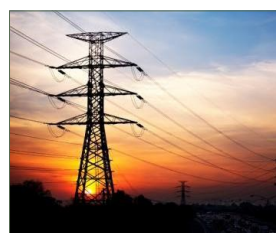


Consultation on NIE's payment security policy

April 2014



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

The level of payment security credit cover under NIE's Payment Security Policy was set by the Utility Regulator in 2006, to strike a balance between the costs to customers of bad debts and the cost to suppliers for the provision of security cover.

The consultation paper sets out NIE's proposal to increase the payment security cover. It also highlights the potential customer impact of NIE's proposals and seeks stakeholder's views on these proposals.

Audience

Electricity customers, consumer groups, electricity suppliers, electricity industry participants, statutory bodies and other stakeholders.

Consumer impact

The consultation paper is designed to promote transparency and provide customers and suppliers opportunity to comment on the proposals put forward by NIE.

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1. Payment Security Policy Background

Executive Summary

1. Electricity suppliers (Supplier(s)) use the NIE network to supply their customers' properties. Suppliers pay NIE for their services via Distribution Use of System charges and a Public Service Obligation (PSO) charge.
2. NIE's licence obliges them to have in place a Payment Security Policy (PSP). The PSP requires Suppliers to have 'security cover' in place for payments that would be due to NIE for their use of the distribution network. In a situation where a Supplier is unable to pay its bills, for example if they go out of business, the security cover can be called upon. NIE is able to 'claim' from the security cover that the Supplier has put in place and recoup monies owed. In this way security cover acts like an insurance policy eliminating or reducing the amount NIE have to recover directly from customers if a Supplier defaults on its payments.
3. On the 29th August 2013 NIE wrote to us with a proposal to increase the payment security cover Suppliers are required to provide.
4. The level of payment security cover has not been reviewed since it was set in 2006 and there have since been three significant changes to the circumstances in Northern Ireland:
 - Suppliers now pay DUoS charges quarterly, having previously paid on a monthly billing cycle. The potential level of bad debt has therefore increased.
 - The potential risk of customer and ultimately Supplier default on payments has increased with the economic downturn in Northern Ireland.
 - The level of competition in the NI electricity market has increased significantly since 2006, bringing a number of new suppliers into the market.
5. Under condition 24¹ of their distribution licence, NIE are required to develop a PSP, which describes its security cover and debt recovery procedures.
6. Condition 24 also requires that NIE shall submit a payment security policy and any amendments thereto, to us for approval. Further, NIE may amend the policy, in which case, any proposed changes are also subject to our approval.

¹ Annex 1 - Condition 24 of NIE's Distribution Licence.-
http://www.uregni.gov.uk/uploads/publications/NIE_Ltd_Successor_Distribution_Licence_modified_03_September_2013.pdf (Page 69)

7. The payment security policy is applied by NIE when it collects revenue under:
 - Distribution Use of System (DUoS) tariff; and
 - Public Service Obligation (PSO) tariff.
8. We responded in mid September 2013, customers suggesting that a public consultation between NIE (as Payment Security Policy owner) and relevant parties would be appropriate. Following the completion of the consultation, NIE should then submit to us a written report detailing all responses and make recommendations for a way forward.
9. We stated that the consultation should provide options for the Payment Security Policy.
10. NIE compiled a consultation report (See attached NIE consultation document in [Annex 2](#)²) and issued a public consultation on their website³ at the end of October, to which responses were due by the 20th December 2013.
11. Following this consultation period NIE only received two responses from Suppliers and no feedback from consumers, consumer groups or other stakeholders.
12. NIE then presented a recommendation report to the Regulator on the 22nd January 2014 with their preferred option.
13. The NIE recommendation proposed that the level of payment security cover for DUoS and PSO charges should be set at 2 winter months charges (option 3 in the consultation paper) to protect customers from increased exposure to bad debt. They also stated that this proposal will allow for SEM harmonisation, aligning with the security cover provided by Suppliers to ESB Networks in Rol.
14. Under NIE's preferred option the level of security would be increased by £19m. The cost of the additional payment security cover to Suppliers is estimated as £190k per annum. This is equivalent to an additional average annual charge of £0.23 per customer, if Suppliers choose to pass the cost on to their customers. In the event of a Supplier default with this extra cover in place, the recovery of the defaulting Supplier debt by NIE is estimated at £7 on domestic customers and £8,400 on large industrial customers' network charges.

² Annex 2 – Published NIE Payment Security Cover Consultation.

³ The UR issued a news alert highlighting this publication on the 30/10/2013 - http://www.uregni.gov.uk/news/view/nie_payment_security_consultation/

15. This is set against the impact of the status quo (option 1); with no additional security cover costs. However recovery of the defaulting Supplier debt by NIE under the status quo is estimated as an additional £11 on domestic customers and £15,800 on large industrial customers' network charges.
16. We have reviewed the NIE recommendation and noted the potential impact of the proposed changes could have on customers' bills. We are therefore concerned that there was no representation received from consumer representative groups and limited response from Suppliers.
17. In light of our concerns and being keen to ensure arrangements take account of best practice we have decided to issue this public consultation. We welcome feedback from consumer representatives and other stakeholders on the options put forward by NIE to increase their payment security cover within the Payment Security Policy.

2. Options from the NIE Consultation

NIE Consultation on Payment Security Policy

18. As indicated in NIE's consultation under the current Payment Security Policy, if a Supplier defaults on a payment, NIE can draw down on any existing security cover provided by the Supplier to settle the outstanding DUoS or PSO charges.
19. Any shortfall between payment security held by NIE and the amount owed by the Supplier can be deemed bad debt and passed on to customers through network charges if NIE is unable to recover the debt within 6 months or earlier in the case of administration, receivership or liquidation of the Supplier.
20. In opening up the market to supply competition, all domestic and commercial customers were moved onto quarterly billing cycles from 21st May 2012. As a consequence, the level of credit on DUoS charges afforded to Suppliers has increased substantially.
21. NIE comment that the changes to the billing arrangements have increased the potential level of costs to be recovered from customers in the event of a Supplier defaulting on its payments to NIE.
22. They also stated that these changes mean that the existing level of security cover is set at a level that no longer strikes a fair balance between customers and Suppliers and they believe that it is necessary to increase the payment security cover provided by Suppliers for their network charges in order to protect customers from increased costs associated with exposure to bad debt.
23. In the NIE consultation they put forward 4 options and highlighted the advantages, disadvantages and impacts of each option to Suppliers and customers.

The four Options put forward

24. Four options were put forward for discussion;
 - Option 1 – Maintain the Status Quo;
 - Option 2 – Payment Security Cover Based on Estimated DUoS and PSO Charges Accrued by Suppliers;
 - Option 3 - Payment Security Cover in Line with Levels Required in Republic of Ireland; and

- Option 4 - Payment Security Cover Equal to 2 Average Months DUoS and PSO Charges.

25. Each of these options has their own advantages, disadvantages and impacts to Suppliers who in turn have an option to pass these increased costs onto consumers.

26. The following table highlights the 4 options, the potential bad debt shortfall and the cost of the additional credit cover.

	Proposed Increase in Current Security Cover (£m)	Shortfall "potential bad debt"		Cost of Additional Cover	
		Total Shortfall (£m)	Potential increase in Network Charges to Average Customers	Bank Charge to Supplier (£m)	If passed to Customer (£ / Cust)
Option 1 - Status Quo		50	Dom=£11; LIC=£15,800		
Option 2	50	0	Dom=£0; LIC=£0	0.500	£ 0.60
Option 3	19	31	Dom=£7; LIC=£8,400	0.190	£ 0.23
Option 4	9	41	Dom=£9; LIC=£12,200	0.090	£ 0.11

27. NIE in its recommendation report to the Regulator in January 2014 selected Option 3 - Payment Security Cover in Line with Levels Required in Republic of Ireland.

28. This option is based 2 winter months cover as NIE have indicated that customer exposure to bad debt is more significant in the winter months and therefore it is reasonable to base the payment security cover on charges in the winter months.

29. They stated that, in addition to providing a reasonable rebalance between the potential costs to customers of bad debts and the cost to Suppliers for the provision of security cover, this option would also harmonise the level of NIE's payment security cover with that already provided by Suppliers in the Republic of Ireland.

30. They also commented that as the cover is based on charges in the winter months, Suppliers with predominantly large industrial customers will see a higher increase in their DUoS payment security cover than Suppliers with predominantly domestic customers.

3. Utility Regulator Comment

31. The UR welcomes NIE's process in opening consulting on this matter, given the impact of a proposed increase could have on customers' bills we were concerned that representation received from consumer related stakeholders was under-represented and we wish to engage further for stakeholder's views.

32. Any changes to the Payment Security Policy must look at the overall level of risk, the risk allocation and the balance between the potential risk of bad debt to NIE and cost to the Supplier\consumer of providing additional cover.

33. NIE stated that there is a potential of a security cover shortfall of £50m, across "all Suppliers" under the current payment security cover levels.

34. Question 1. What is the realistic security cover shortfall that should be considered when reviewing the current Payment Security Cover policy?

35. How likely is a Supplier or multiple Suppliers defaulting and NIE being unable to recover the debt within 6 months or earlier and is it in the public's interest to put in place credit requirements which may be excessive depending on the probability that they will be required?

36. Question 2. What is the likelihood of a Supplier/Suppliers defaulting and NIE being unable to recover the debt within 6 months or earlier?

37. NIE has also suggested in its recommendations that the cost of the cover to Suppliers is based on typical bank charges of 1% per annum for the cover provided in a letter of credit.

38. Question 3. Do Suppliers consider that the 1% charge is a 'typical rate' for them to provide additional cover?

39. We also have concerns on the effects that an increase in Supplier credit cover will have on Supplier competition.

40. Question 4. Will an increase in Supplier cover be seen as a barrier to entry to new Suppliers?

41. The Utility Regulation considers that Option 1 – Maintain the Status Quo is a reasonable option to continue, giving the nature and concentration of the supply business within Northern Ireland.

42. However we would also consider that there may be a requirement to extend the current cover and based on the options available we would be minded to consider Option 4 - Payment Security Cover Equal to 2 Average Months DUoS and PSO Charges.

43. Under option 4, Suppliers would provide NIE with payment security cover based on 2 average months DUoS and PSO charges forecast for a 12 month period, whereas under option 3 would be based on 2 winter months DUoS and PSO charges.

44. Under the option 4 scenario, the level of security would be increased by £9m, In the event of a Supplier default; the potential impact on domestic customers could amount to £9 and for large industrial customers, £12,200. NIE state that the cost of the additional payment security cover to Suppliers is estimated as £90k. This is equivalent to an additional average annual charge of 11p per customer, if the Suppliers choose to pass the cost on to their customers.

45. We wish welcomes all stakeholder views and comments on the proposals set out in this and NIE's consultation paper.

46. Question 5. Which of NIE's options strikes the best balance between the risk and the cost to the consumer?

47. Question 6. Should any other options / risk cost recovery mechanisms be investigated?

4. How to Respond

48. The consultation period will close at 12.00 noon on 27/05/2014. Responses to this consultation should be forwarded to reach the UR on or before 12.00 on Tuesday 27 May 2014 to:

Jody O'Boyle
The Utility Regulator
Queens House
14 Queen Street
Belfast
BT1 6ED
Email: Jody.OBoyle@uregni.gov.uk
Tel: 028 9031 6334

49. Your response to this consultation may be made public by the UR. If you do not wish your response or name made public, please state this clearly by marking the response as confidential. Any confidentiality disclaimer that is automatically produced by an organisation's IT system or is included as a general statement in your fax or coversheet will be taken to apply only to information in your response for which confidentiality has been specifically requested.

50. Information provided in response to this consultation, including personal information may be subject to publication or disclosure in accordance with the access to information regimes; these are primarily the Freedom of Information Act 2000 (FOIA) and the Data Protection Act 1998 (DPA). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

51. In view of this, it would be helpful if you could explain why you regard any information provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation but cannot give an assurance that confidentiality will be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Authority.

52. This document is available in accessible formats on request.

5. Summary of Consultation Questions

53. The UR welcomes all stakeholder views and comments set out in this consultation paper. Respondents are asked for their views on the following:

- Question 1. What is the realistic security cover shortfall that should be considered when reviewing the current Payment Security Cover policy?
- Question 2. What is the likelihood of a Supplier/Suppliers defaulting and NIE being unable to recover the debt within 6 months or earlier?
- Question 3. Do Suppliers consider that the 1% charge is a 'typical rate' for them to provide additional cover?
- Question 4. Will an increase in Supplier cover be seen as a barrier to entry to new Suppliers?
- Question 5. Which of NIE's options strikes the best balance between the risk and the cost to the consumer?
- Question 6. Should any other options / risk cost recovery mechanisms be investigated?

6. Annex 1 - Condition 24 of NIE's Distribution Licence.

http://www.uregni.gov.uk/uploads/publications/NIE_Ltd_Successor_Distribution_Licence_modified_03_September_2013.pdf (Page 69)

Condition 24. Payment Security Policy

1 The Licensee shall develop, and may from time to time amend, a payment security policy describing its security cover and debt recovery procedures in respect of each of the regulated distribution revenue and the PSO Charges (including details of what is to be considered reasonable recovery costs and reasonable interest for the purposes of calculating uncollected revenue).

2 The Licensee shall submit the payment security policy and any amendments thereto, to the Authority for its approval. No policy or amendment shall be effective until approved by the Authority.

3 In this Condition:

“regulated distribution revenue”	means the transmission and distribution revenue (as defined in Annex 2) but excluding any revenue to be collected from the Transmission System Operator.
“PSO Charges”	has the meaning given to that expression in Condition 24A.

7. Annex 2 – Published NIE Payment Security Cover Consultation.

NORTHERN IRELAND ELECTRICITY LIMITED

PROPOSAL TO INCREASE PAYMENT SECURITY COVER PROVIDED BY SUPPLIERS UNDER NIE'S PAYMENT SECURITY POLICY

CONSULTATION PAPER

30 October 2013

1. The Consultation

- 1.1. Each holder of a licence to supply electricity granted under the Electricity (NI) Order 1992 (a "Supplier") must enter into a Distribution Use of System (DUoS) Agreement and a Public Service Obligation (PSO) Agreement with Northern Ireland Electricity Limited ("NIE"). Under these agreements Suppliers must provide NIE with payment security cover in relation to their DUoS and PSO charges.
- 1.2. In accordance with its obligations under Condition 24 of its Electricity Distribution Licence, NIE has prepared and has in force a Payment Security Policy ("PSP") describing its payment security cover and debt recovery procedures in respect of NIE's DUoS and PSO charges.
- 1.3. Under NIE's PSP, if a Supplier defaults on a payment, NIE can draw down on any existing security cover provided by the Supplier to settle the outstanding DUoS or PSO charges. Any shortfall between payment security held by NIE and the amount owed by the Supplier can be deemed bad debt and passed on to customers through network charges if NIE is unable to recover the debt within 6 months or earlier in the case of administration, receivership or liquidation of the Supplier.
- 1.4. The level of security cover under NIE's PSP was set by the Utility Regulator to strike a balance between the potential costs to customers of bad debts and the cost to Suppliers for the provision of security cover.
- 1.5. As part of the process to open up the market to supply competition, all domestic and commercial customers were moved onto quarterly billing cycles from 21 May 2012. As a consequence, the level of credit on DUoS charges afforded to Suppliers has increased substantially. However, the change to billing arrangements also increased the potential level of costs to be recovered from customers in the event of a Supplier defaulting on its payments to NIE. These changes to the billing arrangements mean that the existing level of security cover is set at a level that no longer strikes a fair balance between customers and Suppliers.
- 1.6. Maintaining the status quo is considered under option 1 in this paper, however it has a consequence as set out in paragraph 1.7 below. NIE believes that it is necessary to increase the payment security cover provided by Suppliers for their network charges in order to protect customers from increased costs associated with exposure to bad debt. The options considered by NIE, for increased payment security cover are summarised in paragraphs 1.8 to 1.11 below. More details on the options are available in Appendix A.

1.7. Option 1 – Maintain the status quo

The shortfall in security cover under the current PSP levels for the 3 largest Suppliers in Northern Ireland is approximately £48.6m. If one of these Suppliers defaulted on their payments, the average potential impact on customers' annual DUoS and PSO charges, to recover the outstanding bad debt for the associated year, would be an increase of £11 for a domestic customer and £15,800 for a large industrial customer (connected at 33kV). These values are based on the potential "average" outstanding bad debt of the 3 largest Suppliers.

However, since under the status quo there would be no increase in the level of security, there would be no additional cost associated with this provision.

1.8. Option 2 – increase security cover based on estimated DUoS and PSO charges accrued by Suppliers

Under this scenario, the level of security would be increased by £50m for DUoS plus PSO charges, meaning customers' exposure to potential bad debt falls to a negligible level.

However, the cost of the additional payment security cover to Suppliers is estimated as £500k (based on typical bank charges of 1% per annum for the cover provided in a letter of credit). This is equivalent to an additional average annual charge of 60p per customer¹, if the Suppliers choose to pass the cost on to their customers.

1.9. Option 3 – increase security cover in line with levels required in the Republic of Ireland

Under this scenario, the level of security would be increased by £19m, leaving a potential shortfall of £31m. In the event of a Supplier default, the impact on domestic customers could amount to £7 and for large industrial customers, £8,400.

The cost of the additional payment security cover to Suppliers is estimated as £190k. This is equivalent to an additional average annual charge of 23p per customer¹, if the Suppliers choose to pass the cost on to their customers.

1.10. Option 4 – increase security cover to equal 2 average months of Supplier charges

Under this scenario, the level of security would be increased by £9m, leaving a potential shortfall of £41m. In the event of a Supplier default, the impact on domestic customers could amount to £9 and for large industrial customers, £12,200.

The cost of the additional payment security cover to Suppliers is estimated as £90k. This is equivalent to an additional average annual charge of 11p per customer¹, if the Suppliers choose to pass the cost on to their customers.

1.11. A summary of the impact of each of the options, is set out in the table below.

	Proposed Increase in Current Security Cover (£m)	Shortfall "potential bad debt"		Cost of Additional Cover	
		Total Shortfall (£m)	Potential increase in Network Charges to Average Customers	Bank Charge to Supplier (£m)	If passed to Customer (£ / Cust)
Option 1 - Status Quo		50	Dom=£11; LIC=£15,800		
Option 2	50	0	Dom=£0; LIC=£0	0.500	£ 0.60
Option 3	19	31	Dom=£7; LIC=£8,400	0.190	£ 0.23
Option 4	9	41	Dom=£9; LIC=£12,200	0.090	£ 0.11

¹ NIE has calculated the average annual charge per customer as, the total cost to Suppliers for additional security cover spread across all Northern Ireland customers (839,000 customers).

- 1.12. NIE considers that option 3 would provide a reasonable rebalance between the potential costs to customers of bad debts and the cost to Suppliers for the provision of security cover, this option would harmonise the level of NIE's payment security cover with that provided by Suppliers in the Republic of Ireland.
- 1.13. For all options the cost of providing the additional payment security cover is significantly less than the benefit provided by reduced risk to customers.
- 1.14. NIE would welcome the views of consultees on the options set out in this paper.

2. The Consultation Process

- 2.1. Appendix A of this Consultation Paper describes at a high level the impact of the increased credit risk on customers under current payment security arrangements and the alternatives considered by NIE for increased payment security cover. NIE seeks comments from consultees on the options for increased security cover considered by NIE.
- 2.2. The amount of payment security cover required from Suppliers for their DUoS and PSO charges, is set out in section 2 of NIE's PSP, as approved by the Utility Regulator on 23 April 2012. An extract from the PSP is provided in Appendix B.
- 2.3. Following receipt of comments from consultees NIE will send to the Northern Ireland Authority for Utility Regulation (the "Utility Regulator"):
 - 2.3.1. a report on the outcome of its review;
 - 2.3.2. the proposed revisions to the PSP for change to the payment security amount, which NIE (having regard to the outcome of such review) reasonably thinks appropriate; and
 - 2.3.3. any written representations or objections from consultees (including any proposals by such persons for revisions to the PSP not accepted by NIE in the course of the review) arising during the consultation process.
- 2.4. The revisions to the PSP proposed by NIE and sent to the Utility Regulator will require the Utility Regulator's approval and will, if approved, come into force on such date (or dates) as will be notified by NIE, in accordance with the Utility Regulator's approval.
- 2.5. NIE would be pleased to receive consultees' comments on, or any suggestions consultees may have in relation to, the proposed changes to the amount of security cover provided in NIE's PSP, by 20 December 2013, in order that we can prepare our report to the Utility Regulator.
- 2.6. Suppliers are obliged under their existing DUoS and PSO Agreements with NIE, to provide the amount of security cover requested by NIE in accordance with NIE's PSP. Changes to these Agreements are not required to facilitate the proposed changes to NIE's PSP. These Agreements are not the subject of this consultation.
- 2.7. Your formal responses should be in writing and addressed to:

Roisin Ballentine
Northern Ireland Electricity Limited
Danesfort
120 Malone Road
Belfast
BT9 5HT
- 2.8. Alternatively, responses may be sent by email to:

roisin.ballentine@nie.co.uk

Our preference would be for responses to be sent by email.

- 2.9. If you wish to discuss any aspect of this consultation paper, please contact Roisin Ballentine on 02890 689136 or the email address provided above.

Northern Ireland Electricity Limited
30 October 2013

APPENDIX A**PROPOSED CHANGES TO THE AMOUNT OF PAYMENT SECURITY COVER PROVIDED BY SUPPLIERS TO NIE****Change in NIE's Billing Arrangements**

- A1. NIE invoices DUoS and PSO charges to Suppliers on a monthly basis for all customer bills created in the month.
- A2. On 21 May 2012, unlimited customer switching in the competitive Northern Ireland electricity market was introduced. As part of the changes NIE introduced new DUoS billing arrangements which subsequently increased the credit afforded to Suppliers on the amount of DUoS revenue owed to NIE.
- A3. Prior to the introduction, NIE invoiced Suppliers for their domestic customers with a pre-payment keypad meter, based on the customer vends. As such, when customers paid their Suppliers in advance for their electricity, their Supplier also paid NIE in advance for the customers' use of the NIE distribution network.
- A4. In addition, in relation to Suppliers other than Power NI, NIE produced DUoS bills for all other domestic and small commercial customers based on their estimated electricity usage in the calendar month. This meant that NIE invoiced these Suppliers for all their registered customers each month. The DUoS bills were based on estimated electricity usage for the month, subsequently corrected as meter reads were received.
- A5. As from 21 May 2012, DUoS bills are now created daily rather than monthly for all domestic and small commercial customers in line with the customers' scheduled read date. The DUoS bills relate to the electricity used over the previous quarter (effectively 3 months usage). Suppliers are invoiced for all DUoS bills created in the month. The DUoS billing arrangements described are also applied to customers with pre-payment keypad meters.
- A6. Under the new billing arrangements, all Suppliers now pay DUoS charges to NIE for only those domestic and small commercial customers that are scheduled to have their meters read in that calendar month. As a consequence, NIE only invoice Suppliers for approximately a third of their domestic and small commercial customers each month.
- A7. In the first 3 months following the introduction of daily billing on a quarterly billing cycle, Suppliers received significantly lower DUoS bills for their domestic and small commercial customers to allow for the transition from monthly to quarterly billing cycles. This transition has effectively increased the amount of DUoS revenue owed to NIE by Suppliers by approximately 1.5 months worth of DUoS charges for their domestic and small commercial customers. This is equivalent to a credit of approximately £17m across Suppliers (during winter months).

Option 1 – Maintain the Status Quo

- A8. NIE invoices Suppliers on a monthly basis for all their customers scheduled to be read in that month. By the payment due date (10 business days after the invoice date), a Supplier will accrue up to 3.5 months DUoS charges for quarterly read customers (domestic and small commercial), and 2 months DUoS charges for half hour metered (large industrial customer) and unmetered customers. A Supplier will also accrue 2 months PSO charges for all their customers.
- A9. If a Supplier defaults on their payments to NIE, they may accrue charges for at least a further month by the time their customers are transferred to an alternative Supplier. In our estimation, this time lapse is the least time needed for NIE to terminate an Agreement between NIE and a Supplier, and the revocation of the Supplier's licence by the Utility Regulator. However, we understand that in practice the revocation of a Supplier's licence may take much longer, which consequently increases the credit risk.
- A10. The level of payment security cover required under NIE's current PSP is an average 5 weeks DUoS and PSO charges over the year. This leaves a predicted shortfall between the security cover held by NIE and the predicted amount owed by Suppliers of approximately £50m for DUoS and PSO charges across all Suppliers.
- A11. The shortfall in security cover under the current PSP levels for the 3 largest Suppliers in Northern Ireland is approximately £48.6m. If one of these Suppliers defaulted on their payments, the average potential impact on customers' annual DUoS and PSO charges, to recover the outstanding bad debt, would be an increase of £11 for a domestic customer and £15,800 for a large industrial customer (connected at 33kV). These values are based on the "average" outstanding bad debt of the 3 largest Suppliers.
- A12. Following the move to quarterly billing cycles and the subsequent increase in potential bad debt to be recovered from customers, NIE considers it is necessary to increase the level of security cover provided by Suppliers to rebalance, (i) the costs to customers of bad debts, and (ii) the cost to Suppliers for the provision of security cover. The 3 alternative options considered by NIE for increased security cover are outlined below.

Option 2 – Payment Security Cover Based on Estimated DUoS and PSO Charges Accrued by Suppliers

- A13. For the purpose of this paper NIE has estimated the amount of DUoS and PSO charges owed by a Supplier who has defaulted on a payment as; (i) 4.5 months of DUoS charges for quarterly read customers (domestic and small commercial), plus (ii) 3 months DUoS charges for half hour metered (large industrial customer) and unmetered customers, plus (iii) 3 months PSO charges for all their customers.
- A14. For the payment security cover to match this estimated DUoS and PSO charges accrued by Suppliers, the current payment security cover for DUoS plus PSO charges needs to increase by c £50m in total across the Suppliers.
- A15. Most Suppliers provide payment security cover to NIE in the form of a letter of credit issued by a bank. The cost of the additional payment security cover to Suppliers is estimated as

£500k (based on typical bank charges of 1% per annum for the cover provided in a letter of credit). This is equivalent to an additional average annual charge of 60p per customer, if the Suppliers choose to pass the cost on to their customers.

A16. The advantage of this payment security cover option is customers will not be exposed to increased network charges as a result of bad debt accrued by the defaulting Supplier (assuming the Supplier's accrued charges are no higher than NIE's estimation as per paragraph A13).

Option 3 - Payment Security Cover in Line with Levels Required in Republic of Ireland

A17. Since most Northern Ireland Suppliers also operate in the Republic of Ireland, we looked to the arrangements in the Republic of Ireland as a comparator.

A18. Suppliers in the Republic of Ireland are required to provide ESB Networks with a minimum payment security cover equal to estimated DUoS charges for the following 2 consecutive months, inclusive of applicable taxes. ESB Networks review the level of cover provided by the Suppliers each month and may request additional cover to reflect increases due to winter electricity usage and additional registered customers. However, as ESB Networks does not employ seasonal prices, there is generally sufficient head room in Suppliers' security provisions to allow for normal seasonal fluctuations in charges due to variations in consumption levels.

A19. Under option 3, NIE proposes to adopt the ESB Networks' principle of 2 months payment security cover, allowing harmonised arrangements North and South. However, as there are greater variations in NIE's monthly DUoS charges to Suppliers, mainly due to seasonal DUoS pricing for large industrial customers, NIE proposes to base the level of cover on 2 "winter" months charges for the whole year as opposed to monthly revisions in the cover. This approach will provide stability in the required level of cover and avoid undue administration for Suppliers, who generally provide "annual" letters of credit.

A20. NIE does not propose to include VAT in the security cover requested from Suppliers. NIE would reclaim the VAT element of bad debt from HM Customs and Excise.

A21. Under option 3 the current payment security cover for DUoS plus PSO charges would increase by c £19m in total across the Suppliers. As the cover is based on charges in the winter months, Suppliers with predominantly large industrial customers will see a higher increase in their DUoS payment security cover than Suppliers with predominantly domestic customers. However, as the customer exposure to bad debt is more significant in the winter months, it is reasonable to base the payment security cover on charges in the winter months.

A22. The cost of the additional payment security cover to Suppliers is estimated as £190k, (based on typical bank charges of 1% per annum for the cover provided in a letter of credit). This is equivalent to an additional average annual charge of 23p per customer, if the Suppliers choose to pass the cost on to their customers.

A23. The predicted total shortfall in security cover under this option is approximately £31m for DUoS and PSO charges across all Suppliers.

A24. The shortfall in security cover under this option for the 3 largest Suppliers in Northern Ireland is approximately £29.9m. If one of these Suppliers defaulted on their payments, the average potential impact on customers' annual DUoS and PSO charges would be an increase of £7 for a domestic customer and £8,400 for a large industrial customer (connected at 33kV), to recover the outstanding bad debt. These values are based on the "average" predicted outstanding bad debt of the 3 largest Suppliers.

Option 4 - Payment Security Cover Equal to 2 Average Months DUoS and PSO Charges

A25. Under option 4, Suppliers would provide NIE with payment security cover based on 2 average months DUoS and PSO charges forecast for a 12 month period.

A26. Under this option the current payment security cover for DUoS plus PSO charges would increase by c £9m in total across the Suppliers.

A27. This approach is based on annual rather than winter charges and as such normalises the cover requested from Suppliers of domestic and large industrial customers. However customers' exposure to bad debt is increased compared to option 3.

A28. The cost of the additional payment security cover to Suppliers is estimated as £90k, (based on typical bank charges of 1% per annum for the cover provided in a letter of credit). This is equivalent to an additional average annual charge of 11p per customer, if the Suppliers choose to pass the cost on to their customers.

A29. The predicted total shortfall in security cover under this option is approximately £41m for DUoS and PSO charges across all Suppliers.

A30. The shortfall in security cover under this option for the 3 largest Suppliers in Northern Ireland is approximately £39.6m. If one of these Suppliers defaulted on their payments, the average potential impact on customers annual DUoS and PSO charges would be an increase of £9 for a domestic customer and £12,200 for a large industrial customer (connected at 33kV), to recover the outstanding bad debt. These values are based on the "average" predicted outstanding bad debt of the 3 largest Suppliers.

Summary of Options Considered by NIE for Payment Security Cover

A31. The table below shows the 3 alternatives (options 2, 3 and 4) considered by NIE for increased payment security cover from Suppliers compared to the current payment security provisions (option 1) held by NIE for their DUoS and PSO charges. The table shows:

- a. the proposed increase in payment security cover across all Suppliers for each option;
- b. the total shortfall in cover across all Suppliers;
- c. the potential impact on DUoS plus PSO charges, due to the predicted shortfall in payment security cover associated with the 3 largest Suppliers in Northern Ireland (based on the "average" potential bad debt associated with the 3 largest Suppliers);
- d. the total additional cost to Suppliers for the increased DUoS and PSO cover (based on bank charges of 1% per annum for the cover provided in a letter of credit); and

- e. the equivalent cost per customer of additional security cover under each option (based on 839,000 customers).

	Proposed Increase in Current Security Cover (£m)	Shortfall "potential bad debt"		Cost of Additional Cover	
		Total Shortfall (£m)	Potential increase in Network Charges to Average Customers	Bank Charge to Supplier (£m)	If passed to Customer (£ / Cust)
Option 1 - Status Quo		50	Dom=£11; LIC=£15,800		
Option 2	50	0	Dom=£0; LIC=£0	0.500	£ 0.60
Option 3	19	31	Dom=£7; LIC=£8,400	0.190	£ 0.23
Option 4	9	41	Dom=£9; LIC=£12,200	0.090	£ 0.11

- A32. As regards option 3, in addition to providing a reasonable rebalance between the potential costs to customers of bad debts and the cost to Suppliers for the provision of security cover, this option would harmonise the level of NIE's payment security cover with that already provided by Suppliers in the Republic of Ireland.
- A33. For all options considering increased payment security cover (options 2, 3 and 4), the cost of providing the additional payment security cover is significantly less than the benefit provided by reduced risk to customers.
- A34. The proposed increase in DUoS and PSO payment security cover for individual Suppliers would, in general, depend on the preferred option and the Supplier's mix of domestic, commercial and large industrial customers.

APPENDIX B

EXTRACT FROM PAYMENT SECURITY POLICY

2 Amount of Security Cover

2.1 If a Counterparty does not have an approved credit rating, it must provide security to NIE.

2.2 Except as described in paragraph 2.3 below, the security cover for all Counterparties (new and existing) must be equal to an amount, in the reasonable opinion of NIE, representing the aggregate amount payable to NIE in the period specified in the following table:

	Agreement	Period
1.	Distribution Use of System (UOS) Agreement	5 weeks (based on an average over such period calculated from the annual estimated use of system charges) under the relevant agreement
2.	PSO Agreement	5 weeks (based on an average over such period calculated from the annual estimated PSO charges) under the relevant agreement

2.3 Where the calculated amount is less than £15,000 under the relevant agreement, or £30,000 in aggregate across two or more relevant agreements, then NIE may agree that security cover will not be required.

2.4 NIE will review the level of security cover as it considers appropriate. For this purpose it may require a Counterparty to provide information on projected business activity or customer demand. NIE will inform a Counterparty where an adjustment is required. The Counterparty will be given 5 business days to have the amended level of security in place.

2.5 Where any Counterparty exceeds the credit terms on invoices twice in a 6 month period, it will be required to increase its level of security to an amount, in the reasonable opinion of NIE, representing:

1. where a 5 weeks calculation is applied under paragraph 2.2 above, an amount being twice the original figure; or
2. in any other case, the original amount applied under the agreement plus such additional amount as is provided for under the relevant agreement.

2.6.1 If a Counterparty believes that the level of security cover provided is excessive, because the level of payments it makes in respect of the relevant agreement has decreased, then it can apply for a reduction in the level of security cover. The relevant NIE business will review the request and within 1 month of the date of application, subject to verification of the change in circumstances, seek to agree the appropriate level of security cover required. In the event of a failure to agree, either party may refer the matter to NIAUR for determination.

2.7 A Secured Amount Statement will show the calculation of the security cover required from the Counterparty. The form of the statement is set out in appendix 1 to this schedule.