin will depend on the choice of operating model of an individual firm. Our ROCE analysis is based on a relatively asset-light model under which a firm pays an intermediary a trading fee, rather than holding capital for the purposes of trading collateral, and uses letters of credit rather than cash to meet regulatory collateral requirements. A firm that chose to hold capital rather than pay such fees would, other things being equal, earn a higher EBIT margin. We estimated the competitive EBIT margin implied by our ROCE analysis under the assumption that an equivalent amount of capital was held for trading and regulatory collateral purposes. This indicated a competitive EBIT margin of around 1.9%, which is broadly consistent with a 2% benchmark (see Appendix 9.10).”*

- 10.5. The text above shows that when taken fully the CMA analysis supports the UR proposal of a margin of 2%. However the UR notes another point that CCNI rightly make that being that the 2% margin calculated by the CMA is for companies that operate in a fully competitive market and do not have dominant market power. The CMA notes this itself when they recognise that regulated firms may face lower risks than those in fully competitive markets.
- 10.6. Both gas companies in NI operate in markets which are much less competitive than GB, both in terms of customer switching activity and number of suppliers and as such the UR has erred on the side of caution in allowing SSE Airtricity and firmus a 2% margin. This has been done to ensure that the companies make an appropriate return and that there is enough headroom in the tariff to allow for new entry.
- 10.7. Responses to the 2% proposal were also received from both SSE Airtricity and firmus. Unfortunately both of these responses focused on specific elements of the First Economics analysis and ignored completely the CMA analysis and the Power NI precedent, both of which were equally as important as the First Economics analysis in coming to a final figure of 2%.
- 10.8. The elements that both companies focused on whether or not there should be an allowance for the notional value of customer base, pricing of contingent capital and Beta.

- 10.9. First Economics prepared separate responses for both SSE Airtricity and firmus and these were shared with the companies. In summary First Economics did not agree with the positions of either company on any of the three elements and recommended that the UR maintain its proposal at 2%.
- 10.10. The UR therefore has decided that, consistent with the draft determination proposal, the margin will be 2% of allowable turnover.

# 11.Reconciliation

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

## 11.1 Reconciliation

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.

The reconciliation will take into account

- Billing costs which are retrospectively adjusted as defined in section 7.4.
  - Bad debt
  - Prepayment transaction costs
  - Meter reading
  - Customer information posting and printing
  
- Operating Costs which are retrospectively adjusted as defined in section 7.3.
  - Meter Exchanges
  - Safety Checks
  
- IT costs set as an up to allowance
- Inflation
- Apportionment

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

## 11.2 Inflation

All costs presented in this paper are in October 2015 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 RPI.

### **11.3 Rate of Interest**

Any reconciled amounts, whether under or over recovered, including gas costs, will be rolled forward at an interest rate of LIBOR plus 1.5%. This will apply to both SSE Airtricity and firmus.

The rate of interest reflects the cost to the suppliers of financing the under recovery or the benefits to them of holding any over recovery.

# Annex 1

## Apportionment Cost Drivers

Cost	Driver
Manpower Costs	Manpower Numbers
Staff Engagement	Manpower Numbers
Travel and Subsistence	Manpower Numbers
Training	Manpower Numbers
Recharges	Manpower Numbers
Office Costs	Manpower Numbers
Rates	Manpower Numbers
Professional and Legal Fees	Customer Number
Insurance	Load in therms
IT	Customer Number
Capex	Manpower Numbers
Licence Fee	Load in therms
Network Maintenance	Tariff
Customer Engagements	Customer Number
Prepayment Costs	Tariff
Credit Check Charges	Customer Number
Meter Reading	Meters Read
Customer Information P+P	Number Bills
Bad Debt	Tariff
Bank Charges	Customer Number