NIE Energy Supply's 1 October 2010 Tariff Review

A Regulatory Briefing

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Summary

The Utility Regulator has agreed with the conclusion that there should be no change in NIE Energy Supply's (NIEES) tariffs this October. There has historically been a tariff change in October each year following a review. This review has been carried out this year as usual but, in an uncertain context, it is considered prudent to make no change at this time while keeping tariffs under review through the year. This paper sets out the background and reasoning behind the Utility Regulator's tariff review.

Background

While the electricity supply market has been fully open to competition since 1 November 2007, in practice for some classes of customers, in particular domestic customers, NIEES whilst facing competition from other suppliers is still very much dominant in this sector of the market. The Utility Regulator therefore takes an active role in scrutinising NIEES's proposed retail tariffs which are the final prices customers pay.

NIEES retail tariffs for this upcoming year are made up of a number of components:

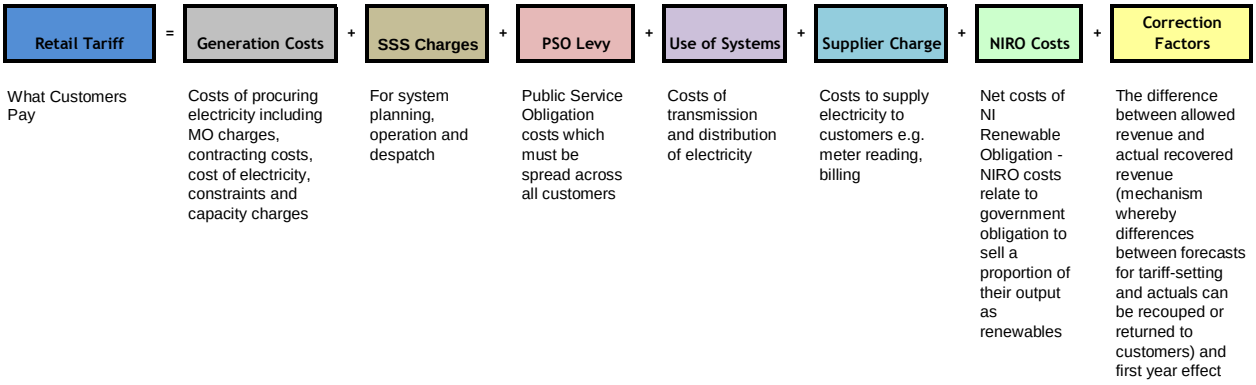


Figure 1: Components of NIEES tariff from 1st Oct 10[1]

Several of these components are common across all suppliers and the final customer should nominally pay these regardless of who their supplier is; these components are all subjected to regulatory review and approval:

Cost/Tariff	Regulatory Approval
Market Operator (MO) Charges	SEMO Revenue & Tariffs 2010 (Price Control still to be finalised)
SSS Charges (System Support Service)	SONI Revenue & Tariffs 2010 (Price Control still to be finalised)
PSO Levy (Public Service Obligation)	Annual approval of other costs
Use of System Charges (UoS)	T&D Price Control 2007 - 2012

Table 1: Tariff Components common across all suppliers and their regulation

These costs are regulated because they represent parts of the industry which are natural monopolies. Independent suppliers are free to enter the market and purchase power, but they must add on the tariffs outlined above before setting the final price to sell to customers.

The remaining components of NIEES tariffs, because of the level of competition in the market, are subject to regulatory scrutiny.

[1] The first year effect relates to the time lag in revenues due to the quarterly billing cycle, this is a decrease in a year when there is a tariff decrease, as it takes actual revenue received some time (approximately three months) to catch up with the tariff change.

Cost/Tariff	Regulatory Scrutiny
Generation Costs	Competitive and regulated wholesale market; approval of NIEES hedging methodology by UR; annual approval of Gt statement.
Supplier Charge	Application of NIEES Supply Price Control 2010 – 2011.
NIRO Costs	Audited on behalf of the UR by Ofgem as part of its UK-wide audit.
Correction Factors	Analysis by the UR of variances between forecasts used for setting tariffs and out-turn costs; agreement to the 'first year effect'. [1]

Table 2: Remaining Components of NIEES tariffs

Annual Review

The table below analyses the required revenues of NIEES for all of its regulated customers[2], by key component, comparing the forecast revenue requirement underlying tariffs for the year beginning 1 October 2010 with the equivalent last year.

Component	Oct 2009/10 (12 mths) £m [3]	Oct 2010/11 (12 mths) Range £m	12 months movement £m	12 months movement % Change
Generation	212.2	231.6 to 211.6	19.4 to -0.6	9.14% to -0.3%
Capacity	52.3	56.8	4.5	8.6%
Other (MO, Imperfections, NIROC)	17.5	19.2	1.7	9.7%
UoS	113.4	101.5	-11.9	-10.5%
PSO	19.8	17.7	-2.1	-10.6%
SSS	10.6	10.8	0.15	1.4%
Supply costs	35.0	36.3	1.3	3.7%
Correction Factors	23.7	9	-14.7	-62.0%
TOTAL ALLOWED REVENUE	**484.50**	**482.9 to 462.9**	**-1.6 to -21.6**	**-0.3% to -4.5%**

Table 3: Price decrease comparison in Total Revenue terms

Given the uncertainty around NIEES un-hedged energy purchase costs it is not prudent to forecast an exact cost for generation. It is however possible to state a range that the actual cost could fall somewhere within, although due to fuel price volatility this is only indicative. Potentially energy costs could fall outside this range if fuel prices were to deviate significantly from the current forward prices given by the fuel markets. Based on the indicative generation cost range

[2] NIE Energy supplies some customers in some sections of the market that are competitive, where tariffs are not reviewed by the UR.
[3] To aid comparison, the 2009/10 amounts have been restated for the same demand that NIEES have forecast for October 2010 – September 2011.

the table gives a range of possible reductions to the total required revenue amount of -0.3% to -4.5%.

Due to the uncertainty discussed above and the minimal percentage change forecast, the Utility Regulator has agreed that at this point there should be no change to the NIEES tariff. We will monitor the situation over the coming months to assess if there is scope to consider a tariff increase or decrease on the basis of actual out turn costs.

If NIEES over-recovers because underlying costs out-turn lower than forecast, this over-recovery can be returned to customers at the next tariff review. Similarly, if NIEES under-recovers because underlying costs out-turn higher than forecast, this under-recovery can be included in customers tariffs at the next tariff review. This process will be in line with NIEES approved Tariff Methodology Statement.

The following sections analyses the above cost components in more detail.

Generation costs

The table above shows that the potential range of forecast generation cost is from a slight reduction of 0.3% on last year's forecast cost to an increase of over 9%. This indicates that the likelihood is that the generation cost for 10/11 will be higher than 09/10 but by how much is uncertain. Forward gas prices for the upcoming tariff year were slightly higher over the contracting period this year than they were last year. The Utility Regulator has analysed gas forward prices during the periods May – August 2009 and May – August 2010 and verified that this was the case. Furthermore NIEES has a lower level of hedging this year than last year and hence there is a higher level of uncertainty around the final generation costs. Hedging a percentage of the generation cost effectively fixes the cost and so it is known. With a lower level of hedging more of the generation cost is unknown and based purely on forecast fuel (mostly gas) prices which are volatile.

The process which was followed was:

NIEES provided the Utility Regulator with detailed forecast wholesale cost inputs to facilitate the Utility Regulator's review. The following information was provided:

- NIEES Demand Forecast, based on an estimate of customer number changes in each retail category, used in conjunction with estimated annual consumption per customer (kWh);
- NIEES forecast Energy Charges. These are based on the price of existing hedged volumes, the price of hedges expected to be entered into and the forecast price of NIEES un-hedged volume;
- Details on forecast capacity charges for the period;
- Market Operator Charges;
- Currency risk and currency hedging; and
- Credit Cover Requirements.

The Utility Regulator analysed all the information provided and also took an independent run of the PLEXOS model to verify the reasonableness of the forecast SMP.

Hedging purchases were reviewed to ensure they align with the approach detailed in NIEES hedging methodology statement. The capacity charges model was analysed in detail and appears robust. The remainder of forecast costs, which make up a much smaller proportion of total generation costs than energy and capacity costs were verified by the Utility Regulator and appear reasonable.

Capacity costs

The capacity charges for tariff year 09/10 out-turned significantly higher than was forecast last year when tariffs were set. The estimate this year is therefore more reflective of the prevailing capacity cost. It should be noted that this is the reason that NIEES capacity cost is increasing by 8.6% from last year, whereas capacity costs for the market have decreased by 5.6% as shown in Annex 1. One of the key drivers associated with this year's under-recovery is the higher level of capacity charges from those forecast that had to be paid. The 09/10 capacity cost forecast was based on the all-island demand forecast published as part of KEMA's plexos validation exercise. This included an element of embedded generation and non-market wind, over-estimating the loss adjusted net demand of all supplier units and thereby understating the supplier capacity charges.

Northern Ireland Network Charges

In terms of ***overall*** demand (i.e. total network demand) it is anticipated that there will be an increase when compared with last year. NIE (NIE Network Business) have forecasted that they expect that ***total*** demand for 2010/2011 will be 8,444 GWhs compared to the forecast for 2009/10 of 8,348 GWhs. This is an increase in the overall expected demand of 1.15%. This increase in demand has the impact of reducing the ***average*** unit costs (i.e. the overall cost is divided across a larger amount of units)

Distribution Use of System (DUoS) Charges:

In terms of the DUoS charges the associated amount recoverable has reduced by almost 10%. This is due to an over-recovery in the current year and a reduction in NIE's regulated entitlement' as set out in annex 2 of its licence. (See Annex 1 for further explanation)

In terms of DUoS, NIEES submitted the tables which form part of the calculation of the tariffs. The tables produced detailed the various unit rates which were used across the categories of tariff. The rates used as inputs were checked and agreed to the rates which were published by NIE in their Statement of Charges (effective from 1 October 2010). The charges for DUoS are calculated by estimating the units used in each category and the time of day which they are used which allows an overall charge for each tariff category to be deemed.

As stated above the fall in DUoS was 10%, and the overall movement in Network charges (UoS) was a decrease of 11% and this is due to the blend of the network charges (with TUoS making up 18% of the costs and DUoS making up the other 82%).

Transmission Use of System (TUoS) Charges:

TUoS has reduced by just over 16%. This has arisen due to an over-recovery in the current year and similarly as with DUoS a reduction in NIE's regulated entitlement. The cost-reflective sculpturing of transmission tariffs is currently under review and a consultation on the subject is currently available on the SONI website[4]. It is intended to apply any changes for the tariff year 2011/12.

Similarly to DUoS, NIEES submitted the tables which form part of the calculation of the tariffs. The tables produced detailed the various unit rates which were used across the categories of tariff. The rates used as inputs were checked and agreed to the rates which were published by SONI in their Statement of Charges (effective from 1 October 2010). The charges for TUoS are calculated by estimating the units used in each category and the time of day which they are used which allows an overall charge for each tariff category to be deemed.

Although the fall in TUoS was 16%, as above the overall movement in UoS was a decrease of approximately 11% and this is due to the blend of the network charges (with TUoS making up 18% of the costs and DUoS making up the other 82%)

Public Service Obligation (PSO)

The Public Service Obligation is a levy which is charged at a flat rate on all units of electricity demand. PSO unit charges levied on all suppliers have decreased by 10% (from 0.549p/kWh to 0.491) in 2010/11 compared to the previous year. There are a number of elements within this charge. Amongst the most notable movements are in relation to the Non-Fossil Fuels Obligation (NFFO)/Renewable Obligation Factor (ROF) and Legacy Generation Costs. NFFO/ROF is expected to have an over recovery at the end of the current tariff year due to the proceeds from the sale of Renewable Obligation Certificates (ROC) being passed back to customers. As a result of this, there will be a rebate for the 2010/11 tariff year (moving from a NFFO/ROF cost of £0.4m in 2009/10 to a rebate of £1.5m in 2010/11. In terms of Legacy Generation Costs, these have moved from an income of £15.1m in 2009/10 to a cost of £5.6m in 2010/11. There are a number of factors contributing to this, including under-recovery, loss from trading, less hedging profit etc. these are more fully explained in Annex I.

NIEES submitted the PSO amount to be included in the tariffs, this was agreed by checking the PSO unit charge used (published by NIE). This rate is charged as a flat rate across all

[4] The paper is available at www.soni.ltd.uk/newsstory.asp?news_id=89

categories. To calculate the overall amount for PSO, the unit rate is multiplied by the estimated consumption.

System Support Services (SSS)

System Support charges cover the cost of SONI and ancillary services required to operate the transmission system safely and reliably. SONIs current price control has now finished and as a result a new price control will need to be determined. The new price control will be applied to SONI during 2010/11 and at this stage it is difficult to predict what the exact impact of this will be on SONI's charges. Given this uncertainty, the maximum amount recoverable for 2010/11 has increased. In addition to this, SONI are predicting a lower demand in their forecasts than NIE, this leads to a higher ***average*** per unit cost (i.e. a higher cost divided over a smaller demand unit base). SSS unit charges levied on all suppliers have increased by 1.3% (from 0.294p/kWh to 0.298p/kWh) in 2010/11.

NIEES submitted the SSS amount to be included in the tariffs, this was agreed by checking the SSS unit charge used (published by SONI in their Statement of Charges). This rate remained as a flat rate across all categories. To calculate the overall amount for SSS, the unit rate is multiplied by the estimated consumption.

Annex 1 provides further explanation of the reasons for the increases from the 2009/2010 tariff year in the above tariff components (Annex I was previously published on 6th August 2010).

Supply Costs

Supply costs have increased by 3.7% from the previous tariff year. Whilst there was a reduction in allowed revenues in the NIEES price control this has been offset by the costs of replacing a now moribund billing system. Overall, supply costs make up 7% of the overall tariff.

Correction Factors

If the amount of revenue recovered in any one year exceeds or falls short of the amount allowed by the relevant price control formula, the correction factor operates in the following year to give back any surplus with interest, or to recover any deficit with interest, as appropriate. As discussed above capacity charges for 09/10 were higher than anticipated and this is the principal driver of the new under-recovery over the last tariff year. However, the overall total of Correction Factors has fallen since last year due largely to lower total under-recoveries.

NIEES submitted a forecast for the amount of under-recovery to be included in the tariff, as well as an analysis of the actual monthly profile of this under-recovery for the past 24 months. This amount was checked by checking the actual outturns to the NIEES financial system. This account also forms part of the NIEES External Audit.

Next Steps

In light of the uncertainty in terms of the lower level of hedging and the volatility of the forward gas prices, the Utility Regulator intends to continue to monitor NIEES regulated tariff revenues relative to their costs, to assess if there is scope for a tariff adjustment in accordance with the approved Tariff Methodology Statement.

Recent Tariff Changes

For NIEES domestic customers using 3,300 kWh per annum on standard credit, this tariff review will see no movement in their bill which would be £496 per annum.

The graph below takes an average customer with average consumption of 3,300kWh per year, and compares the average bill for Oct 2010, Oct 2009, Jan 2009, October 2008 and November 2007.

This graph shows that wholesale costs have risen slightly since last year and that network costs have fallen. The graph also shows the potential year-on-year volatility of wholesale costs.

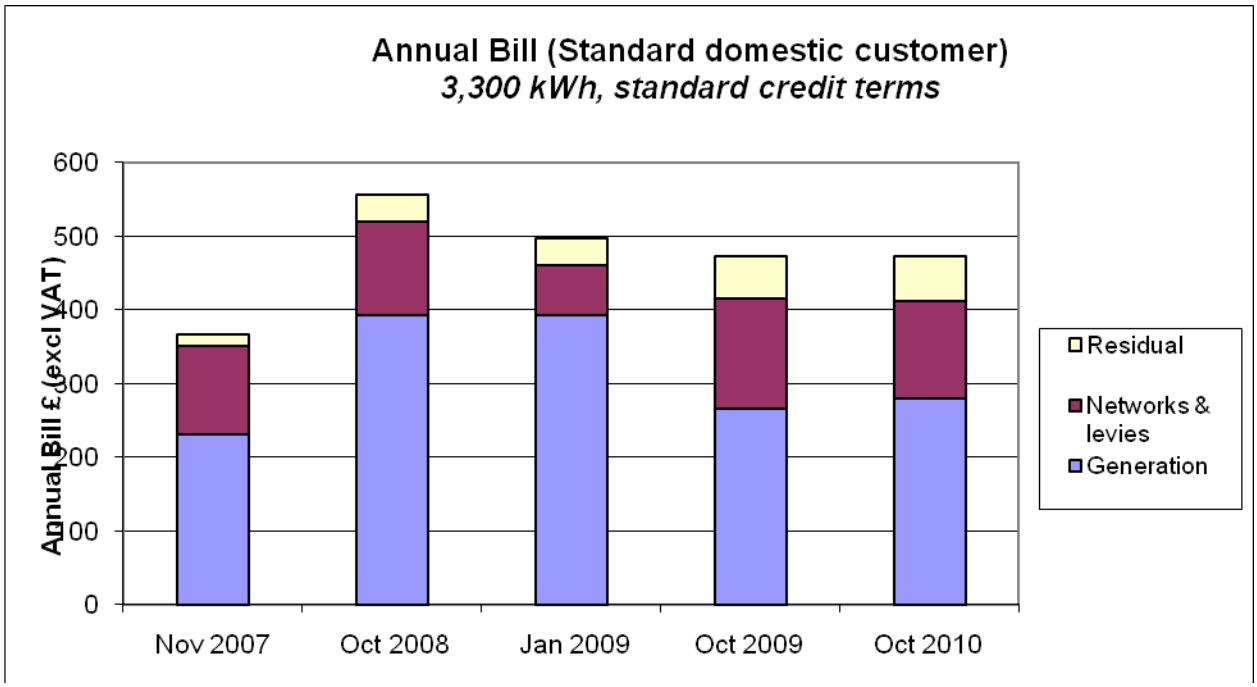


Figure 3: Recent Tariff changes based on an average annual customer usage of 3,300kWh (excl VAT). [Note: in the chart above, "Networks & Levies" includes SSS charges, PSO Levy, Use of System charges, NIRO charges and Supply costs].

Comparisons with ROI and GB Suppliers

The October 2010 NIEES domestic standard tariff compares favourably to the equivalent ESB tariff. In 2010 the recently published ESB tariff is on average 14.4% higher than the NIEES standard domestic tariff. The table below compares the previous tariff level in October 09 and the current October 2010 level to the equivalent ESB urban and rural charges.

	October 2009	**Higher than NIEES £**	**Higher than NIEES %**	**October 2010**	**Higher than NIEES £**	**Higher than NIEES %**
NIEES	**£496**			**£496**		
ESB – urban	£545	£49	9.9%	£553	£57	11.5%
ESB – rural	£575	£79	15.9%	£582	£86	17.3%

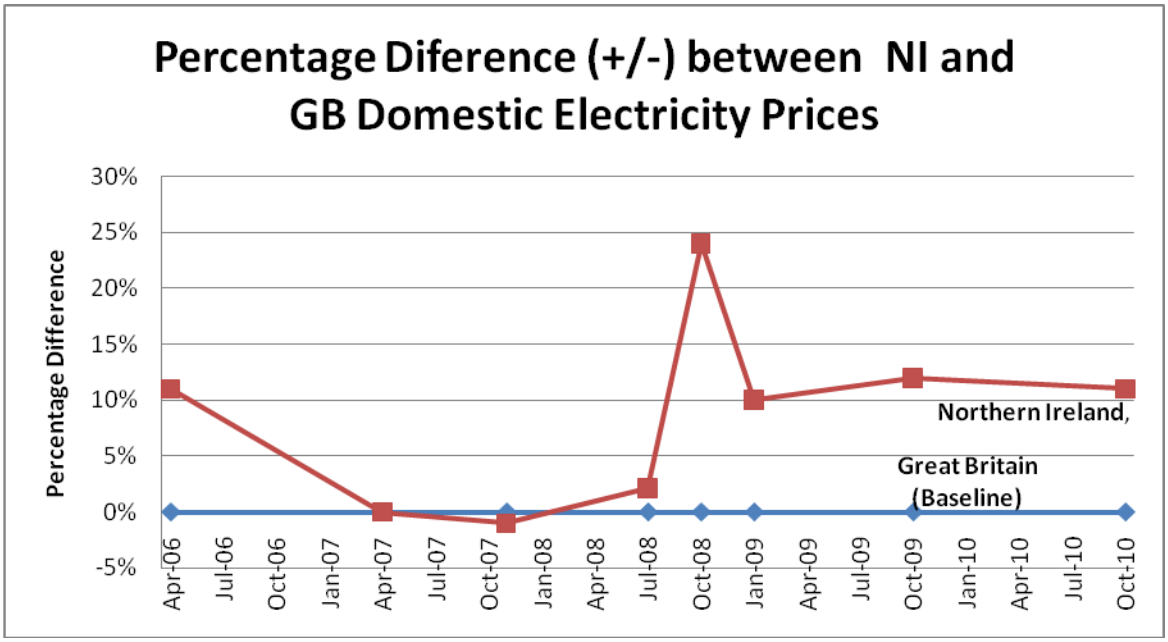
Table 4: Domestic Electricity costs based on average annual customer usage of 3,300kWh (including VAT, using a euro exchange rate of 1.21 for October 2010 and a rate of 1.16 for October 2009)

Comparison with GB and RoI

% Price Change	Effective Date	GB Comparison	RoI Comparison
10.8% increase	April 2006	NI prices 11% higher for domestic, and 28% higher for SME's than in GB	NI domestic prices will be around 7% lower than RoI prices, but SME's 10% higher in NI.
3% decrease	April 2007	NI prices same as GB average for domestic, and around 28% higher for SME's	NI prices 17% lower than RoI average.
3.6% increase (domestic) 1% increase (businesses)	November 2007	NI domestic prices just below GB comparator regions[5]; and SME prices 21% higher than GB average.	NI domestic prices around 8% lower than RoI , and SME's around 4% higher than av. RoI
14% increase	July 2008	NI domestic prices approx 2.1% higher than GB	NI prices around 9% lower than RoI.
33.3% increase	October 2008	NI domestic prices 20-24% higher than GB	NI prices comparable to RoI prices
10.8% decrease	January 2009	NI domestic prices around 10% higher than GB average and around 5% higher than comparator GB regions.	NI prices around 17% lower than RoI prices
5% decrease	October 2009	Following the round of price reductions in GB in spring 2009, NI domestic prices around 12% higher than GB average and 8% higher than comparator GB regions.	NI prices around c 13% lower than the RoI prices (ESBCS).
0% Price Change	October 2010	NI Domestic prices around 11% higher than GB average and 7% higher than GB comparator regions.	NI prices around 13% lower than RoI prices (ESBCS)

Table 5: Historical NIEES price adjustments compared to GB and RoI

[5] The three GB comparator regions are: Sweb, Swalec and Scottish Hydro Electric (these relate to the regions of the former GB electricity boards: South-Western Electricity Board (SWEB), South Wales Electricity Board (SWALEC) and North of Scotland Hydro-Electric Board (Scottish Hydro)). These are the normal comparator regions when assessing domestic electricity prices vis-à-vis Northern Ireland, due to similarities in the distribution and the lower density of population.



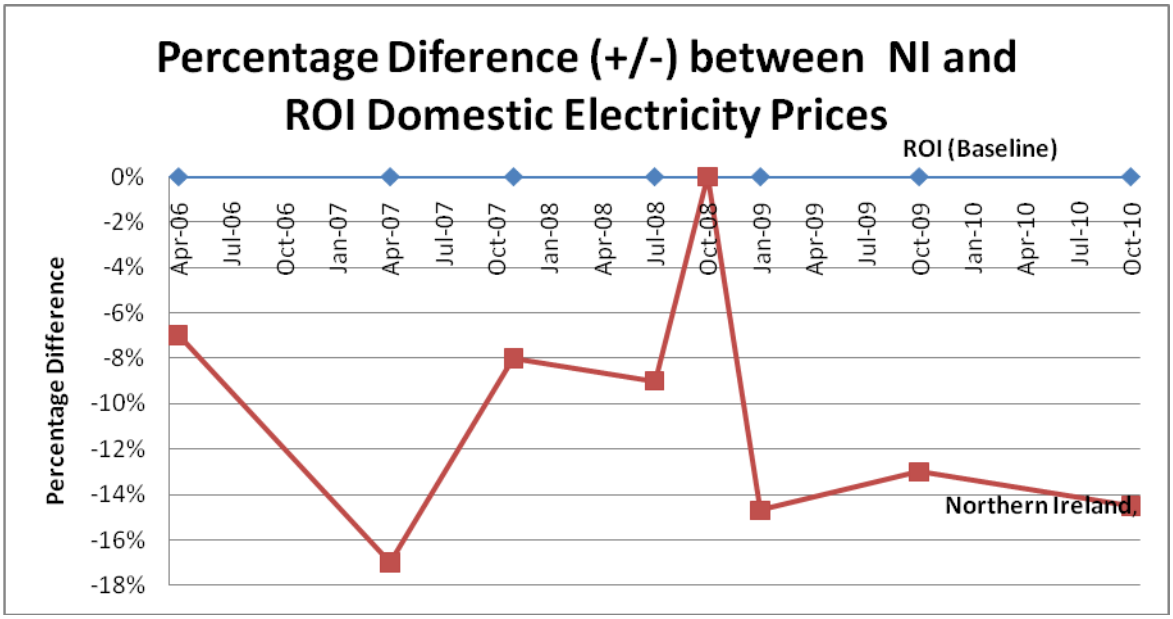


Figure 4: NI v's GB (GB Average) and RoI - domestic comparison.

The long-run trend is for electricity prices to be c.10% higher than those in GB (reasons are discussed below in Figure 5). Note that 2007 was an unusual year. The principal cause of the temporary parity between GB/RoI prices in the period April 07 to April 08 was as a result of a significant over-recovery built up by NIEES in the previous tariff year.

The following graph compares the October 2010 prices for NI and RoI to the prices from the larger suppliers in GB.

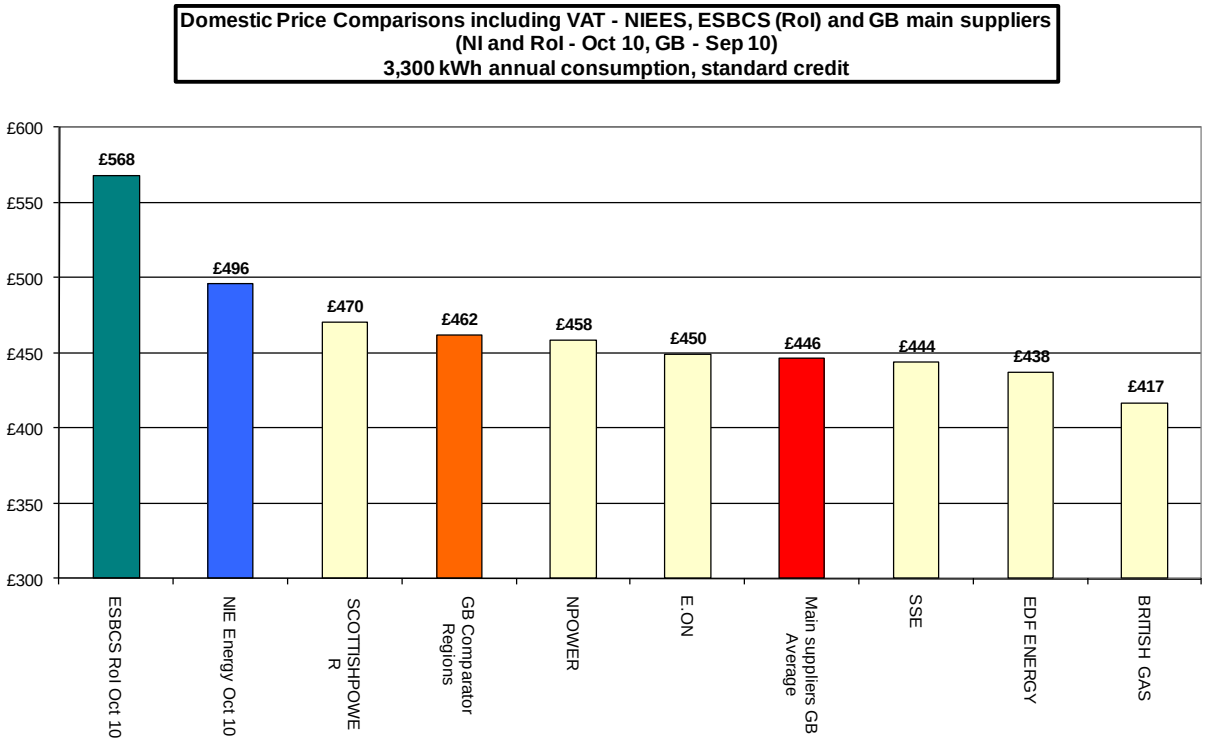


Figure 5: NIEES tariffs per average customer compared to RoI and GB

From the graph it can be seen that NIEES tariff is c.11% higher than the main suppliers in GB (average) and 7% higher than the GB comparator regions.

Historically electricity prices in Northern Ireland have tended to be higher than Great Britain. Key disadvantages that have led to higher prices in Northern Ireland are:

- higher energy transport costs;
- economies of scale in Great Britain owing to the size of the market there compared to Northern Ireland;
- the additional cost of long term legacy generation and associated contracts (not present in GB markets); and
- the different fuel mix in Great Britain (i.e. Northern Ireland has a reliance on gas, Great Britain's generation mix is spread between nuclear, gas and coal).

Comparison with Europe

The following graph compares the October 2010 prices for NI and RoI to September 2010 prices in GB and to the most recent available data for other countries in Europe (which relate to the second half of 2009).

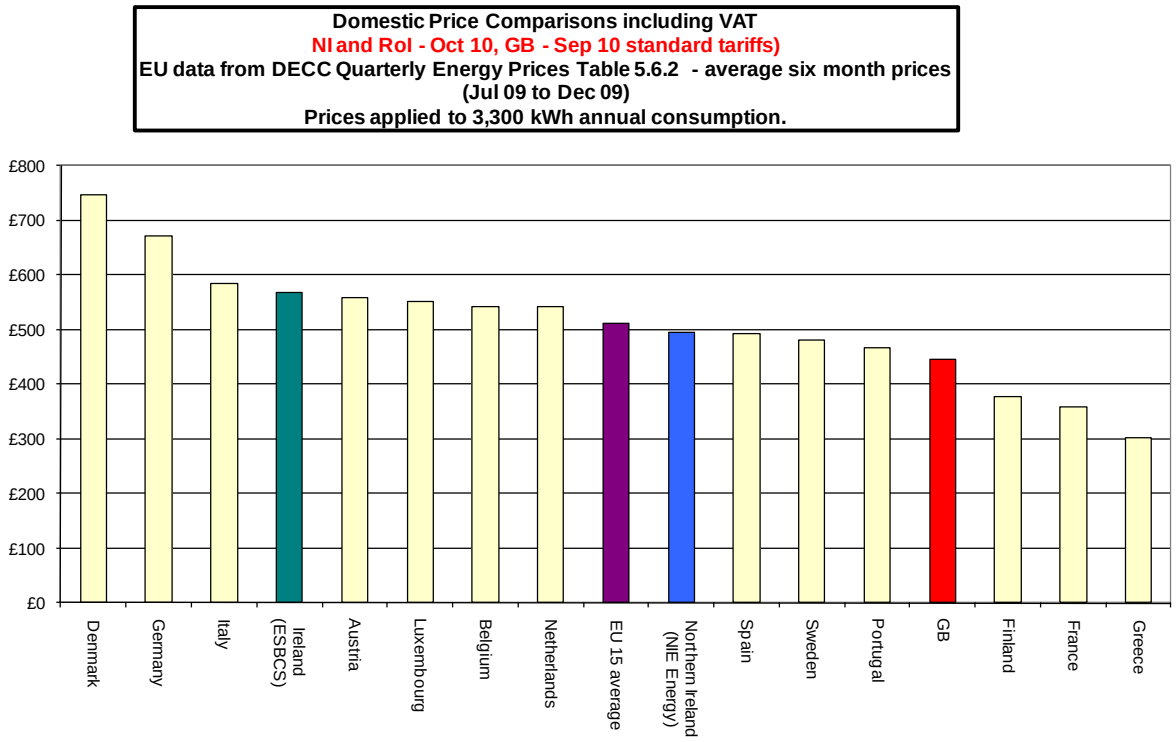


Figure 6: NIEES tariffs per average customer compared to RoI, GB and EU

With the caveat that data from the rest of the EU is relatively old, from the graph it can be seen that NI tariffs are around the EU average.

ANNEX 1 – Information Note on regulated inputs to the Tariff model (published on 6 August 2010)

Regulated Tariff Values

Information Note

August 2010

1 – Introduction

Electricity suppliers in Northern Ireland pay a number of regulated charges which they in turn pass on to their customers. Regulated charges for the use of the electricity network in Northern Ireland and a levy known as the Public Service Obligation (PSO) are set by NIE and SONI (the system operator in Northern Ireland), and the maximum amount recoverable is approved by the Utility Regulator. Other regulated charges associated with the Single Electricity Market (SEM) are set by the Market Operator (SEMO) and the maximum amount recoverable is approved by the SEM Committee. The purpose of this note is to communicate the approved changes which will take effect from 1 October 2010, together with explanations for these changes.

NIE, SONI and SEMO set tariffs to reflect the total amount that can be recovered in the forthcoming tariff year and forecast demand. These tariffs vary between individual customers depending on load profile, maximum demand, connection voltage, etc. NIE's revised tariffs are now published on their website and are linked to the Utility Regulator website. SONI's revised tariffs for use of the transmission network are expected to be published shortly.

Electricity bills also include wholesale energy costs, the climate change levy (for businesses only), supplier charges and VAT. Energy costs will vary between suppliers and customers depending on the timing and extent of hedging contracts.

2 – Charges Regulated by the Utility Regulator

The Utility Regulator regulates network charges and the PSO. NIE are forecasting a total demand for 2010/11 of 8,444 GWhs compared to the forecast for 2009/10 of 8,348 GWhs. This represents an increase of 1.15% and has the effect of further reducing average unit costs.

2.1 Northern Ireland Network Charges

Details of the movements in the maximum amount recoverable from network charges are set out in table 1.

Distribution Use of System (DUoS) Charges:

The maximum amount recoverable has reduced by almost 10%. This is due to an over-recovery in the current year and a reduction in NIE's 'regulated entitlement' as set out in annex 2 of its licence.

Transmission Use of System (TUoS) Charges:

The maximum amount recoverable has reduced by just over 16%. This is due to an over-recovery in the current year and a reduction in NIE's regulated entitlement as set out in annex 2 of its licence. Supplier TUoS charges will all be reduced by 18% and generator TUoS by 13.7%. The difference is due to the over-recovery being applied to supplier tariffs only, as this was the source of the over-recovery. The cost-reflective sculpturing of transmission tariffs is currently

under review and a consultation on the subject is currently available on the SONI website[6]. It is intended to apply any changes for the tariff year 2011/12.

System Support Services (SSS) Charges:

These charges cover the cost of SONI and ancillary services required to operate the transmission system safely and reliably. The maximum amount recoverable for 2010/11 has increased by 2%. A new price control will be applied to SONI during 2010/11 and at this stage it is difficult to predict what the exact impact of this will be on SONI's charges.

Table 1: Northern Ireland Network Charges

	2009/10	**2010/11**		
	£m	**£m**	**% Change (nominal)**	**% Change (real)[7]**
Distribution Charges (DUoS)	164.7	148.6	-9.8%	-14.1%
Transmission Charges (TUoS)	35.8	30.0	-16.2%	-20.2%
Support Charges (SSS)	24.2	24.7	2%	-2.9%
Total Network Charges	**224.7**	**203.3**	**-9.5%**	**-13.8%**

Table 1 shows that the maximum amount recoverable for network charges reduced by 9.5% (nominal). Based on NIE's forecast demand of 1.15%, average unit charges will decrease by around 10.6%.

2.2 Northern Ireland Public Service Obligation (PSO) Charge

The PSO is a levy which is charged at a flat rate on all units of electricity demand. The components of the levy are described below. The year-on-year movements and details of the year-on-year changes in the maximum amount recoverable are set out in table 2.

Non-Fossil Fuel Obligation (NFFO) / Renewable Obligation Factor (ROF) Charges:

The NFFO contracts and the associated ROFs are managed by NIE Energy Supply (NIEES). These are contracts put in place to encourage renewable generation prior to the ROCs (Renewable Obligation Certificates) scheme being introduced. Any costs and benefits associated with these processes are claimed through the PSO. The amount is expected to have

[6] The paper is available at www.soni.ltd.uk/newsstory.asp?news_id=89

[7] RPI has increased by 3.75% in the nine-month period between October 2009 and June 2010. Assuming a similar increase between June and October 2010 would result on year-on-year inflation of 5%.

an over-recovery at the end of the current tariff year due to proceeds from the sale of ROCs being passed back to customers. This over-recovery results in a rebate for the 2010/11 tariff year and this income is expected to continue for the next tariff year.

Table 2: Northern Ireland Public Service Obligation (PSO) Charges

	2009/10	**2010/11**		
	£m	£m	% Change (nominal)	% Change (real)
NFFO/ROF	0.4	(1.5)		
Landbank	0.1	0.1		
Ballylumford CBO	20.7	20.7		
Kilroot FGD	24.0	1.4		
Legacy Generation Costs	(15.1)	5.6		
Market Opening Costs	8.0	7.0		
NISEP	7.8	7.9		
Total PSO Charges	**45.9**	**41.3**	**-10.0%**	**-14.3%**

Table 2 shows that the maximum amount recoverable under the PSO levy reduces by 10.0% (nominal). Given that demand is forecast to increase by 1.15%, average unit charges will decrease by around 10.6%. Therefore the PSO levy will reduce from 0.549 p/kwh to 0.491 p/kwh.

Customer Buy-out (CBO) and Kilroot Flue Gas Desulphurisation (FGD) Costs:

The Ballylumford CBO costs arose from a buy-out of power purchase agreements back in 2003. These costs are due to end in March 2012. The Kilroot Flue Gas Desulphurisation costs are due to a clause in the power purchase agreement which allowed recovery of these cost since 2007. These costs are due to end on 1 November 2010.

Legacy Generation Costs:

The NIE Power Procurement Business (PPB) has power purchase agreements with the power stations owners in Northern Ireland. These contracts were put in place with privitisation of the industry back in 1992. PPB purchase power under the terms of these contracts and then sell this power in the SEM. Any profit or loss is levied on all customers in Northern Ireland via the PSO.

The PPB business and the associated generation contracts are forecast to cost customers £5.6m in the 2010/11 tariff year. This compares to a net income of £15.1m in the 2009/10 tariff year. The swing is explained by a number of factors, the most significant of these are listed below:

- PPB are expected to carry an under-recovery of £3m into the 2010/11 tariff year, as opposed to the over-recovery of £20m they had going into the 2009/10 tariff year.

- PPB is expected to make a loss from trading in the wholesale market in 2010/11, compared to a significant profit in 2009/10.
- As part of PPB's risk management strategy they enter into hedges for both the sale of electricity and the purchase of gas. PPB is expected to earn less profit from these hedges during 2010/11 than in 2009/10.
- In 2010/11 PPB is expected to make a profit from the sale of excess carbon credits, whereas going into the 2009/10 tariff year they expected to have to purchase credits.

It should also be noted that the Utility Regulator has now issued a notification of our intention to cancel the contracts associated with the Kilroot generating units 1 and 2. The expected cost to customers in 2010/11 would be significantly higher if these contracts had not been cancelled.

Northern Ireland Sustainable Energy Programme (NISEP) Costs:
A levy is imposed on all demand to fund the NISEP. The objective of this programme is to promote energy efficiency with particular regard to vulnerable electricity consumers. The increase for 2010/11 is in line with RPI.

Market Opening Costs:
This charge is for the capital and operating costs for the new IT systems required to facilitate retail competition.

3 – Charges Regulated by the SEM Committee

The SEM Committee regulates certain charges in the all-island electricity market including charges for generation capacity, the operation of the market and market imperfections (or constraints). Details of the movements in the maximum amount recoverable for these charges on an all-island basis are set out in table 3.

All-island forecast demand for 2010/11 is 36,990 GWhs compared to the forecast last year for 2009/10 of 36,772 GWhs, representing an increase of 0.6%. This has the effect of reducing average unit costs.

Table 3: Charges Regulated by the SEM Committee

	2009/10 €m	**2010/11 €m**	% Change (nominal)	% Change (real)
Capacity Charge[8]	579.14	546.81	-5.6%	-10.1%
Imperfections Charge	93.73	107.32	14.5%	9.0%
Market Operator Charge	19.24	23.62	22.8%	16.9%
Total Charges	**692.11**	**677.75**	**-2.1%**	**-6.7%**

Capacity Charges:

In the SEM, generators receive a capacity payment as a contribution to fixed investment and operating costs. The total amount is revised annually to reflect the cost of new peaking capacity and the amount of capacity required to meet security standards. Suppliers in turn pay a capacity charge which is profiled monthly. These charges are calculated and published on a calendar year basis.

The total capacity charge for tariff year 2010/11 is down by 5.6%. On a unit basis the reduction will be greater due to increased forecast demand.

Imperfection Charges:

Actual dispatch on the all-island transmission network differs from the optimal dispatch derived for the market schedule. This is because constraints are introduced due to network bottlenecks (including the N-S interconnector) and due to the need for the system operators to maintain reserve for operational security.

The Imperfections charge mainly covers the cost of the variance between actual dispatch and the unconstrained economic dispatch reflected in the market schedule. Generators receive constraint payments to keep them financially neutral for the difference between the market schedule and the actual dispatch.

Year-on-year movement in this charge is 14.5%. This is mostly due to a reduction in the size of the k factor carried forward from previous years.

Market Operator Charge:

The Market Operator charges, defined within the SEMO price control, are currently out to consultation and will not be finalised until late September 2010. This has increased due to additional staff and a new proposed regulatory framework that will provide a lower long-term

[8] The capacity charge is calculated and published on a calendar year basis, these numbers have been adjusted to tariff year values for comparison with the other SEM charges.

revenue requirement. Tariffs set prior to this are likely to use the consultation value within the tariff structure.

4 – Other Costs

Energy

The largest component of electricity bills is the cost of purchasing energy from the wholesale electricity market (the SEM). In order for suppliers to offer fixed energy prices they must therefore enter into forward hedges. Prices will vary between suppliers and customers, depending on the extent, timing and duration of hedging contracts.

Whilst the SEM Committee does regulate bidding behavior in the spot market, the wholesale energy component of bills is not regulated for most customers. In Northern Ireland this component remains regulated for customers (mainly domestic) of the incumbent supplier, NIEES, who consume less than 150 MWh per year. Further information will be made available in September on NIEES's regulated tariff that will take effect from 1 October 2010.

Climate Change Levy (CCL)

The CCL was introduced on 1 April 2001. Only non-domestic electricity customers pay the levy, at a rate of 0.47p/kWh. Electricity from qualifying renewable sources is exempt from the levy. The Utility Regulator issues Levy Exemption Certificates (LECs) as evidence that electricity meets the definition of having been generated from a qualifying renewable source. LECs are issued by the Utility Regulator to generators and are traded with the electricity to suppliers.

Suppliers then use the LECs as evidence to HMCE of the amount of qualifying renewable electricity supplied to non-domestic customers. Businesses can also enter into a climate change agreement which reduces the amount they pay under this levy.

Supplier Costs and Margin

Electricity bills will also include a component to cover supplier costs and margin.

VAT

Value added tax (VAT) is applied to electricity at a reduced rate (currently 5%) for average consumption less than 33kWh per day, above that the standard rate is applied.