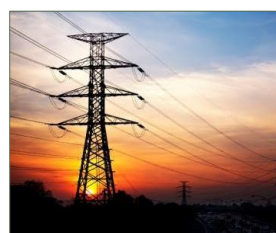


Conclusion of the Utility Regulator's Review of the SSE Airtricity Gas Supply (NI) Ltd Maximum Average Price in the Greater Belfast area

September 2015



About the Utility Regulator

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

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

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

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

Our Mission

Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

Protecting customers is at the heart of the Utility Regulator's role and ensuring that customers pay the correct price for energy from the price regulated supplier SSE Airtricity Gas Supply (NI) Limited (**SSE Airtricity**) is a core part of our work. We commenced a review of the maximum average price with SSE Airtricity in July 2015. We have scrutinised the submission provided by SSE Airtricity to ensure that the maximum average price approved is not more than the sum of the costs allowed under the price control determination. This ensures that customers pay no more than the costs of purchasing and supplying gas plus a pre-determined allowance for the operating costs of the business and an agreed profit margin.

The maximum average price for SSE Airtricity's domestic and small business customers in Greater Belfast will decrease to 112.50 pence per therm from 1 October 2015. This is an average reduction of 10%.

Audience

Customers and customer groups, industry and statutory bodies.

Consumer impact

SSE Airtricity customers in the Greater Belfast area will benefit directly from this review as the price they pay for the gas they use will be on average 10% lower. This change will affect domestic and small business customers. The change will take effect from 1 October 2015. This follows a decrease of 7.8% in April 2015.

The impact of the tariff change on a domestic customer on a standard credit tariff with average consumption of 12,500 kWh per annum will be a saving of £58 per annum (including VAT) on their gas bill.

Approval by the Utility Regulator of the SSE Airtricity Gas Supply (NI) Limited Maximum Average Price in the Greater Belfast area

Summary

On 16 July 2015 the Utility Regulator, in conjunction with SSE Airtricity Gas Supply (NI) Limited (**SSE Airtricity**), the Department of Trade, Enterprise and Investment (**DETI**) and the Consumer Council began a review of the SSE Airtricity maximum average price for domestic and small business customers using less than 25,000 therms per annum. The current maximum average price has been effective from 1 April 2015 and covers approximately 125,000 customers within the Greater Belfast Area.

We carry out formal reviews of the SSE Airtricity maximum average price on a bi-annual basis (in advance of April and October). The Utility Regulator can also initiate a further review of the maximum average price at any stage should the wholesale cost of gas change significantly such that it would result in an increase or decrease of at least 5% to the maximum average price. On an ongoing basis we analyse the cost of wholesale gas on the forward curve, along with the forward purchases that SSE Airtricity has made to date.

We initiated the formal review to establish the new maximum average price to become effective from 1 October 2015. The review is a formal process agreed by SSE Airtricity, DETI and the Consumer Council. It is set out within the SSE Airtricity¹ price control and details the processes to be followed and the timescales for the review process.

SSE Airtricity uses the maximum average price to set the actual tariffs that are charged to customers. The tariffs are calculated on a weighted average basis, based on average usage and the number of customers using each tariff. SSE Airtricity cannot charge more than the maximum average price overall.

The maximum average price for domestic and small business customers will be 112.50 pence per therm from 1 October 2015. The new maximum average price has been modelled and forecast over a period of 12 months however it will be kept under constant review and adjusted within that time period if required. We will complete another formal review in advance of 1 April 2016 and will continue to monitor gas prices to identify if an additional review is required.

From 1 October 2015, the unit rates of tariffs for SSE Airtricity's customers in the Greater Belfast area will decrease by 10% on average. These unit rates are detailed in Table 5 later in this paper.

¹ Utility Regulator Determination on Phoenix Supply Price Control 2012 – 2016, November 2011: http://www.uregni.gov.uk/uploads/publications/PSL_PC03_Determined_to_Position_Table_26_blanked_for_website2.pdf (Note that SSE Airtricity purchases Phoenix Supply Limited in June 2012)

Background

In Northern Ireland there are two distinct distribution areas for natural gas. These are the Greater Belfast area and the Ten Towns area. Phoenix Natural Gas Limited (PNGL) own and operate the distribution network in the Greater Belfast area while firmus energy (Distribution) Limited own and operate the distribution network in the Ten Towns area.

In the Greater Belfast area SSE Airtricity² has operated as the incumbent gas supplier since 1996. One competing supplier has been active in the domestic gas market since 2010. Customer switching has been largely constant since 2010, however levels have started to fall over the past year. SSE Airtricity remains the dominant supplier in the Greater Belfast area for customers using less than 25,000 therms per annum (referred to as tariff customers), they currently supply around 125,000 tariff customers, this represents around 72% of the tariff market in Greater Belfast.

Under the terms of SSE Airtricity's licence to supply gas, the Utility Regulator ("**the Authority**") has the power to control the maximum amount that SSE Airtricity can charge for gas. These controls apply when customers are not protected by competition.

'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' (Condition 2.4)³

The Utility Regulator has established a price control determination which sets out SSE Airtricity's allowed costs. The price control determination sets out how each of the costs will be treated in the maximum average price.

² In June 2012, Airtricity Energy Supply (Northern Ireland) Ltd purchased the entire issued share capital of Phoenix Supply Ltd and was subsequently renamed SSE Airtricity Gas Supply (NI) Limited (SSE Airtricity).

³ SSE Airtricity Licence for the supply of gas: [http://www.uregni.gov.uk/uploads/licenses/2014-03-28_Airtricity_Gas_Supply_NI_Ltd_\(PSL\)_Supply_Licence.pdf](http://www.uregni.gov.uk/uploads/licenses/2014-03-28_Airtricity_Gas_Supply_NI_Ltd_(PSL)_Supply_Licence.pdf)

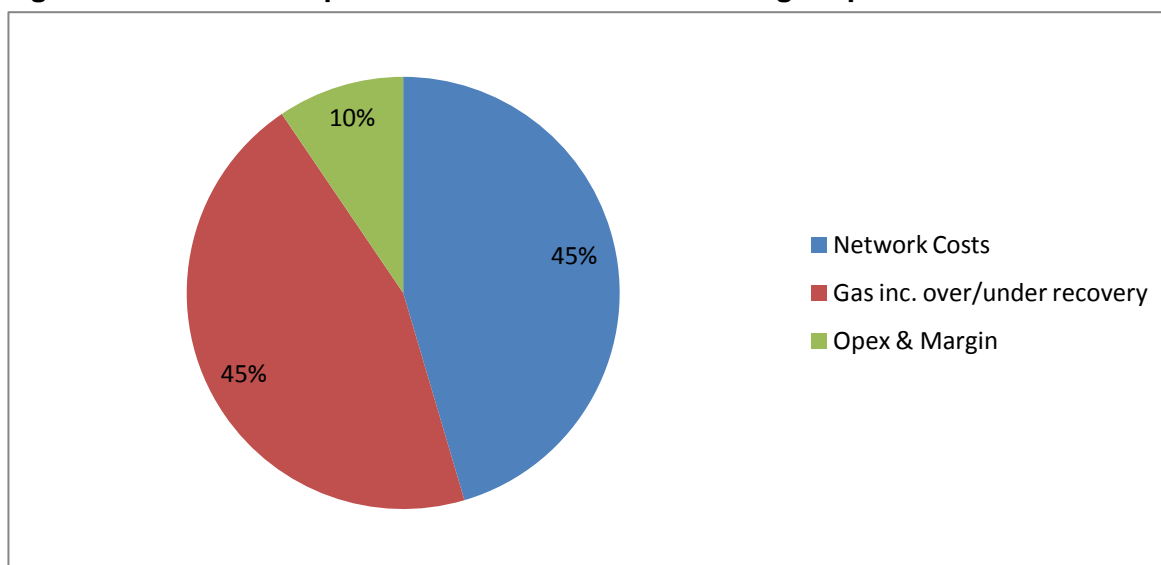
Elements of Maximum Average Price

The maximum average price is made up of a number of costs:

- Operating costs and supply margin;
- Network costs; and
- Wholesale cost of gas and over/under recovery from previous tariff periods.

The breakdown is shown in figure 1 below.

Figure 1 - Makeup of the maximum average price October 2015



The Utility Regulator scrutinises the costs within each of the elements of the maximum average price of SSE Airtricity's submission. SSE Airtricity uses the maximum average price to set the actual tariffs that are charged to customers. SSE Airtricity cannot charge more overall than the maximum average price.

Operating Costs and Supply Margin

Operating costs are the costs necessary for SSE Airtricity to run its supply business for tariff customers. The operating costs are determined under the price control carried out by the Utility Regulator. These costs include the costs of billing, customer service, offices, meter reading, salaries and IT systems.

The margin refers to the amount of profit SSE Airtricity is allowed to make. The margin is also determined within the price control and is currently set at 1.5% of allowable turnover from tariff customers.

The current price control determination⁴ runs from 1 January 2012 to 31 December 2016.

⁴ Utility Regulator Determination on Phoenix Supply Price Control 2012 – 2016, November 2011: http://www.uregni.gov.uk/uploads/publications/PSL_PC03_Determined_to_Position_Table_26

Network Costs

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.

The SSE Airtricity price control determined that the transmission and distribution system charges will be treated as pass through charges, which means that the customer pays for the actual cost of the network charges.

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 at <http://www.premier-transmission.com/>.

The costs for the distribution system are those costs associated with moving gas throughout the Greater Belfast area to homes and businesses. These can be found on the Phoenix Natural Gas website at <http://www.phoenixnaturalgas.com/help-and-advice/networks/charges/>. For the purposes of setting the maximum average price the Distribution charges for the Phoenix Natural Gas network have been estimated based on the current charges as the latest charges have not been published at this time.

Wholesale Gas Costs and Over/Under Recovery from Previous Tariff Periods

This element of the maximum average price includes the forecast cost of wholesale gas and any over/under recovery from the previous tariff period that needs to be deducted/added in the maximum average price. This makes up around 45% of the total. Further detail on these costs is provided below.

- **Wholesale Gas Costs**

As determined within the SSE Airtricity price control, the gas cost element of the maximum average price incorporates the wholesale cost of gas as well as charges for transporting gas through Great Britain and costs for securing credit.

The price control determines that gas costs are treated as pass through which means that the customer pays for the actual cost of gas. Therefore where wholesale gas costs decrease or increase over those set in the tariff, the resulting savings or additional costs are passed on to the customer.

SSE Airtricity has a gas purchasing strategy in place which means that they purchase a percentage of their forecast volumes in advance on an ongoing basis. This is known as

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hedging and limits the exposure to fluctuations in wholesale gas prices and therefore aims to create more stability in the gas price for final customers.

At the time of review, the overall cost of gas for the maximum average price is estimated based on a combination of actual gas purchases that have already been secured, along with forecast volumes of gas required, and the wholesale cost of gas from the forward curve. Buying gas in advance (hedging) can help to reduce any over/under recoveries building up as the price of the hedged gas in the maximum average price is known when the price is set.

- ***Over/Under Recovery from Previous Tariff Periods***

Wholesale gas costs make up a large component of the final maximum average price and as these costs can be volatile there will always be a difference between the outturn cost of the wholesale gas compared to the forecast costs that were included in the maximum average price.

Where the wholesale gas costs out turn less than was forecast in the maximum average price, SSE Airtricity will 'over recover'. This means that they recovered more money from customers than they spent on gas costs and they will subsequently refund the over recovered difference to customers in the following tariff periods.

Or, where the wholesale gas costs turn out higher than forecast in the maximum average price, SSE Airtricity will 'under recover', the means they spent more on gas costs than they recovered from customers and they will therefore be able to recharge the under recovered difference to customers in the following tariff periods. This ensures that customers only pay for the actual cost of gas.

Therefore, each maximum average price includes an amount of over or under recovery which was accumulated during previous tariff periods

Both SSE Airtricity and the Utility Regulator strive to keep the over/under recovered amount as low as possible in order to avoid distortion of the maximum average price. This is carried out through ongoing monitoring and tariff changes being put through when over or under recoveries are increasing to such an extent that they would adversely affect the tariff.

The maximum average price effective from 1 October 2015 includes an amount of £1.1m which SSE Airtricity has over recovered previously and will now be returned to customers.

Why is the Maximum Average Price for SSE Airtricity decreasing?

The maximum average price for SSE Airtricity's tariff customers in Greater Belfast will reduce to 112.5 pence per therm from 1 October 2015. Table 1 below shows the movement in the regulated maximum average price from May 2008 to date.

Table 1 - Historic maximum average price

| Effective from date | Approved Maximum Average Price (pence per therm) |
|---------------------|--|
| 01-May-08 | 128.00 |
| 01-Oct-08 | 152.58 |
| 08-Jan-09 | 118.92 |
| 01-Oct-09 | 96.32 |
| 01-May-11 | 133.97 |
| 01-Apr-12 | 122.64 |
| 01-Apr-13 | 133.26 |
| 01-Apr-15 | 125.17 |
| 01-Oct-15 | 112.50 |

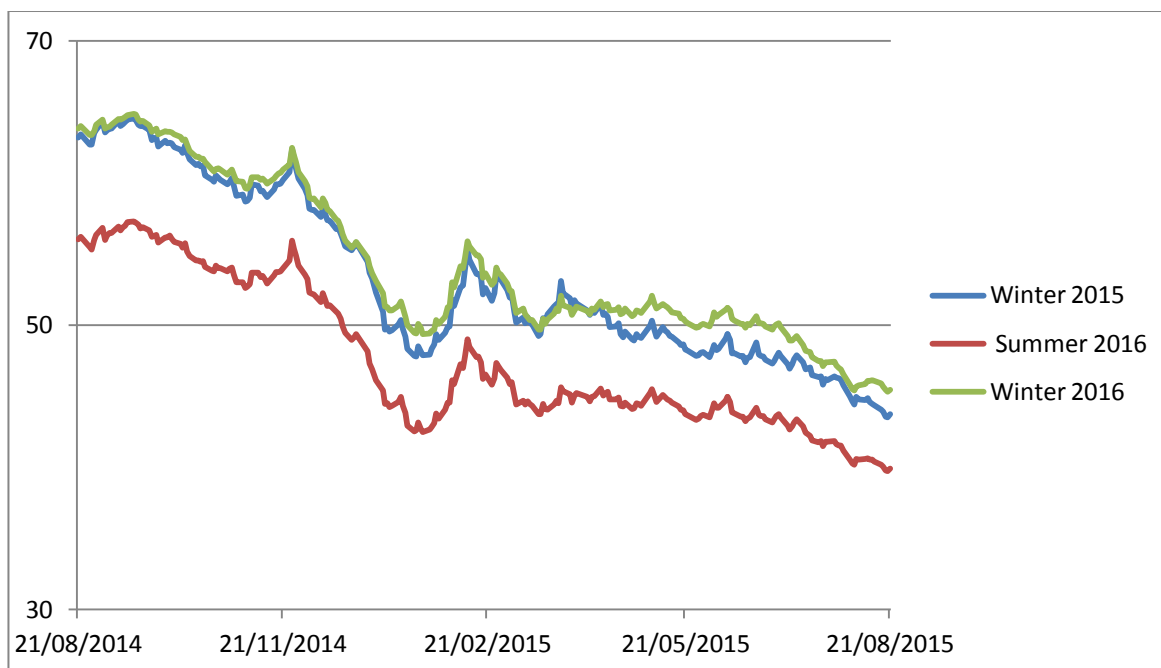
The overall decrease in the SSE Airtricity maximum average price is driven by the decrease in the cost of wholesale gas as explained below.

- ***Decrease in Wholesale Gas Cost and Over/Under Recovery from Previous Tariff Periods***

The main driver for the reduction in the maximum average price is the decrease in the forecast wholesale cost of gas (when compared with the forecast wholesale gas cost included in the maximum average price set in April 2015).

Overall forecast gas costs on the forward curve have fallen over the last number of months. This is shown in the graph below.

Figure 2 – Movement in forward curve of wholesale gas cost



Source: Platts McGraw Hill Financial

Table 2 below shows that the forecast cost of gas within the maximum average tariff has reduced from 63.38 pence per therm in the April 2015 tariff to 50.57 pence per therm in the October 2015 tariff.

It is important to note that an element of the gas price included within the maximum average price is a forecast cost and the actual outturn prices may be higher or lower.

If the actual gas prices turn out to be lower than those forecast then SSE Airtricity will over recover, and if actual gas prices turn out to be higher than those forecast then SSE Airtricity will under recover. Any amounts that are over or under recovered will be returned to customers or recovered from customers in the following tariff period.

The maximum average price coming into effect from 1 October 2015 will include an over recovery. This acts to decrease the maximum average price as SSE Airtricity return the previous over recoveries to customers. The position has moved from an under recovery of £3.7m at the setting of the April 2015 maximum average price to a forecast over recovery position of £1.1m at 1 October 2015 (estimated up until the point of the maximum average price change). The impact of the change in the over/under recovery on the maximum average price is shown in Table 2 below.

Table 2 - Wholesale Gas Costs and Over/Under Recovery from Previous Tariff Periods within Maximum Average Price

| Elements within Maximum Average Price | April 2015 (pence per therm) | October 2015 (pence per therm) |
|--|---------------------------------|-----------------------------------|
| Wholesale Gas Cost | 59.65 | 52.08 |
| Over/Under Recovery | 3.73 | -1.51 |
| Total Wholesale Gas Cost and Over/Under Recovery from Previous Tariff Periods | 63.38 | 50.57 |

- ***Increase in Network Charges***

Transmission Network charges have increased over the level set in the April 2015 maximum average price. This increase has been driven by the reduction of forecast exit capacity volumes for 2015-16 in comparison to 2014-15, meaning that the capacity cost element of the transmission tariff (which is a fixed cost) is being spread over fewer units and hence has increased in £ per unit.

The table below shows the difference between the forecast annual tariff for 2014/15 and the forecast annual tariff 2015/16. Note that the 2015-16 gas year is the first year for which forecast tariffs have been calculated by entry and exit points. However it is the total capacity charge which is relevant and as the table shows it has increased for the reason outlined above.

Table 3 - Annual Transmission Forecast Tariffs

| | 2014/15 | 2015/16 | Difference |
|---|-----------|----------|------------|
| Entry Capacity Charge (£ per Kwh/d booked) | N/A | 0.27044 | |
| Exit Capacity Charge (£ per Kwh/d booked) | N/A | 0.27044 | |
| Total Capacity Charge (£ per Kwh/d booked) | 0.45013 | 0.54088 | 20.16% |
| Commodity Charge (£ per Kwh) | 0.0009841 | .0009445 | -4.02% |

Distribution charges have been forecast at approximately the same level as for the previous tariff period. These charges will be published on 1 October 2015.

Overall network costs (transmission and distribution combined) have increased only slightly. This increase has had an immaterial effect on the overall cost to consumers as it

accounts for only 1% of the final unit price of gas. This can be seen in Figure 3.

Breakdown of Maximum Average Price

The graph shown in Figure 3 below compares the breakdown of the October 2015 maximum average price with a breakdown of the previous maximum average price set at April 2015. The graph demonstrates that the operating costs and margin remain largely the same. As explained previously, the decrease in the maximum average price is as a result of wholesale gas costs.

Figure 3 – Breakdown of October 2015 maximum average price compared with the previous maximum average price

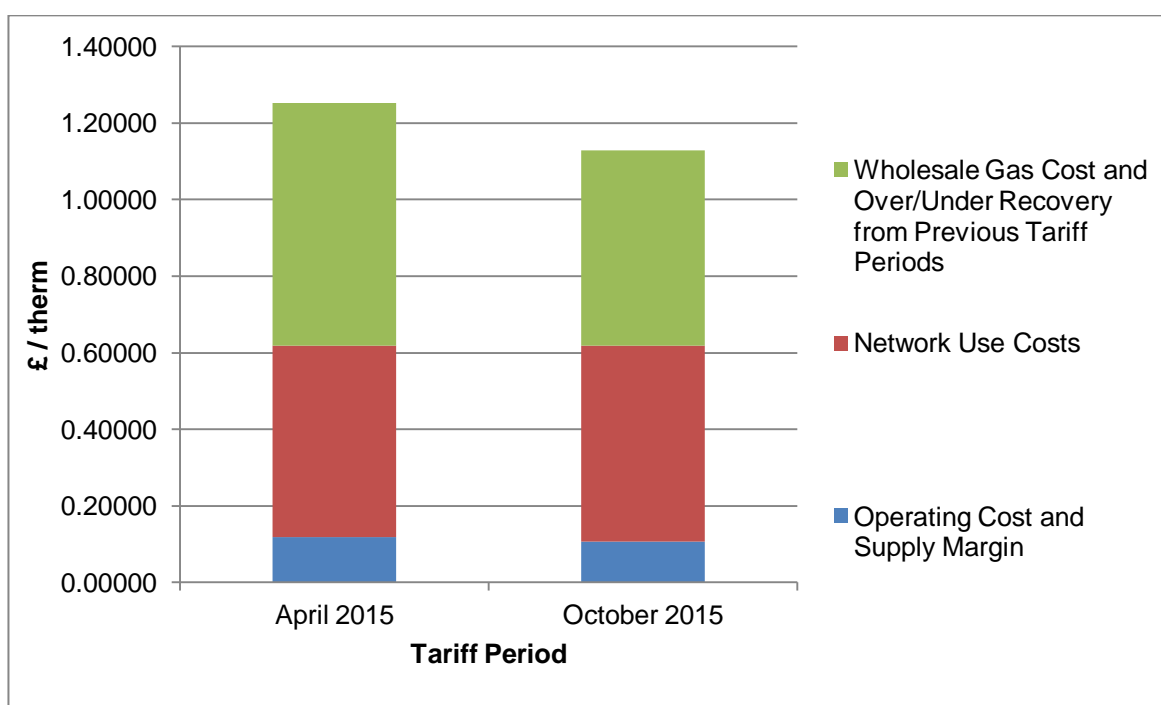
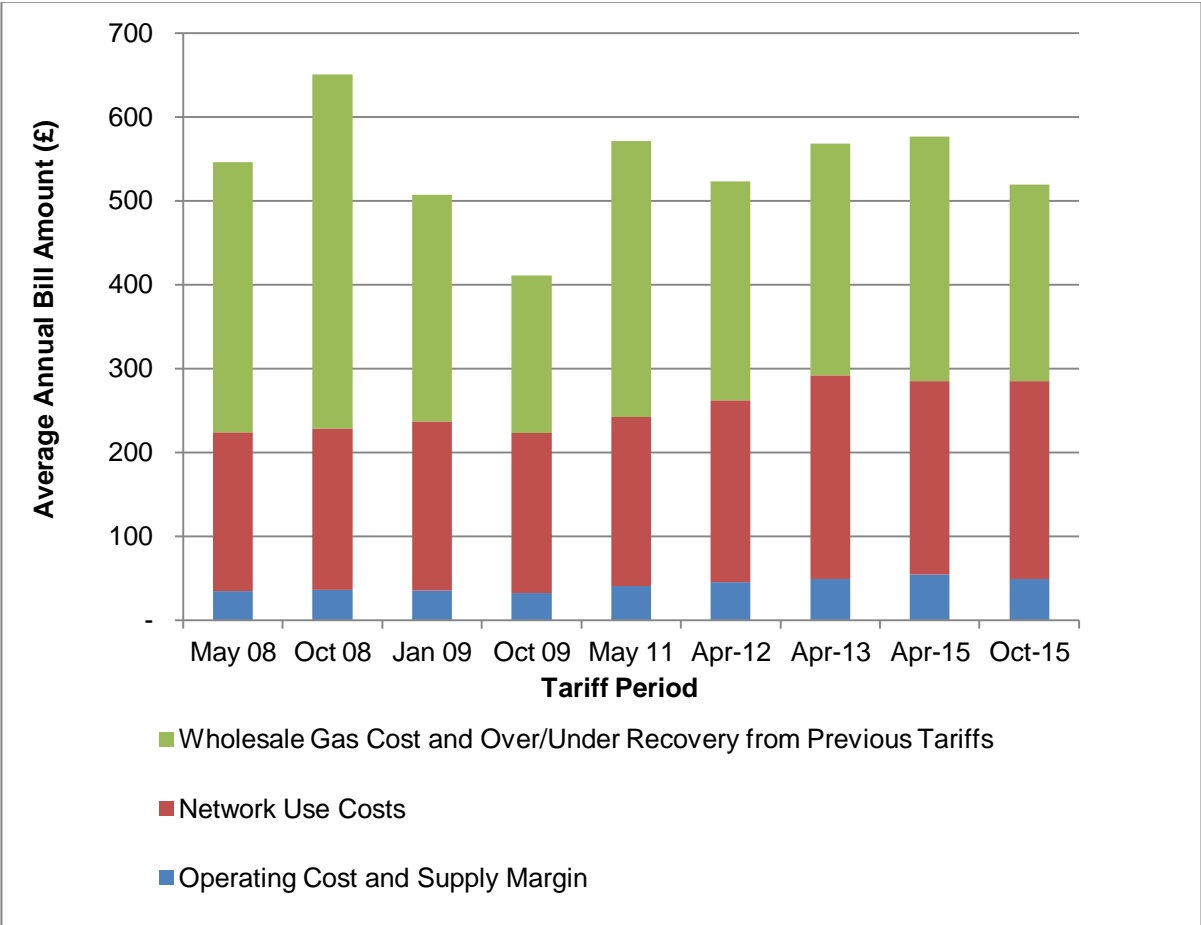


Figure 4 below shows the breakdown in the average annual bill for SSE Airtricity tariff customers over the past few years and illustrates again the variation caused by different components of the maximum average price. As expected, it can be seen that the variations in the maximum average price are largely driven by changes in the wholesale cost component and resulting over/under recovery positions.

The average annual bill amounts in this graph have been calculated based on the maximum average price set at each review (which excludes VAT) and are based on average annual consumption of 12,500kWh⁵.

⁵ 12,500 annual usage estimate is based on the figure published by Ofgem on their website at <https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/typical-domestic-consumption-values>;

Figure 4 - Graph to show breakdown of average annual bill



Impact on Tariff

As stated earlier, SSE Airtricity uses the maximum average price to set the actual tariffs charged to customers. The tariffs are calculated on a weighted average basis, based on average usage and the number of customers on each tariff. SSE Airtricity cannot charge more than the maximum average price overall. From 1 October 2015, the unit rates of tariffs for SSE Airtricity's customers in the Greater Belfast area will decrease by an average of 10%. Table 4 below shows the movement in the tariffs from May 2008 to date.

Table 4 – Historic changes in tariffs

| Effective from date | Change |
|---------------------|---------|
| 01-May-08 | 28.00% |
| 01-Oct-08 | 19.20% |
| 08-Jan-09 | -22.10% |
| 01-Oct-09 | -19.00% |
| 01-May-11 | 39.10% |
| 01-Apr-12 | -8.50% |
| 01-Apr-13 | 8.70% |
| 01-Apr-15 | -7.8% |
| 01-Oct-15 | -10% |

The new unit rates for tariff customers that will apply from 1 October 2015 are shown in Table 5 below. Table 6 shows the percentage decrease for each individual unit rate of the domestic and small business tariffs.

Table 5 – SSE Airtricity's tariff unit rates from 1 October 2015 (shown in pence per kWh including VAT)

| Pence per kWh | Home Energy inc. 5% VAT | PAYG inc. 5% VAT | IC1 inc. 20% VAT | IC2 inc. 20% VAT |
|-----------------------|----------------------------|---------------------|---------------------|---------------------|
| Up to 2,000 kWh | 5.635 | 4.100 | 6.440 | 6.440 |
| Over 2,000 kWh | 3.862 | 4.100 | 4.414 | 4.414 |
| Over 73,200 kWh | | | | 4.086 |
| Direct Debit discount | 22.05 | | 22.05 | 22.05 |

Table 6 – Percentage decrease in SSE Airtricity's tariff unit rates from 1 October 2015

| | Home Energy | PAYG | IC1 | IC2 |
|-----------------|-------------|--------|--------|--------|
| Up to 2,000 kWh | -10.0% | -10.0% | -10.0% | -10.0% |
| Over 2,000 kWh | -10.0% | -10.0% | -10.0% | -10.0% |
| Over 73,200 kWh | | | | -10.0% |

The change in the SSE Airtricity maximum average price from 1 October 2015 equates to a decrease in domestic customer bills of around £58 per year (including VAT) based on the SSE Airtricity standard domestic credit tariff unit rates using average annual consumption of 12,500 kWh (rounded to nearest pound).

Comparison with GB and Ireland

Figure 5 below, shows the average annual bill of a domestic customer for SSE Airtricity compared to the “Big 6”⁶ supply companies in GB and Bord Gais in Ireland.

This comparison is based on the latest available information on the standard domestic credit tariffs⁷ of each company and is based on average annual consumption of 12,500 kWh⁵. The average annual bill amounts in this graph have been calculated based on actual tariff unit rates (including VAT) and are based on average annual consumption of 12,500kWh⁵.

This graph shows the SSE Airtricity tariff that will become effective on 1 October 2015 and also takes account of any tariff changes for supply companies in GB and Ireland which have been published, even if the tariff change has not yet taken effect.

Figure 5 below illustrates that the SSE Airtricity tariff for an average domestic credit customer will be over 19% cheaper than the GB average standard tariff and around 12% cheaper than the Bord Gais standard tariff in Ireland.

⁶ The Big 6 companies are British Gas, SSE, Scottish Power, npower, E.on UK and EDF Energy.

⁷ The tariffs used for comparison purposes are the standard tariff rates for domestic credit customers excluding any discounts available for payment by direct debit, viewing bills online etc.

Figure 5 - Comparison of average annual domestic bills (based on standard domestic credit tariffs with estimated usage 12,500 kWh per annum including VAT)

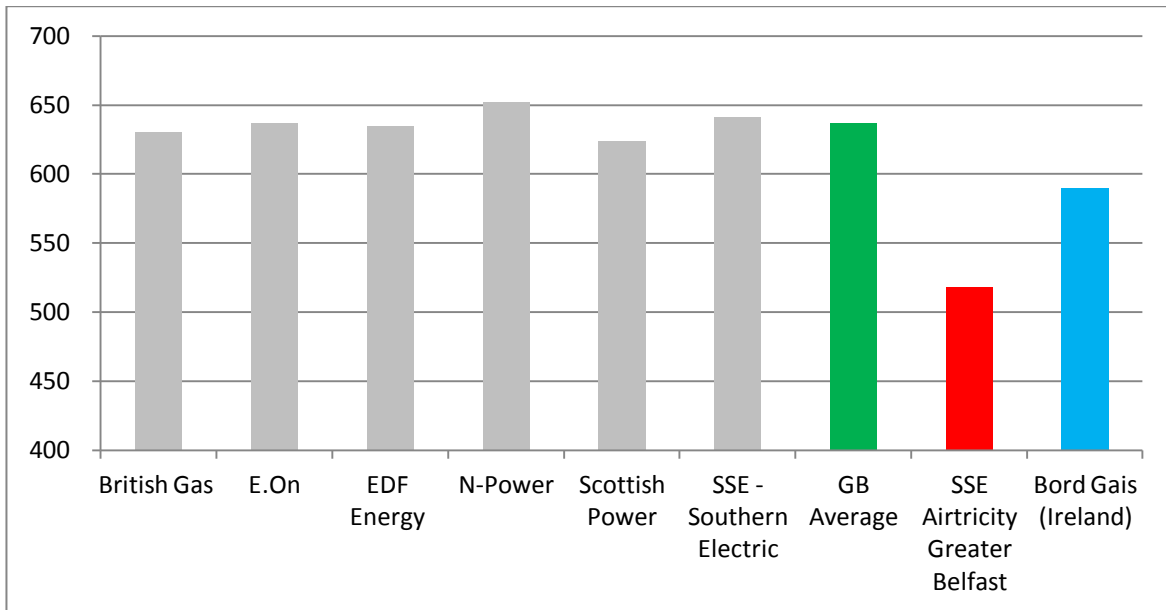
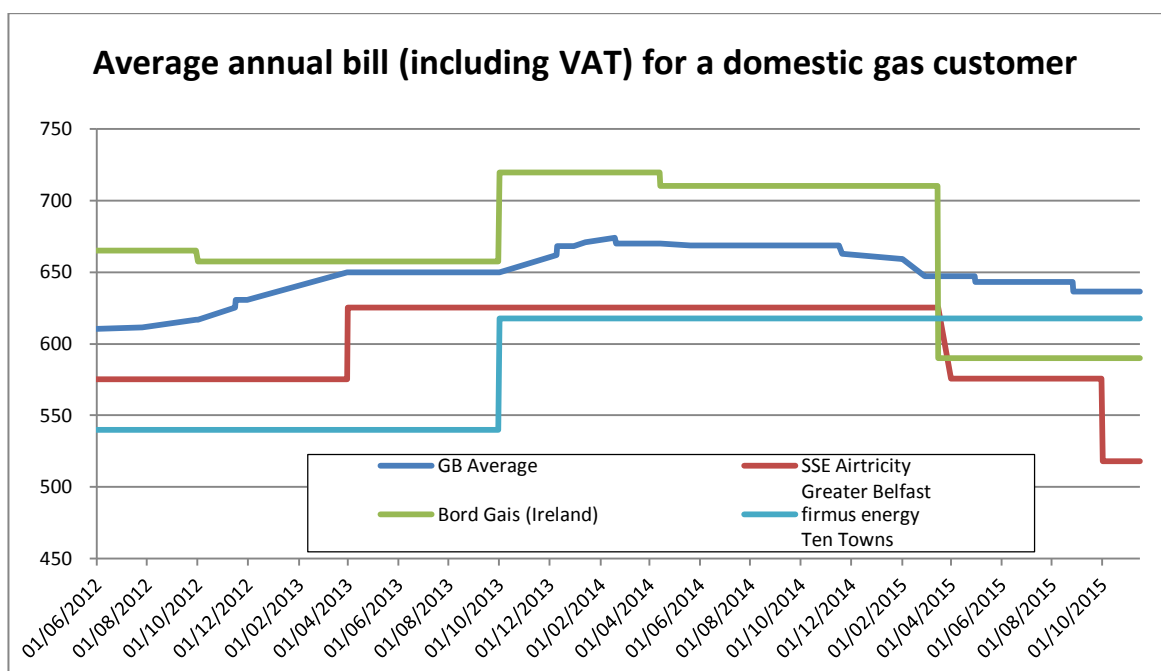


Figure 6 below shows a historic comparison of SSE Airtricity’s domestic annual bill against firmus energy in the Ten Towns, the average in GB and Bord Gais in Ireland. The comparison uses the standard credit tariff unit rates for domestic customers and assumes average annual consumption of 12,500 kWh. The graph shows that since June 2012, SSE Airtricity’s prices have been lower than the average standard tariff in GB of the Big 6 Gas Suppliers.

The GB comparisons include any recent tariff change made by the Big 6 energy providers.

Figure 6 - Historic Comparison of average annual domestic bills (based on standard domestic credit tariffs with estimated usage 12,500 kWh per annum including VAT)



Outcome

The Utility Regulator has reviewed the maximum average price submission provided by SSE Airtricity and reviewed SSE Airtricity’s forecasts against its own market analysis. The Utility Regulator is satisfied that this decrease is appropriate and therefore approves the new maximum average price of 112.50 pence per therm for SSE Airtricity’s tariff customers in Greater Belfast. This maximum average price will be effective from 1 October 2015 for one year. This represents an average decrease of 10% in the actual tariff unit rates that SSE Airtricity uses to charge customers.

However the Utility Regulator retains the flexibility to initiate a review of gas prices at any stage if it is considered to be in the interest of customers.