Price Control for firmus energy (Supply) Ltd 2023-2026

Final Determination

23 September 2022

About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our mission

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

Our vision

To ensure value and sustainability in energy and water.

Our values

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

Abstract

This document sets out the UR's final determination for the price control on firmus energy (Supply) Ltd (FES) in the Ten Towns gas supply market. The FES control will come into effect on 1 January 2023 and will run until 31 December 2026.

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

Audience

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

Consumer impact

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

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Glossary

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

1. Introduction

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

1.2 The control will apply for the four year period of 1 January 2023 to 31 December 2026.

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

1.4 This final determination follows the UR’s FES Consultation Paper published in May 2022 which set out our high level proposals for supply price control 2023 – 2026 (SPC23). We received three organisational responses to this consultation and three individual responses which are published alongside this final determination and addressed where relevant within this consultation.

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

1.6 All costs presented are in October 2021 prices. These prices will be adjusted within the tariff for inflation as discussed in Section 9.

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

2. Background

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

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

2.3 The Ten Towns area is a relatively small market, and there are currently approximately 62,333 gas connections (comprising of 2,961 I&C connections and 59,372 domestic connections)[2].

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

2.5 The current FES price control applies for the period from 1 January 2020 to 31 December 2022.

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

[2] Quarterly Retail Energy Market Monitoring Report (Q122) - https://www.uregni.gov.uk/files/uregni/documents/2022-06/Q1%202022%20QREMM%20%28FINAL%29v2.pdf

3. Scope and Duration

Scope

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

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

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

3.3 Due to the continued dominance of FES in the EUC1 category, for SPC23 we proposed to retain the scope of the control at domestic and small business customers using up to 2,500 therms (73,200kWh) per annum.

Duration

3.4 In the November 2021 Information Paper we stated that we considered a four year period to be the most appropriate duration for the price controls as it balances the resource implications of carrying out a control with the ability to forecast accurately over the medium term.

3.5 Therefore, it was our proposal in the consultation to apply the control for a period of four years; from 1 January 2023 to 31 December 2026.

Response to Consultation

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

Final Determination

3.7 It is the decision of the UR that the scope of SPC23 for FES will remain structured as it was in SPC20, with the duration being increased by one year; as is laid out in the consultation.

4. The Regulated Tariff

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

2.4.1 Control over Charges

"*The Licensee shall take all reasonable steps to secure that in any Relevant Year the average price per unit of gas supplied by it to Regulated Premises*[3] *shall not exceed the maximum price calculated*"

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

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

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

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

K Factor

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

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

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

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

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

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

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

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

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

Tariff Review

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

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

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

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

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

Trigger Mechanism

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

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

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

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

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

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

Tariff Structure

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

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

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

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

Response to Consultation

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

Final Determination

4.27 It is the decision of the UR that the regulated tariff will remain structured as it was in SPC20; as is laid out in the consultation.

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

5. Network Costs

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

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

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

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

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

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

Response to Consultation

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

Final Determination

5.8 It is the decision of the UR that network costs will remain pass through costs for SPC23.

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[6] GMO NI charges: https://gmo-ni.com/assets/documents/GY2021-2022-Postalised-Tariff-Explanatory-Note.pdf

[7] FES conveyance charge statement: https://www.firmusenergy.co.uk/publications/category/conveyance-charges/specific/conveyance-charge-statement-2022

6. Supply Operating Costs

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

6.2 In November 2021 the UR provided FES with an initial information request for the operating costs wholly incurred by the Ten Towns supply business in the provision of gas to customers within the Ten Towns. This included the total operating costs for serving both price controlled and non-price controlled customers using more than 73,200 kWh per annum in the Ten Towns area.

6.3 The submission requested historical actual costs, Latest Best Estimates (LBE) of current costs (2021), and a forecast of costs for 2022 and the four years of the price control period 2023-2026. We stated that we would welcome any evidence to support the figures given in the submission. Additionally, the information request was clear that the burden of proof rests with FES to justify the cost base set out in the submission.

6.4 In January 2022 the supplier presented its initial submission to the UR. Over the next four months we engaged with FES to understand this submission through meetings and various additional information requests. We have analysed the forecast cost figures against historical costs and previous determinations and benchmarked information against other companies where appropriate. We have also engaged consultants to review specific elements of the submissions (e.g. FES margin submission).

6.5 In May 2022 we published the consultation paper which set out our proposals for the price control. FES and other stakeholders submitted responses to the consultation in July 2022.

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

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

6.8 The costs shown throughout this paper are the total FES Ten Towns Supply business costs only (i.e. not including the FES Greater Belfast supply business costs). The apportionment allocation of these costs determines the appropriate level of costs to the tariff sector (i.e. the price regulated sector of

FES Ten Towns business). This ensures there is no cross-subsidisation between the tariff and non-tariff businesses. In order to calculate the apportionment, each cost line is apportioned on the basis of the most appropriate cost driver and these apportionments summed to provide the overall percentage. A list of the apportionment cost drivers can be found in Annex 1.

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

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

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

Table 1 SPC23 Final Decisions (£000)

Tariff Costs	FES Submission				UR Consultation				UR Decision			
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
Manpower Costs	1,121	1,153	1,186	1,219	1,100	1,121	1,142	1,163	1,100	1,121	1,142	1,163
Operations Costs	650	699	796	794	570	608	694	682	570	608	694	682
Billing Costs	1,245	1,350	1,452	1,552	1,209	1,309	1,407	1,503	1,214	1,315	1,413	1,509
Total Costs	**3,015**	**3,202**	**3,434**	**3,565**	**2,880**	**3,039**	**3,243**	**3,348**	**2,884**	**3,045**	**3,250**	**3,354**

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

Manpower Costs

Table 2 Manpower Costs (£000)

Tariff Costs	FES Submission				UR Consultation				UR Decision			
	2023	**2024**	**2025**	**2026**	**2023**	**2024**	**2025**	**2026**	**2023**	**2024**	**2025**	**2026**
Manpower	1050	1081	1112	1144	1030	1049	1069	1088	1030	1049	1069	1088
Entertainment	4	4	4	4	4	4	4	4	4	4	4	4
Training	19	20	20	20	19	20	20	20	19	20	20	20
Travel and subsistence	21	22	22	23	21	22	22	23	21	22	22	23
Recruitment Costs Contract staff	27	27	28	28	27	27	28	28	27	27	28	28
Total	**1121**	**1153**	**1186**	**1219**	**1100**	**1121**	**1142**	**1163**	**1100**	**1121**	**1142**	**1163**

Salaries

6.13 Salaries make up the vast majority (93%) of the manpower cost submission along with some other smaller items of manpower cost. The submission for manpower costs for FES' Ten Towns gas supply company reflects an increase of 0.5 Full Time Equivalents (FTE) for each year until the end of the 2026. FES has stated that this FTE increase is a direct result of the additional c.30k tariff customers forecast over the next 4 years (overall a 50% increase in current customer numbers). The extra 0.5 FTEs per year was said to be needed to cover the additional billing resource and customer service staff necessary to facilitate this customer growth.

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

Note: In their initial submission FES originally asked for Manpower costs to increase by 1% above inflation. We proposed not to allow this as it would be inconsistent with the treatment of salaries in the gas distribution controls.

Response to Consultation

6.15 FES accepted this allowance in its response to the consultation. FES did however argue that an annual salary increase of 1% above inflation was justified to attract and retain staff in their supply business.

6.16 CCNI responded to the proposed manpower allowance in the consultation with a request for the addition of 0.5 FTEs to be lowered or removed from SPC23. CCNI quoted a customer increase number during SPC23 of 20,000 opposed to the increase of circa 30,000 customers that FES have proposed.

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6.17 It is the decision of the UR that the allowance will remain at the levels outlined in the consultation, as detailed in Table 2. The UR notes FES' belief that a 1% above inflation increase in salaries but the UR was not provided evidence as to why this was necessary.

6.18 In response to CCNI's concern, the UR takes CCNI's comments into consideration but needs to remain consistent with the customer numbers outlined in GD23. Furthermore, CCNI in its calculation used an outlying year (2020 which was impacted by COVID) to calculate their forecast customer number increase.

Health and Social Care Levy

6.19 FES submitted an additional cost in their response to the SPC23 consultation for the Health and Social Care Levy (HSCL) that is due to be implemented in 2023. The HSCL is an additional cost that employers are required to pay as part of the Employer National Insurance Contributions. The levy is 1.25% and would increase the manpower costs submitted by FES by approximately £7k p.a. for the duration of SPC23.

Final Determination

6.20 The allowances provided to FES in the May 2022 consultation will remain unchanged. We see this additional £7k p.a. requested by FES to offset the permanent introduction of the HSCL as being a relatively small cost that can be absorbed within the overall allowance and it does not warrant a change to the salaries cost line.

Other Manpower Costs

6.21 Entertainment - We proposed to accept FES' submission as it is in line with HMRC recommendations and SPC20.

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

6.23 Travel and subsistence (including Fleet Costs) - We proposed to allow this cost which is in line with historical spend, and commensurate with expected travel norms.

6.24 Recruitment costs for contract staff - We proposed to forecast the SPC23 costs based on the historic recruitment costs.

Response to Consultation

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

6.26 CCNI responded with a request that UR continue to monitor and analyse the costs of training and recruitment to ensure value for money and that FES allocate all travel and subsistence costs fairly and transparently between firmus' supply and distribution businesses as well as between the regulated and non-regulated supply business.

Final Determination

6.27 It is the decision of the UR to allow the costs for entertainment, training and travel, and recruitment costs for contract staff as laid out in the consultation. The apportionment methodology will be applied to ensure costs are apportioned fairly.

Operation Costs

Table 3 Operation Costs (£000)

Tariff Costs	FES Submission				UR Consultation				UR Decision			
	2023	**2024**	**2025**	**2026**	**2023**	**2024**	**2025**	**2026**	**2023**	**2024**	**2025**	**2026**
Office Costs including stationery, telephone and postage	48	49	51	52	48	49	51	52	48	49	51	52
Rates	5	5	5	5	5	5	5	5	5	5	5	5
Professional and Legal Fees	78	85	92	98	71	71	71	71	71	71	71	71
Insurance	45	47	49	51	45	47	49	51	45	47	49	51
Information Technology	227	246	265	284	227	246	265	284	227	246	265	284
CAPEX	13	14	64	17	13	14	64	17	13	14	64	17
Licence Fee	2	2	2	2	2	2	2	2	2	2	2	2
Network Maintenance including safety inspections	108	117	127	136	108	117	127	136	108	117	127	136
Call Centre	43	47	51	55	43	47	51	55	43	47	51	55
Advertising, Website and Sales Development	60	65	70	75	7	8	8	9	7	8	8	9
Supplier of Last Resort	20	20	20	20	0	0	0	0	0	0	0	0
Total	**650**	**699**	**796**	**794**	**570**	**608**	**694**	**682**	**570**	**608**	**694**	**682**

IT OPEX and CAPEX

6.28 IT costs make up the majority of the operation costs incurred by FES. The new billing system implementation is the IT solution replacing firmus energy's current IUS system.

6.29 The IT costs submitted for SPC23 are broken down into an OPEX and CAPEX element. OPEX costs relate to the ongoing maintenance and support of the various IT platforms/systems and other general IT and telecoms costs. We proposed that these are based on existing OPEX costs increasing in line with customer growth. The CAPEX costs of the new billing system were previously captured in the current Price Control SPC20. The CAPEX costs going forward are thus very small in comparison to the current control. We proposed to allow these small costs for SPC23 including an extra allowance in 2025 to cover the need for lifecycle replacement laptops, PCs, monitors and meter reading tablets due in 2025.

FES Consultation Response

6.30 CCNI responded by stating that IT OPEX costs should not go up with customer numbers. They felt that this was inappropriate.

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6.31 The UR view is that it is reasonable to increase IT OPEX costs in line with customer numbers as a large portion of IT OPEX is licensing costs which are based on customer numbers and the OPEX is also required for various IT platforms and general IT and telecoms.

Professional and Legal Fees

6.32 In both its SPC20 and SPC23 submissions, FES has forecasted costs for Professional and Legal fees to be driven by the forecast increase in customer numbers. After review, we stated this methodology does not accurately reflect how Professional and Legal spend will change. In reality, this spend decreased from 2021 to the forecast in 2022 despite rising customer numbers. Therefore, for the four years of SPC23 we proposed that the forecast for 2022 be used to set a fixed allowance. An average of the actual amounts spent in SPC20 was not used as 2020 is considered an outlier due to the pandemic.

FES Consultation Response

6.33 FES stated the requested allowances for Professional and Legal Fees were necessary to navigate the currently challenging energy supply market and to continue to provide a high level of customer satisfaction. FES informed the UR that some costs in this area will be fixed in nature but the remaining costs will vary depending on events (such as a price control consultancy and legal advice). FES indicated that, since their submission in January 2022, they have encountered numerous issues due to the volatile social and economic environment. FES also highlighted that an allowance of £178k p.a.

has been proposed in the SSE SPC23 draft determination

CCNI however supported the UR approach to the setting of Professional and Legal fees.

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6.34 Whilst FES has provided some detail as to why Professional and Legal fees are driven by growth in customer numbers, it has failed to provide solid evidence of increased costs in this area. The proposed allowances are based on the 2022 forecast spend for Professional and Legal Fees as this year is seen as a good candidate that encapsulates how FES operated in the volatile market and post-COVID. Additionally, the forecast spend for 2022 decreased from 2021 even though customer numbers rose. This evidences that even with rising customer numbers, the costs for Professional and Legal Fees does not increase in line with rising customer numbers.

6.35 The allowance provided for Professional and Legal Fees in the May 2022 consultation paper will remain unchanged. This decision is consistent with the UR treatment of other regulated companies in the NI energy market.

Advertising, Website and Sales Development

6.36 FES included a fixed amount in its submission of £50k for each year from 2023-2026 in anticipation of entry into the Ten Towns market by other domestic gas suppliers. The supplier stated that if this entry were to occur FES would have to adopt a new competitive operational strategy.

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

6.38 Therefore, we proposed that FES be provided no additional advertising and marketing allowance. This would be consistent with the treatment of both Power NI and SSE Airtricity, neither of which were provided a marketing allowance under their respective price controls when their regulated businesses first faced competition in the early years after new entry by competitors. FES is still the monopoly domestic supplier and faces no competition in the Ten Towns market, and we cannot envisage that there will be sufficient erosion of market share during the 4 year horizon of this new control to move them from a dominant position in the domestic sector. However, we are committed to keep this under review as the market develops and observe whether FES' domestic market share deteriorates should significant competition emerge.

FES Consultation Response

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

CCNI supported the UR approach.

Final Determination

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

Supplier of Last Resort

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

FES Consultation Response

6.42 In its consultation response, FES stated that the costs that would be covered during the SoLR procedure would not include the costs associated with ensuring that FES are prepared and ready to manage a SoLR event. FES referenced a letter sent to them by the UR in March 2020 that emphasises the importance that FES are 'SoLR ready'. FES believe that their submitted costs for SoLR are essential to ensuring that FES remains 'SoLR ready'.

UR Final Determination

6.43 We agree that nominated suppliers should be 'SoLR ready' but do not believe that an allowance of £20k p.a. is required for a regulated supplier to be ready for this process. In SPC20, an allowance of £3,800 p.a. was provided to FES to ensure that they would be 'SoLR ready'. This allowance should have effectively covered the costs incurred by FES to test their systems and therefore no further allowance is necessary as we deem FES to be properly prepared for a SoLR event.

Other Operations Costs

6.44 Office Costs (including stationery, telephone and postage) – We proposed to allow this cost which is in line with historical spend, and commensurate with increases in FTEs.

6.45 Rates - FES submitted costs for Rates which increase with numbers of

FTEs. We believed this as an inappropriate driver for rates as they will not be impacted by additional FTEs, but rather the size of Land and Property Services (LPS) increases. We therefore proposed that Rates forecasts are set at the 2021 level, as per SPC20 (i.e. the cost observed in the most recent LBE).

6.46 Insurance - We proposed to allow this cost which is in line with historical spend, and commensurate with forecast volumes for the price control period. FES provided proof for the increases in overall insurance costs stating that insurance costs had been highly impacted by COVID.

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

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

6.49 Call Centre – FES' submission had forecasts based on the average of previous 3 years. The forecasts are inflated by customer numbers throughout SPC23 and this is reasonable.

Response to Consultation

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

6.51 CCNI requested clarification on how the Insurance costs would be apportioned by FES. CCNI has also requested more information on what has determined the proposed increases in Network Maintenance Costs and for the UR to confirm that the allowances are as cost reflective as possible.

UR Final Determination

6.52 To answer CCNI's points; the Insurance costs are being apportioned by FTEs and the increased costs incurred due to the pandemic affect the regulated and unregulated sides of the business equally. The Network Maintenance Costs are retrospectively adjusted and are reflective of trends being experienced by FES regarding numbers of faulty meters, increased inspection rates, increased number of meter exchanges and number of tampered meters. All the rates are set by the network company for Network Maintenance Costs and the volumes of fieldwork appointments are retrospectively adjusted so these costs are effectively pass through of network company charges set in the distribution controls.

6.53 It is the decision of the UR to maintain the allowance for Other Operations Costs as outlined in the consultation.

Billing Costs

Table 4 Billing Costs (£000)

Tariff Costs	Initial Submission				Consultation Proposals				UR Decision			
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
Bad debt	85	96	107	117	49	56	62	68	54	61	68	75
Paypoint costs	616	663	709	754	616	663	709	754	616	663	709	754
Credit Check Costs	2	2	2	2	2	2	2	2	2	2	2	2
Bank and Interest Charges	7	7	8	8	7	7	8	8	7	7	8	8
Meter reading	303	329	355	380	303	329	355	380	303	329	355	380
Customer Information Bill Processing and Postage	232	252	272	291	232	252	272	291	232	252	272	291
Total	**1245**	**1350**	**1452**	**1552**	**1209**	**1309**	**1407**	**1503**	**1214**	**1315**	**1413**	**1509**

Bad Debt

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

6.55 We proposed in the consultation that Bad Debt is based on the FES actual debt write-offs rather than bad debt provisions. This average is calculated at 0.29% of tariff credit revenue based on the average of 2019 - 2021 and this calculation is used to forecast 2022 write offs (the last year of the current control) and then the allowances for SPC23 (0.29% of credit revenues). Bad debt would be retrospectively adjusted and allowed as 0.29% of actual outturn tariff credit revenue each year.

Note: the figures for Bad Debt in the table above (Actuals/Forecast, Initial Submission and Consultation Proposals) relate to tariff customer debt only.

Response to Consultation

6.56 FES agreed that our proposal of a bad debt calculation of 0.29% of credit revenues was a reasonable benchmark for determining future allowances for tariff bad debt. FES were apprehensive however on applying this figure going forward based on the social and economic events of the last 6-12 months. FES requested that due to the mounting financial pressure on its customers, which is forecast to increase bad debt levels during SPC23, the UR reassess the bad debt provision that was proposed in the SPC23 consultation. FES requested that an allowance closer to the initial 0.5% of credit revenue is given so that FES can continue to support those customers who are struggling with making a payment.

6.57 CCNI asked that the UR ensure that FES' Bad Debt be cost reflective and based off historical data. CCNI also requested that the difference between the Bad Debt allowance for SPC20 and the actual Bad Debt costs for 2020, 2021 and the LBE for 2022 was clarified.

UR Final Determination

6.58 In response to CCNI's comment, we can provide assurance that rigorous analysis has been performed on FES' actual levels of historical bad debt, and the level we have determined is cost reflective and benchmarks well against other energy suppliers. The allowance that is being given to FES for Bad Debt in the SPC23 can be seen above.

6.59 The UR believes that the new calculation for actual bad debt is more appropriate for setting the bad debt allowance for SPC23. The previous methodology was based on bad debt provisions instead of the actual bad debt write-off levels therefore the allowances that were given in previous price controls did not reflect the actual bad debt that the business was incurring

6.60 However we agree that bad debt is notoriously hard to forecast and that the economic outlook is worse than the conditions that have been in place for the historic period. We therefore propose to uplift the Bad Debt allowance that was outlined in the May 2022 consultation paper by 10% from 0.29% to 0.32% of tariff credit revenue. This is to create a buffer for FES due to the economic uncertainty that many customers in Northern Ireland are facing due to the current energy price crisis.

6.61 The figure of 10% is somewhat arbitrary as there is little empirical data or forecasts of how much consumer debt will increase, other than some survey work done by price comparison website USwitch, that we can call upon to set the uplift. However it does recognise that bad debt levels will likely rise due to the cost of living crisis. Furthermore the uplift is for a 4 year period and hopefully the current hardship faced by customers will ease in years 3 and 4 of the control. On that basis we see 10% as a reasonable figure.

Other Billing Costs

6.62 Bill Processing and Postage – We proposed to accept FES' forecast costs for Customer Information Bill Processing and Postage as they were considered reasonable. The forecasts are based on actual 2021 costs uplifted for customer numbers.

6.63 Credit Check Costs - We proposed to accept the FES requested allowances as the costs are based on 2021 costs and are uplifted for increases in customer numbers for SPC23.

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

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

6.66 Bank and Interest Charges – We proposed to accept these costs to be allowed as they are based on the average of 2019-2021 and thereafter increase in line with forecast volume.

Response to Consultation

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

6.68 CCNI asked if the roll-out of smart meters will reduce allowance required for Paypoint Costs including PAYG Cards. CCNI also asked if the rates being used for Meter Reading have been benchmarked against the rates being used by SSE. The final question posed by CCNI referenced incentives that FES use to encourage customers to read the meters themselves. CCNI asked if these incentives have increased the number of self-reads being completed by customers and therefore lowering the allowance required for Meter Reading.

UR Final Determination

6.69 It is the decision of the UR to maintain the allowance for Bill Processing and Postage, Credit Check Costs, Paypoint Costs and Meter Reading Costs as outlined in the consultation. In response to CCNI queries on Bill Processing and Postage, Paypoint Costs and Meter Reading Costs, all these are retrospectively adjusted and as such any reductions in these over the 4 year control will see the monetary savings passed to customers.

7. Gas Costs

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

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

Energy Balancing

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

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

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

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

7.5 This is in line with the energy balancing figures currently within the FES tariff. We will discuss the parameters of the energy balancing element of the tariff with FES during the consultation period.

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

Credit Support

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

7.7 The submission for the supplier's credit costs are reasonable when benchmarked to other suppliers in the energy supply industry. We therefore proposed to allow these costs.

Response to Consultation

7.8 FES made no comment on gas costs in its response to the consultation. CCNI questioned whether there should be a greater incentive to purchase more gas in advance and whether 10% premium was too much to cover the cost of purchasing gas within month.

Final Determination

7.9 We determine that gas costs will remain as pass through costs. In response to CCNI the 10% premium will pass through the K factor if it is not needed and it is more the suppliers hedging strategy rather than the gas balancing figure that will determine how much gas is purchased in advance.

8. Margin

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

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

8.3 We outlined in our Information Note in November 2021 that we did not believe that market conditions have changed sufficiently to warrant any amendment to this level of margin. FES retains a dominant position in supply to price regulated customers (and is the monopoly supplier to domestic customers) in the Ten Towns area and has associated market power. This is one of the principal reasons for the continuance of the price control, and FES still has more market share and fewer competitors than Power NI had when the 2.2% was set for that supplier.

8.4 However FES engaged with consultants Frontier Economics on the issue of margin and, alongside their business plan submission, submitted to the UR a paper from Frontier that outlined a retail supply margin proposal which refreshed the numbers used in the calculations for the SPC17 margin. This again was based on the methodology of a notional supply business capital base (made up of “core” and “contingent” capital) and the cost of capital. It also compared the result of that methodology to relevant benchmarks such as the GB price cap and the Power NI margin to calculate a range within which the FES margin should come. The range suggested by Frontier was 2.2% - 3% of allowable turnover.

8.5 The UR engaged consultants First Economics to assess the Frontier analysis. Both consultants engaged and the UR also met with FES and both sets of consultants in April. Alongside some minor differences in approach, principally to do with the value of the customer base, the main area of disagreement was the cost of capital for that portion of the capital base which is contingent capital i.e. trading collateral requirements and risk capital.

8.6 Whilst Frontier felt that this contingent capital should receive the full rate of return (pre-tax nominal WACC 8.6% – 10.9%), First Economics are of the view that it should receive a return of 2%. First Economics cited the CMA decision in its energy market enquiry when it calculated the cost of letters of credit at 2%, alongside observed cost for letters of credit and PCGs of 2%.

8.7 First Economics concluded that whilst these did not provide a definitive answer to the question of what is the cost of contingent capital, the evidence did point clearly in the direction of a costing of around 2%, and that is what the CMA had decided was appropriate in its findings to the enquiry.

8.8 First Economics also compared the result of its own methodology to relevant benchmarks such as the GB price cap and the Power NI margin to calculate an appropriate FES margin and their conclusion was that there is no justification for an increase to the current 2%.

Response to Consultation

8.9 FES acknowledged the challenges associated with reviewing margin as part of the SPC23 price control review and provided no further evidence as to why the margin should be changed from the current 2% level. FES did however ask that we keep margin in mind if changes to the market take place.

8.10 CCNI responded to the FES SPC23 consultation by questioning whether the 2% margin level was currently too high of a return for the risk associated in SPC23. CCNI believe that the margin should be reviewed and tapered to a lower percentage when wholesale prices increase but operating costs remain the same. CCNI believe that this would help alleviate some of the pressure being placed on gas consumers in the Ten Towns network. National Energy Action (NEA) also responded ion the question of margin and suggested a tapering of margin.

UR Final Determination

8.11 The UR proposes no change at this point to the margin for SPC23. We note CCNI's and NEA's suggestion that the margin should be tapered. We also note that very recently Ofgem have published an initial consultation on reviewing the margin in the GB price cap in response to the energy price crisis. Changing the structure or methodology for margin in response to these recent events is not something that could be completed within the time frame for setting the new FES control (1 Jan 2023) as full consideration would need given to the outcome of the Ofgem consultation and our own analysis completed. We will however assess the effect of the consultation and consider with board whether there needs to be any future specific margin focused discussions for NI.

9. Reconciliation

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

Reconciliation

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

9.3 The reconciliation will take into account:

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

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

Inflation

9.5 All costs presented in this paper are in October 2021 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 Consumer Prices Index Including Owner Occupiers' Housing Costs (CPIH).

Rate of Interest

9.6 We proposed that any reconciled amounts, whether under or over recovered, will be rolled forward at an interest rate of Bank of England Base Rate plus 1.5%. The Bank of England Base Rate will replace LIBOR which was previously used. The proposed rate of interest reflects the cost to the suppliers of financing the under recovery or the benefits to them of holding any over recovery.

Response to Consultation

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

Final Determination

9.8 It is the decision of the UR that reconciliation will remain structured as it was in SPC17; as is laid out in the consultation. Inflation will be changed from RPI to CPIH and LIBOR replaced with the Bank of England Base Rate.

Annex 1

Apportionment Cost Drivers

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

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