

Review of K factors & Supply Margins and Tariff Structure Review

Information Note

21st December, 2009

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1.0 INTRODUCTION

On the 22nd of June the Commission for Energy Regulation (CER) and the Northern Ireland Authority for Utility Regulation (NIAUR) published two consultation papers¹ that had been commissioned on an all-island basis by both Regulatory Authorities (RA's) covering;

1. Review of K factors and Supply margins, by external consultants Skyplex²; and
2. Review of Tariff Structures, by external consultants Poyry³.

This paper presents the final documents produced by the respective consultants, taking into consideration the views expressed and issues raised during the consultation process and outlining their recommendations to the RA's.

There were 14 respondents in total. Table 1 below shows the list of respondents and all responses not marked confidential have been published alongside this information note.

Respondent	K-Factors & Supply Margins	Tariff Structures
Bord Gais Energy	Yes	Yes
Northern Ireland Electricity PLC	No	Yes
NIE Energy Limited	Yes	No
Gemserv Limited	Yes	Yes
ESB Networks Ltd	No	Yes
Sustainable Energy Ireland	No	Yes
The Consumer Council	Yes	No
Airtricity Ltd	Yes	Yes
ESB Independent Energy Ltd.	Yes	Yes
NIE Energy Limited	Yes	Yes
Endessa Ireland Ltd	Yes	Yes
ESB Customer Supply	Yes	Yes
NIE Energy Power Procurement Business	Yes	Yes
Confidential Respondent	Yes	Yes

Table 1 – List of respondents to consultation

¹ Review of K Factors and Supply Margins and Tariff Structure Review Consultation Paper - [CER09093](#)

² Skyplex Consulting Report on a Review of K Factors and Supply Margins – [CER09093a](#)

³ Poyry Consulting Report on Tariff Structure Review - [CER09093b](#)

2.0 REVIEW OF FACTORS AND SUPPLY MARGINS

2.1 Background

In the original consultation paper produced by Skyplex, the following three proposals were set out for respondents to consider;

- The first proposal is for minimum change to the current system whereby k-factors are retained with some enhancements, specifically in terms of enhanced transparency, to the existing arrangements.
- The second proposal is for the introduction of asymmetric k-factors, where over-recoveries are repaid with a premium and under-recoveries are not fully recovered.
- The third proposal is to remove of k-factors and put in place a maximum revenue restraint, which would be determined on an ex-post basis.

In addition to the three proposals a number of specific questions were asked on each proposal in order to provide direction for responses and to gauge opinion on specific issues.

The consultation period for the K-factors and Supply Margins ran until Friday the 11th of September and a total of ten, non-confidential responses were received. The Skyplex paper highlights the main issues and concerns raised in the ten responses by providing a summary of the issues under each proposal and the specific questions asked. As well as providing a summary of the main issues raised during the consultation process Skyplex has attempted to address these issues by setting out their view on the relative merits of each proposal.

Skyplex has outlined its views in the paper, and taking into consideration the different competitive situations in each market, has made recommendations for each RA on the proposal they believe should be adopted in each jurisdiction. The Skyplex recommendations are set out in the following section.

2.2 Republic of Ireland

As retail competition is more advanced in the ROI market, including competition in the domestic sector, Skyplex are recommending that Commission consider adopting Proposal 3. This proposal involves the removal of K-factors and puts in place a maximum revenue restraint to be determined on an ex-post basis. Under this proposal;

- the regulated supplier would be given additional freedom to revise tariffs;
- k-factors would be discontinued, and the maximum allowable revenue for the regulated suppliers set equal to their customers' demand priced at pool price;
- in the first year, the maximum allowable revenue would be adjusted to correct for any prior year over or under recovery;

- the costs of any contracts for differences would not be included in the allowable revenues, although regulated suppliers would be permitted to contract as they saw fit; and
- the regulated supplier would be afforded a small increase in supply margin set so as to ensure that they had a reasonable expectation of covering costs given that the regulated suppliers would have to set tariffs so as to recover an expected amount below their maximum allowable revenues in order to avoid breaching their maximum allowable revenue licence condition and to cover the costs of more frequent tariff changes.

2.3 Northern Ireland

Skyplex is recommending that Proposal 1 should be considered for adoption in Northern Ireland at this stage, given that retail competition has not yet developed in the domestic section of the market and the known constraints on the switching system which will limit the amount of actual switching should competition emerge. Under Proposal 1 (Minimal Change), the form of regulation and tariff setting processes would remain broadly unchanged, although a number of changes would be introduced with the intention of addressing some of the issues associated with the existing k-factor regime. This would include;

- ensuring that there is greater transparency and certainty associated with the application of k-factors, more specifically publishing the following additional information:
 - detailed data with respect to Directed and Non-Directed contract purchases, including weighted average prices, total contract quantities and associated, delivery profiles/periods;
 - CfD volumes for all periods (baseload, peak, MM1 and MM2) and forecasts of over/under recovery on a quarterly basis; and
 - demand forecasts and assumptions by tariff class, treatment of bad debt provisions, customer switching assumptions, level of hedging targeted and how the under/over recovery of k from the previous year is treated.
- providing additional certainty to the processes followed by the RAs in approving any k-factor; and
- undertaking a legal review of the relevant existing licence conditions so as to ensure that they are robust against any under-pricing and any cross-subsidisation between tariffs.

3.0 REVIEW OF RETAIL TARIFF STRUCTURES

2.1 Background

The consultation document on the Review of Tariff Structures contained Poyry's views and proposals for harmonising the approaches in both jurisdictions, for the purposes of creating consistency and promoting competition through providing choice for customers.

2.2 Proposals

The Poyry consultation paper sets out three main categories of proposals (12 detailed proposals in total):

- Group A - All Island Market Structure Proposals:
- Group B – All Island Regulatory Proposals:
- Group C – PES Regulatory Proposals:

Based on the relative ease of implementation and time to deliver Poyry proposed that Group C as the primary recommendation, followed by Group B and finally Group A.

The consultation period ran until Friday 11th September 2009 and a total of 12 responses were received. Poyry has summarised the main issues raised in the responses, and attempted to address these issues through the following detailed recommendations;

Group C - PES Regulatory Proposals

- Require PES to separate their network and energy charges on bills to customers, possibly in tandem with the implementation of the next distribution price control.
- Permit PES to offer longer and shorter contract terms as an alternative to a one year tariff provided it can be demonstrated that these are hedged to the same degree as the annual offerings. This may be dependent on improvements in CfD liquidity.
- Develop a common template for the allocation to different customer classes of supply costs and the associated margin as part of the supply cost price control.
- Generally promulgate the time of use cost pattern in the SEM so as to encourage customer pressure for ToU metering. If a metering code of practice panel is established then task it with considering the specification for ToU meters for smaller premises as an interim to the roll-out of smart meters.
- Require PES to produce its Tariff Methodology Statement in accordance with a template jointly approved by the RAs. As a parallel exercise obligate the network company in each jurisdiction to produce a similar description of the charging methodologies and cost allocation principles it adopts in constructing DUoS tariffs.

Group B - All Island Regulatory Proposals

- Extend the established programme of developing profiles in the RoI to become an all island programme under the oversight of a steering group that included supply businesses. Ensure that all profiles used in the settlement of charges are published.
- Retain a relatively few profiles for the smaller end of the SME sector, but consider extending interval (advanced) metering for supplies to larger premises, with a consumption threshold to complement the capacity threshold that currently governs the installation of interval meters.
- Ensure close liaison between the RAs when setting the distribution price control and approving the DUoS tariff structure. As part of the price control review the appropriateness of the various tariff features such as standing charges in DUoS tariffs and their purpose in the allocation of costs. Defer consideration of locational signals in distribution use of system tariffs until low carbon policies are better developed.

Group A - All Island Market Structure

- Establish a Trading Committee of market participants that would specify a short term CfD form that could be traded on the Tullett Prebon platform for the purpose of improving the granularity of contract cover, and thus encourage higher traded volumes.
- Progress the development of a system of Global Aggregation whilst being cognisant of the need for common profiling across the island of Ireland as an integral part of the specification.
- Establish a cross jurisdictional Panel to develop a common Metering Code of Practice. This Panel might be tasked with considering how metering that can deliver appropriate time of use cost signals might be implemented as an interim to the roll-out of smart metering.

4.0 NEXT STEPS

Both RAs are committed to delivering a fully competitive retail market for the benefit of all customers. With this goal in mind there is considerable planning underway on the short, medium and longer term programme for the development of retail competition in both jurisdictions.

While final decisions on the proposals set out in the attached papers have yet to be taken, the recommendations set out in the consultants' papers will be given full consideration by the RA's making any final decisions for implementation. The prevailing competitive circumstances within each jurisdiction will obviously be a major factor in determining how these recommendations will be implemented.

4.1 Ireland

On the 2nd December 2009 the Commission published its consultation paper, 'Review of the Regulatory Framework for the Retail Electricity Market: Proposals on a Roadmap for Deregulation'⁴. This document set out proposals on the circumstances under which price controls should be removed from the Public Electricity Supplier ESB Customer Supply. The Commission will publish its response to the consultation in early March 2010.

In that paper the Commission identified the interim regulatory framework that would endure until such time as the level of competition in the market was deemed to be sufficient to deregulate. This may include the implementation of some of the measures set out in the K-factors and Tariff Structures review. The Commission is minded to pursue the Skyplex recommendation of Proposal 3 which would see the Commission adopt a less restrictive form of ex post regulation, with greater freedom in tariff setting for the PES. The Commission will publish a proposed decision paper on this proposal in Q1 2010, for implementation in the 2010/2011 tariff year.

In parallel the Commission will consider the recommendations made by Poyry with respect to tariff structures.

4.2 Northern Ireland

The Utility Regulator in Northern Ireland will publish a roadmap paper outlining the route envisaged towards a fully competitive market in the spring of 2010. Like CER NIAUR see an interim regulatory framework enduring until all the criteria for full competition are in place e.g. a full switching system. Part of this interim framework may include a move to Proposal 1 and the UR is currently minded to take the approach. Proposal 1 would not see any major change to the form of regulation of NIEES but would include much

⁴ [CER09/189](#)

more transparency around NIEES hedging and “K” positions throughout any given tariff year.

Consistent with the approach of CER the Authority will consider the recommendations made by Poyry with respect to tariff structures in the context of the overall roadmap for Northern Ireland.

5.0 FURTHER INFORMATION

For further information on this information note, please contact;

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