

**Approval by the Utility Regulator of the  
Phoenix Supply Ltd Tariff**

**September 2008**

**Approval by the Utility Regulator of the Phoenix Supply Ltd. 1st October 2008  
Tariff Review**

**Summary**

The Utility Regulator has approved a 19.2% increase in its tariff price for Phoenix Supply Limited (“PSL”) consumers using less than 25,000 therms per annum. This paper sets out the background to and reasoning behind our decision.

**Background**

The Utility Regulator has the power to set a maximum average tariff that PSL may set under condition 2.4.1 of the licence which states that

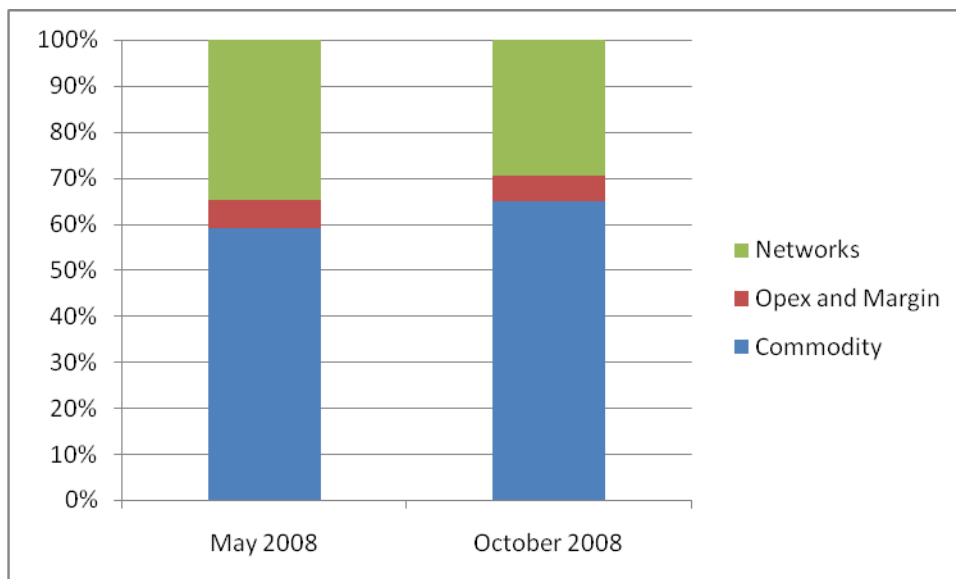
*‘the Licensee shall take all reasonable steps to secure that in any period of 12 months the average price per therm of gas supplied to such consumers shall not exceed a maximum price to which the Authority has consented’*

The maximum average tariff is made up of a number of costs.

- The cost of gas
- The cost of using the Transmission systems and the Phoenix Distribution system
- The operating expenditure of the supply business and supply margin

The following graph shows how these components make up the gas tariff in % terms.

Graph showing make up of tariff in May 08 v October 08



The commodity cost is the largest element of the tariff comprising almost 60% of the total gas cost in May 2008 which increases to over 65% in October 2008.

These components are established under the regulatory price control which was finalized in April 2008. For further information on the price control process or the final determination please see the following documents on our website;

- 19 May 2008 – Synopsis of the Approval by the Utility Regulator of the Phoenix Supply Ltd. 1st May 2008 Tariff Increase
- 15 April 2008 – Phoenix Supply Price Control 2007, 2008. Final Determination

As a result of the price control determination by the Utility Regulator the maximum average tariff was set at £1.28 per therm which represented a 28% increase effective from 1 May 2008.

The cost of wholesale gas was treated as pass through in the price control determination. This meant that PSL could pass through to customers the total cost of its gas purchases in the form of under or over recoveries in the following year.

Included within the determination was a trigger mechanism which stated that;

*‘A mid year review of gas tariffs will take place if Phoenix can demonstrate that the weighted average cost of gas has diverged from forecast sufficiently to cause a rise in the annual maximum average tariff of more than 5%.’*

The aim of the trigger mechanism was to ensure that PSL can finance its regulated activities whilst also ensuring a smooth path of prices for customers where possible by preventing large over or under recoveries from building up.

Should this trigger point be reached it allows PSL the opportunity to seek the consent of the Utility Regulator to amend the maximum average tariff under condition 2.4.1 of the Phoenix Supply Licence which states that

*‘where this Condition 2.4.1 [the maximum average price] applies, then the Licensee shall continue to comply with charging arrangements to which the Authority has consented until the Authority otherwise agrees with the Licensee that such consent may be modified or the need for such consent is no longer relevant.’*

The process and rationale for agreeing this increase is detailed below.

## Process

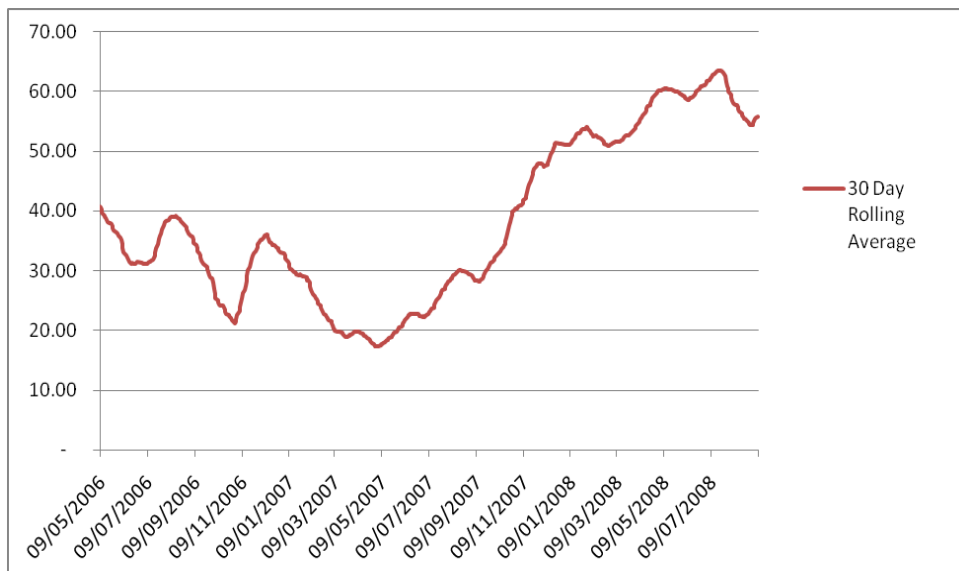
In July 2008 PSL indicated to the Utility Regulator that the wholesale price of gas had risen to such an extent since the May review that it would be necessary to initiate the trigger mechanism and on 17 August 2008 submitted a tariff review paper for approval stating that;

*‘Since the time of the tariff review in May 2008 there have been further sustained and significant increases in wholesale gas costs. As a result PSL is forecast to incur an additional £10.3 million in respect of wholesale gas costs for the tariff period from 1st May 2008 to 31st March 2009, over and above the level contained within the May tariff review. This has triggered a within year review of tariffs.’*

### Rationale

Wholesale gas markets have continued to increase and are trading at very high levels. The graph below shows the movement in the Day Ahead wholesale cost of gas from 2006 to date and shows the increasing trend in prices.

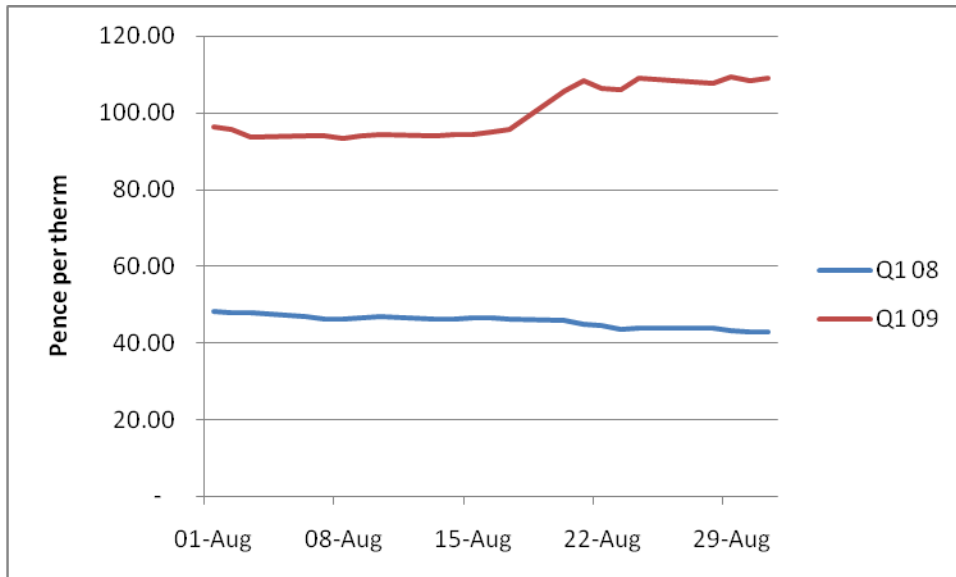
Graph showing 30 day Rolling Average for Day Ahead prices from 2006 to date



The following graph shows the price of gas for the first quarter of the year (January to March) for 2007 and for 2008 if it had been purchased in August of the previous year. For example Q1 2008 gas purchased in August 2007 and Q1 2009 gas purchased in

August 2008. This graph shows that the cost of wholesale gas for the first quarter has more than doubled from 2007 to 2008.

Graph comparing cost of gas for Q1 08 v Q1 09



PSL purchase gas throughout the year for the remainder of the tariff year and the Utility Regulator has monitored these purchases in line with market conditions.

The following table compares the cost of buying gas on the wholesale market for each month from October 08 to March 09 in April 2008 when the last tariff was set with the cost of buying the same gas in August 2008. Since the tariff review in May 2008 wholesale prices have risen consistently with the price for winter gas being almost 40% higher than the level set in the May tariff. Over the tariff period for 1 May 2008 to 31 March 2009 the increase in gas costs over those set in the tariff equates to around 30%.

	<b>Oct-08</b>	<b>Nov-08</b>	<b>Dec-08</b>	<b>Jan-09</b>	<b>Feb-09</b>	<b>Mar-09</b>
<b>Apr-08</b>	67.09	73.99	77.54	79.54	78.12	75.67
<b>Aug-08</b>	79.00	100.25	108.10	111.05	108.50	102.00
<b>Increase</b>	18%	35%	39%	40%	39%	35%

## Outcome

The Utility Regulator has reviewed the Tariff Review submission provided by Phoenix Supply and reviewed the PSL forecasts against its own market analysis. The analysis showed that over the tariff year, from 1 May 2008 to 31 March 2009, wholesale gas costs have risen by over 30%. As gas costs make up almost 60% of the tariff the impact of this 30% increase is to increase the tariff by 19.2% from £1.28 per therm to

£1.53 per therm. The Utility Regulator is satisfied that this increase is necessary and therefore approves the tariff review. PSL have now purchased a significant percentage of its wholesale gas requirements for the remainder of the tariff year, therefore any further movement in the market will impact tariffs to a lesser degree. However the Utility Regulator retains the flexibility to approve a review of gas prices at any stage if it is considered to be in the interest of customers.