



Conclusion of the Utility Regulator's Review of the Power NI Ltd Maximum Average Price

12 May 2020



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

Protecting consumers is at the heart of the Utility Regulator's (UR) role and ensuring that domestic customers pay the correct price for energy from the price regulated supplier Power NI Ltd is a core part of our work.

To this end the UR scrutinises Power NI submissions in relation to price changes, and ensures that the maximum average charge per unit supplied is not more than the sum of the input costs allowed in the Power NI price control formula.

This ensures that customers pay no more than the efficient costs of purchasing and supplying the electricity plus an agreed profit margin set by the UR.

Audience

Consumers and consumer groups; industry; and statutory bodies.

Consumer impact

The direct consumer impact of this review will be a change to the regulated electricity tariff. This change will affect domestic customers only. Those domestic users who are currently customers of Power NI will see a change to their tariff rates from 1 July 2020. The tariff will decrease by 4.8%.



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1. Approval by the Utility Regulator of the Power NI Ltd Maximum Average Charge per Unit Supplied

Summary

- 1.1 In March the Utility Regulator, in consultation with Power NI, DfE and the Consumer Council began a review of the Power NI maximum average charge for domestic customers. The current maximum average price has been effective from 1 October 2019. This review was triggered (as part of ongoing monthly monitoring) primarily due to a fall wholesale costs and correction factors (which will be discussed in greater detail later in the paper).

Therefore, a review was initiated to establish the new maximum average charge to become effective from 1 July 2020.

- 1.2 The new price for tariff customers on the Standard Home Energy tariff will decrease to 16.99 pence per kWh (ex VAT) or 17.84 pence per kWh (inc VAT) from 1 July 2020. This represents a decrease of 4.8%. The tariff has been modelled and forecast over a period of 24 months. However, as is the usual practice, it will be kept under constant review and adjusted within that time period if required. An adjustment would be necessary if changes in actual input costs (for example wholesale or network costs) created a significant difference between Power NI future actual costs and revenues. The tariff would then need to be adjusted upwards or downwards to align costs and revenues.

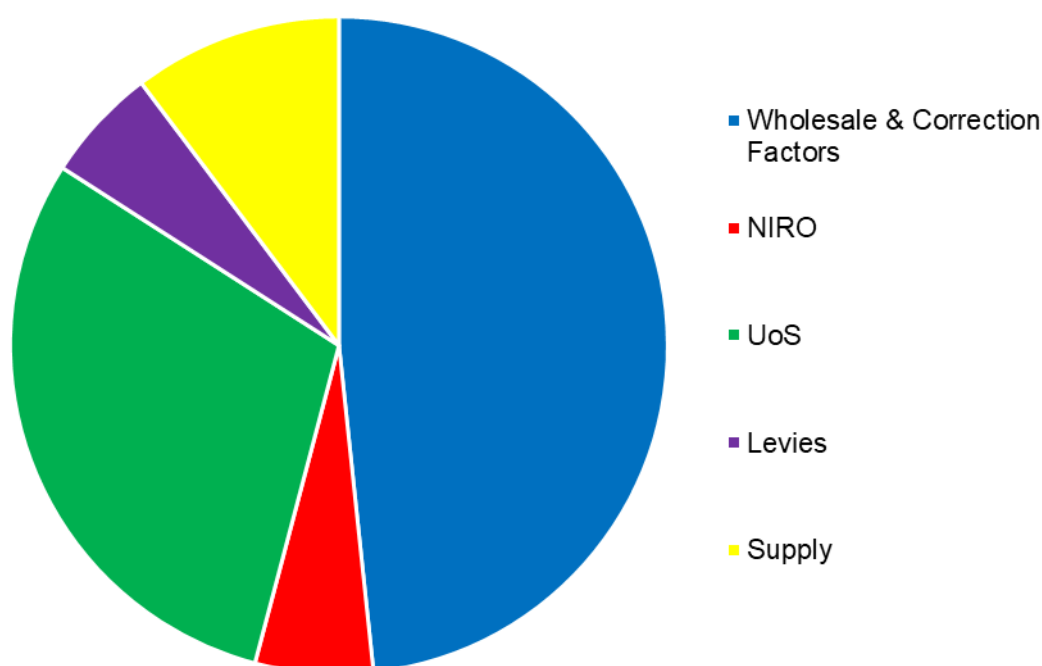
Background

- 1.3 The domestic electricity supply market has been fully open to competition since 1 November 2007, and since June 2010 a number of suppliers have entered the domestic market. There are now five active suppliers in the domestic market. However, whilst facing competition from other suppliers, Power NI is still dominant in this sector of the market.
- 1.4 Under the terms of Power NI's licence to supply electricity, the Utility Regulator ("the Authority" or "UR") can ensure the maximum amount that Power NI can charge for electricity to domestic customers is not more than the price control allows.

2. Elements of the Maximum Average Charge

- 2.1 The UR takes an active role in scrutinising Power NI's proposed retail tariffs, which are the final prices customers pay. The UR continues to set a price control that sets allowances for Power NI's operating costs and profit margin. In addition to this, any other Power NI operating costs that are passed through the tariff (which are not allowed for in the price control, e.g., licence fees) must be approved by the UR. The aggregate of the price control allowances and pass through costs are termed the supplier charge (see Figure 1 below).
- 2.2 Power NI retail tariffs (derived from the maximum average charge) for this upcoming year are made up of a number of components (including the supplier charge discussed above):

Figure 1 - Makeup of the maximum average tariff



These elements are further discussed in the sections below.

Levies and Use of System Charges

- 2.3 Several of the final tariff components are common across all suppliers and the final customer will usually pay these regardless of who their supplier is. These components are all subject to regulatory review and approval:
- Levies – System Support Services (SSS), Public Service Obligation (PSO); and

- Use of System charges (UoS) – these are the costs of transmission and distribution of electricity through the NIE Ltd network to homes and business.

2.4 These costs are regulated because they are levied to recover the costs of those parts of the electricity industry which are natural monopolies. Independent suppliers are free to enter the market and purchase power. They will usually add on the charges outlined above to their energy costs before setting the final price to sell to customers. This is because they are required to pay these charges in order to safely and securely transport the power to the customer.

2.5 For the purpose of setting a July 2020 tariff, the published Levy and UoS rates have been used where available and, where they haven't yet been published, forecast estimates for these network components have been used to derive the Power NI revenue requirement for them over the next 24 months. Generally speaking in normal circumstances, an increase for RPI will be assumed for these elements in the absence of having the actual published tariff rates that will apply from October 2020 onwards. In addition to this RPI uplift, if other information is available, e.g., from consultation papers or other sources, this will also be used to inform a best estimate of the rates if they have yet to be finalised. It is important to note that Power NI's tariffs will be adjusted in future depending on the actual cost out-turns that materialise, the forecasts used at this time are simply for initial tariff setting purposes.

2.6 The remaining components of Power NI's tariffs are subject to regulatory scrutiny which are detailed in the following paragraphs.

Wholesale Energy Cost and Over / Under recovery

2.7 The all-island Integrated Single Electricity Market (I-SEM) is both a competitive and regulated wholesale energy market on the island of Ireland. It is an all-island market encompassing the generation plants of both Northern Ireland and Ireland (RoI). Whilst in the previous SEM market there was one "pool" and timeframe which all suppliers would have purchase from on a half hourly basis, as well as the potential to enter into "hedges" with generators to help limit exposure to price fluctuations, the new market has different markets and timeframes which the supplier can purchase energy from. These include:

- Day Ahead Market;
- Intra Day Market;
- Balancing Market (difference between the suppliers demand and what

they have already purchased); and

- Forwards Market (same principle as a hedge in the previous SEM).

2.8 Hedges effectively mean that the supplier is purchasing power on a forward basis at a fixed price based on forecast market prices (plus a premium). The approval of the Power NI hedging methodology is given by the UR, as well as the approval of the forecast of the total of Power NI wholesale costs for their estimated demand for the tariff period. Due to the fact that the wholesale component of final tariffs is both large and volatile, over or under recoveries of revenues in any tariff period are generally caused by wholesale costs out turning lower or higher respectively, than was forecast at the time of tariff setting. Over recoveries that occur in any given tariff period are handed back to customers in the subsequent tariff period and under recoveries are added to the total cost forecast of the subsequent tariff period.

2.9 Wholesale costs also include:

- Capacity Costs – these are the costs suppliers pay to help ensure there is sufficient generation available within the system in order to meet peak demand. Generators receive capacity payments even when they don't generate (for instance when wind generation is covering most of the electricity demand) but are incentivised to be available to do so should they be needed.
- Imperfection charges - these charges are mainly the costs associated with constraints on the all-island transmission network. Constraints are caused by network bottlenecks (such as the North-South interconnector, which is one of the most significant). These constraints result in the system operators (SONI and EirGrid) taking action to 'balance' the system in order to ensure stability of the electricity system. These actions are a normal and necessary part of electricity markets in other jurisdictions but are particularly important in the SEM, which is a small and highly constrained electricity system that has a high level of renewable generation.

Supplier charge

2.10 The supplier charge is made up of the efficient costs of Power NI's own supply business and are approved by the UR. These costs are assessed and implemented through the application of the Power NI Supply Price Control and any other costs approved on a pass through basis (after thorough regulatory scrutiny). The allowance set in the price control is for Power NI own operating costs (e.g. salaries, IT systems, rent and rates, legal fees, bad debt costs, keypad meter transaction costs and a profit margin of

2.2% of forecast turnover). Other costs which are unknown, but treated as “passthrough” as they are unavoidable (e.g., licence fees, certain IT project costs), are allowed and these also go into the overall supplier charge.

NIRO costs

- 2.11 These costs are audited on behalf of the UR by Ofgem as part of its UK-wide audit. NIRO is the Northern Ireland Renewables Obligation and the costs of it go towards the subsidisation of investment in renewable energy, e.g., windfarms in Northern Ireland.

Why are Power NI’s Tariffs decreasing?

- 2.12 The maximum average charge for domestic customers will decrease by 4.8% from 1 July 2020. Table 1 below shows the movement in the regulated tariff from April 2015 to date.

Table 1 - Historic tariff (excl. VAT)

Effective from date	1 Apr 2015	1 Apr 2016	1 Oct 2017	1 Oct 2018	1 Oct 2019	1 Jul 2020
Approved Tariff (pence per kWh)	15.6	13.99	14.78	16.82	17.85	16.99
% Change	-9.2%	-10.3%	+5.6%	+13.8%	+6.1%	-4.8%

- 2.13 The primary reason for the drop in the tariff is the falling cost of energy (electricity). However, the COVID-19 pandemic has placed significant upward pressure on a number of cost lines within the Power NI regulated tariff (as discussed in more detail below). There has been an unprecedented drop in demand for electricity from Northern Ireland consumers, due primarily to the closures of businesses arising from the lockdown, which has directly impacted other non-energy costs. This demand drop is forecast to continue for some time.
- 2.14 The full impact of the decrease in demand will not be fully known for several months and until meter reading returns to normal. However, the UR has been monitoring demand along with other stakeholders and significant reductions have been recorded compared to 2019.

Wholesale Energy Cost and Power NI Over/Under recovery element

- 2.15 The falling wholesale cost of electricity has been a key driver of this tariff reduction.

- 2.16 Previously, Power NI faced higher than forecast wholesale costs in 2018/2019, leading to a position of under recovery of revenue when setting the October 2019 tariff. However, the actual wholesale prices for that subsequent tariff period were lower than forecast, and these lower costs meant that the under recovery would normalise more rapidly than was forecast; perhaps leading to Power NI over-recovering.
- 2.17 These lower electricity wholesale prices have been driven primarily by a fall in the cost of wholesale gas which is used to generate electricity.
- 2.18 Therefore, whilst Power NI is still in a position of under recovery going into the July 2020 tariff, this under recovery amount has been included in the tariff calculation and is forecast to return to zero by June 2022.
- 2.19 Both Power NI and the Utility Regulator strive to keep the over/under recovered amount as low as possible in order to reduce volatility in the tariff. This is carried out through ongoing monitoring and tariff changes being put through when over or under recoveries are in danger to becoming too large.

Capacity Cost

- 2.20 As highlighted above, electricity demand has dropped significantly. Capacity costs are forecast to increase due mainly to this COVID-19 impact on demand, with the fixed costs of capacity being spread across a reduced volume of demand leading to a higher tariff rate.

Imperfections Cost

- 2.21 There is also an expected increase in the cost of imperfections for 2020/21. Whilst there will be some downward pressures, such as the unwinding of the 2019/20 K-factor under recovery, there remains uncertainty over the impact of COVID-19; in particular in relation to issues such as generator maintenance for the upcoming tariff year, which may increase imperfections costs above what may otherwise be the case. Therefore, a prudent estimate of imperfections has been used for the Power NI tariff and the expected decrease in imperfections has not been built in for year 1, only year 2, when imperfections costs should normalise.

Use of System Costs (UoS)

- 2.22 The COVID-19 pandemic has placed significant upward pressure on electricity network costs; both DUoS and TUoS, which are paid to NIEN the network owner. The result of the large drop in demand is, similar to capacity costs, that network costs which are largely fixed, are collected over less

units, therefore increasing the per unit cost in the 2020/21 UoS network tariffs (the 2020/21 UoS tariff year is October 2020–September 2021).

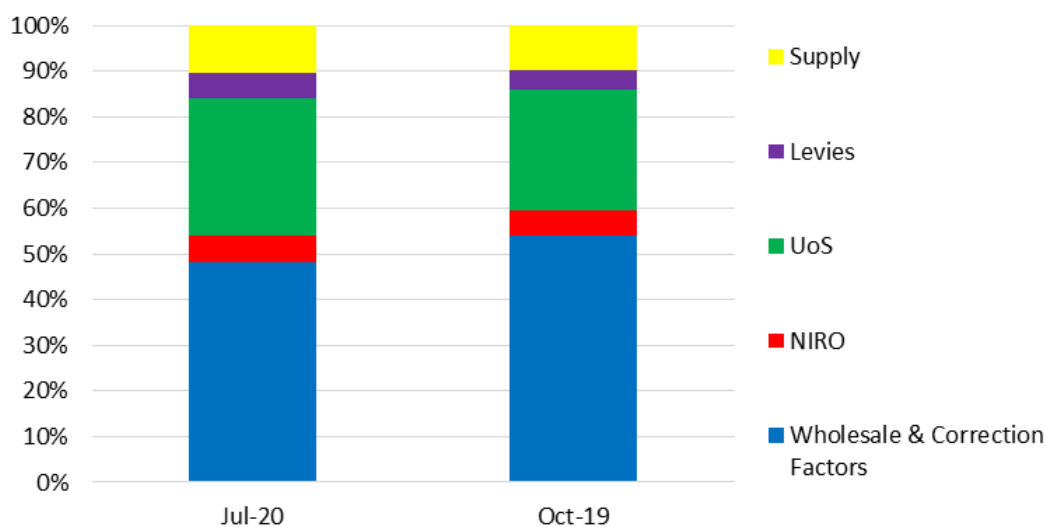
2.23 Whilst the UoS rates for 2020/21 are not due to be published until later this year, an informed estimate of their level is a key element of the Power NI tariff review process.

2.24 Furthermore, the effect of reduced demand in this current October 2019–September 2020 UoS tariff year will lead to an under-recovery for NIEN, which will need to be taken into account in the 2020/21 UoS tariffs; further increasing the per unit cost for the 2020/21 UoS tariffs.

Breakdown of Tariff

2.25 The graph shown in Figure 2 below compares the breakdown of the July 2020 tariff with the breakdown of the previous tariff set at October 2019. This demonstrates that the wholesale element makes up a decreased proportion of the tariff costs when compared with the October 2019 tariff, whilst UoS has increased.

Figure 2 – Breakdown of July 2020 tariff costs compared with a breakdown of the previous tariff costs

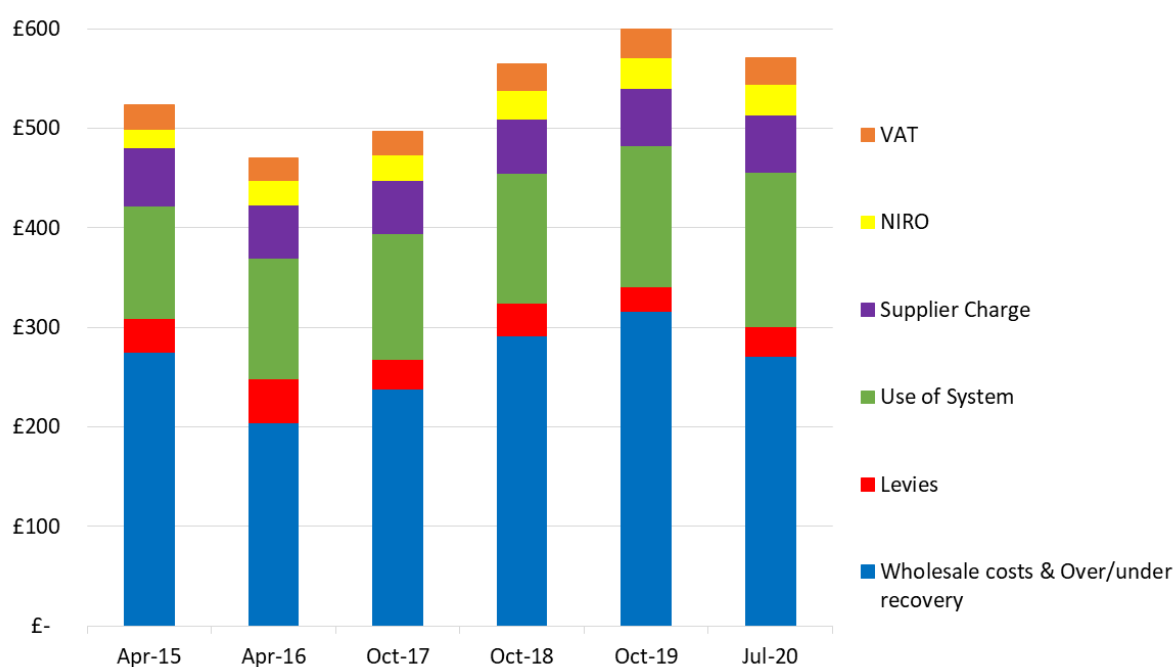


2.26 Figure 3 below shows the breakdown in the average annual domestic bill for Power NI consumers for the last five years and illustrates the variation caused by movements in the various components of the tariff. Generally, it can be seen that the variations in the tariffs are largely driven by variations in the wholesale cost component of the Power NI tariff. It also demonstrates that the UoS element is more this year when compared to last year.

2.27 The average annual bill amounts have been calculated based on the

standard domestic tariff set at each tariff review (including VAT) and are based on an average annual consumption of 3,200 kWh as has been used in previous years. Figure 3 shows that the annual bill for a typical credit customer (non-direct debit) on the standard tariff will be £571 inclusive of VAT. This compares with a previous equivalent annual bill (based on the tariff set at October 2019) of £600. On this basis, a typical customer will pay on average £29 less per annum.

Figure 3 - Graph to show breakdown of average annual bill

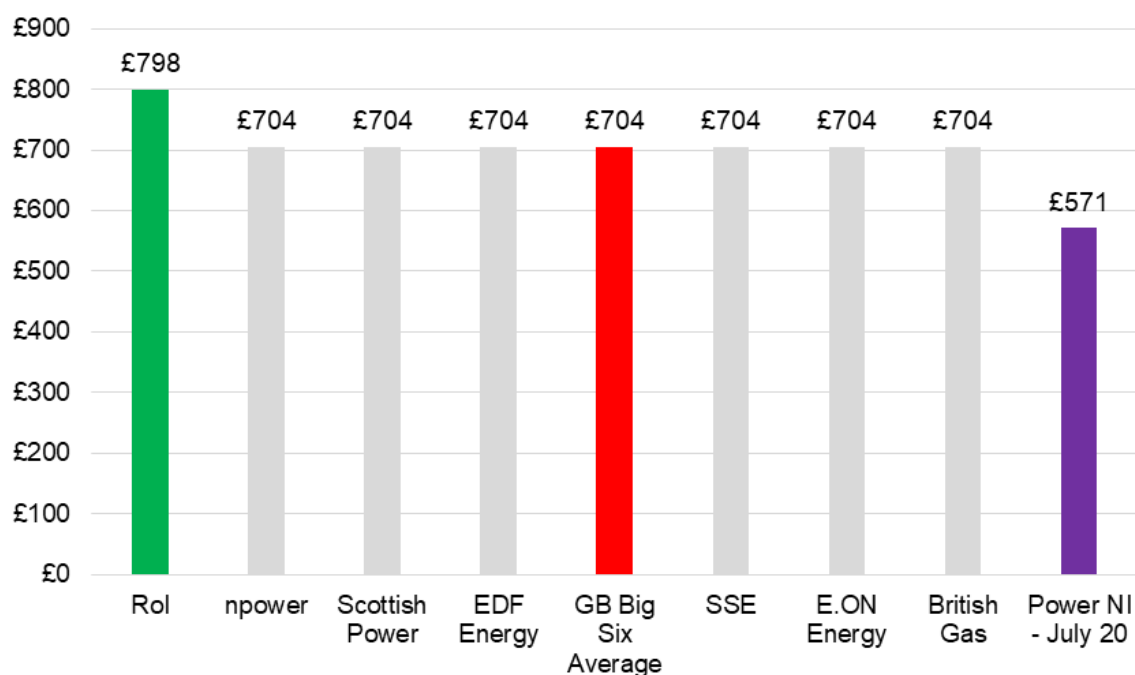


Comparison with GB and Rol

2.28 Figure 4 below shows the average annual bill for a Power NI domestic credit customer compared to the “Big Six” Supply companies in GB and the average of the three biggest suppliers in the Rol (Electric Ireland, SSE Airtricity ROI and Bord Gais). This comparison is based on the latest available information on the standard domestic credit (non-direct debit) tariffs of each company and is based on average annual consumption of 3,200 kWh. This graph takes account of any tariff changes which have been published to date in each jurisdiction.

2.29 Figure 4 illustrates that the Power NI tariff for an average domestic credit customer will be circa 19% cheaper than the GB average standard tariff, and will be circa 28% cheaper than Rol average standard tariff.

Figure 4 - Comparison of average annual bill in GB and ROI (based on estimated usage 3,200 kWh p/a including VAT)



*NB the ROI comparison is the average of the 3 largest suppliers in ROI - **standard tariff** average of urban and rural. 3,200 kWh represents typical medium consumption which has been used in previous years for tariff comparison*

Outcome

- 2.30 The Utility Regulator has reviewed the Maximum Average Price submission provided by Power NI and reviewed the supplier's forecasts against its own market analysis. The Utility Regulator is satisfied that this decrease is appropriate and therefore agrees the new standard domestic tariff of 16.99 (excluding VAT) pence per kWh from 1 July 2020 (17.84 pence per kWh including VAT). This represents a decrease of 4.8% from the previous tariff.