



Conclusion of the Utility Regulator's Review of the Phoenix Supply Ltd Tariff

December 2008

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

Summary

On 13th October 2008, in response to falling wholesale gas costs, the Utility Regulator initiated a review of the Phoenix Supply Limited (“PSL”) tariff for consumers using less than 25,000 therms per annum. This review has resulted in our approval of a 22.1% decrease in PSL’s tariff price effective from 8th January 2009. This paper sets out the background to and reasoning behind our decision.

Background

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

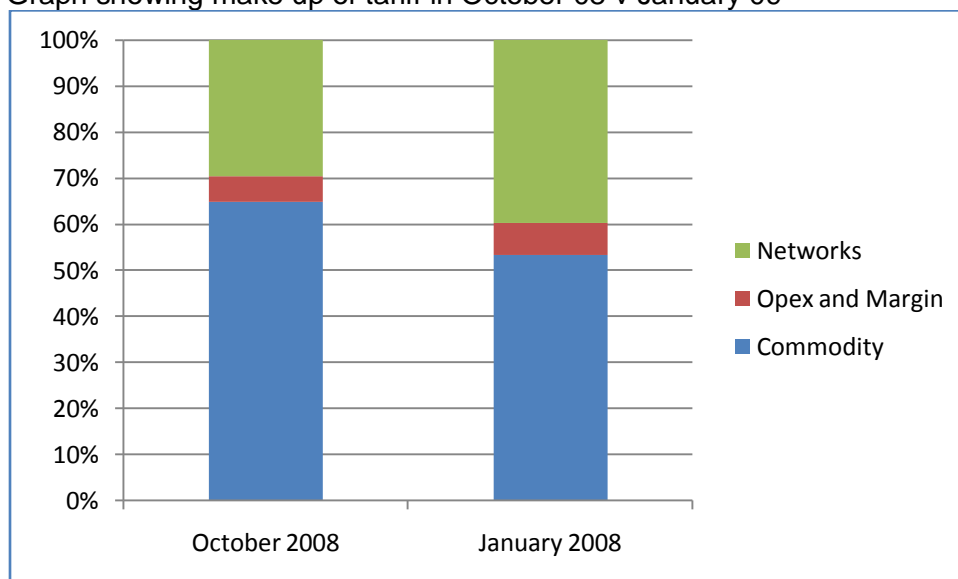
‘the Licensee shall take all reasonable steps to secure that in any period of 12 months the average price per therm of gas supplied to such consumers shall not exceed a maximum price to which the Authority has consented’

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

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

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

Graph showing make up of tariff in October 08 v January 09



The commodity cost is the largest element of the tariff comprising almost 65% of the total gas cost in October 2008 which decreases to 53% in January 2009. Similarly to the October review, gas costs are treated as a pass through item. Therefore all of the savings from price decreases

have been passed through to customers. This figure has also included an amount of over recovery PSL have made based on the October forecast gas prices and actual outturn. Again all of this over recovery is being passed back to customers.

The PSL supply opex for 2009 onwards will be determined by the Utility Regulator shortly and the figure used in this tariff review is the current estimate based on our work thus far. The correct figure will be applied at a future date and any required retrospective adjustments will be applied. Network costs are those charged to all suppliers by Phoenix Distribution and are approved by the Utility Regulator on the basis of our distribution price control determination:

<http://ofreg.nics.gov.uk/pdf%20files/Gas%20%202008/PNG%20-%20Public%20Determination.pdf>

As a result of these measures the Utility Regulator has approved the maximum average tariff of £1.19 per therm which represents a 22.1% decrease effective from 8th January 2009.

Comparison with most recent tariffs

Effective from date	1 st October 2006	1 st April 2007	1 st May 2008	1 st October 2008	8 th January 2009
Approved Tariff (per therm)	£1.18	£1.00	£1.28	£1.53	£1.19
% Change		-14.6%	28.0%	19.2%	-22.1%

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

Process

On 13th October 2008 the Utility Regulator initiated a tariff review on the basis that wholesale gas costs started to drop sufficiently below the level set in the October 2008 tariff to warrant a review. The expectation was that a reduction would be possible if wholesale gas costs, which were then very volatile, remained low enough at the end of the review period. The outturn was that wholesale gas prices continued to drop during the review period such that an even larger tariff reduction was possible by the end of the review. Thus the tariff was approved on 12th December 2008 to be applied on 8th January 2009.

Given that the scheduled review was due for April 2009 this review encompassed the period up to that time and the following 12 months to April 2010. However, the Utility Regulator retains the flexibility to approve a review of gas prices at any stage if it is considered to be in the interest of customers.

Rationale

The forward wholesale gas price for this winter and into next winter has fallen significantly since its peak in early Autumn. Prices have been very volatile over the period but the downward trend has continued and stabilized to a degree which has allowed us to approve the new tariff. Whilst PSL had hedged a large amount of its gas already for the winter 2008/2009 period we have applied the latest prices to the tariff model for the un-hedged position based on the latest forward curve prices. We have also taken the opportunity of this review to set the prices for a 15 month period which should avoid the need for a new review in three months and provide gas customers with some stability. However we would note that markets remain volatile and we will continue to monitor gas prices going forward.

Outcome

The Utility Regulator has reviewed the Tariff Review submission provided by Phoenix Supply and reviewed the PSL forecasts against its own market analysis. The Utility Regulator is satisfied that this decrease is justified and therefore approves the tariff of £1.19 per therm effective on 8th January 2009, which represents a decrease of 22.1% over the previous tariff effective on 1st October 2008 of £1.53 per therm.