



Endesa Ireland response to CER/09/093 A Review of the K-factors, Supply Margins and Tariff Structure

Endesa Ireland welcomes the opportunity to respond to the consultation papers on the review of k-factors, supply margins and the regulated supply tariff structure. We welcome the Regulatory Authorities efforts to promote competition within the supply business and agree that the use of k-factors undermines competition in supply.

This consultation comes at a time when ESB CS is carrying over an €81mil k-factor, which will have to be recovered from an ever-diminishing customer pool. This will result in ESB CS tariffs being less competitive, which in turn places risk on ESB CS and Irish taxpayers as any failure on the part of ESB CS will be borne by all Irish taxpayers. It is unsustainable to continue carrying forward this k-factor. If ESB CS is able to remain profitable without recovering these costs, it would seem that their allowable costs are being set too high. If the deferred recovery is due to subsidisation by the parent company, this would seem to be contrary to ESB's licence requirements. Endesa Ireland considers that the k-factor should be written off if ESB CS is able to remain profitable without it. If this is not the case, the RAs should require that the monies be recovered in full over the next tariff year.

Following are Endesa Ireland's responses to the specific questions included in this consultation:

K-factors and Supply Margins

A1. Do customers prefer a single tariff change per year? Are there any other matters that should be taken into account in considering the issues associated with reducing the effects of, or abolishing k-factors?

It is Endesa's experience that customers prefer a single tariff change per year. Customers budget annually for electricity consumption. Within-year changes are not welcome.

Given the experience of NIE and ESB in the market, they have significant advantage in managing the variability in wholesale prices and customer demand. Should the RAs require that NIE and ESB manage this variability without the benefit of a k-factor, it may necessitate that a greater percentage of their estimated volume is hedged. In addition, the RAs may consider allowing the regulated suppliers a larger profit margin in recognition of the higher risk that is being placed upon these companies.

B1. What additional information should the regulated suppliers be required to make available in relation to their contract cover and forecasts of over/under recovery? In what timescales?

In the event that the RAs decide to continue to utilise a k-factor, the regulated suppliers should publish their CfD volumes for all periods (baseload, peak, MM1 and MM2) and forecasts of over/under recovery on a quarterly basis.

- B2. *Are there any reasons why it would not be appropriate for additional information on such issues to be made available?*

As long as these companies are benefitting from a k-factor, any over- or under-recovery will have an impact on competitive suppliers. The abolition of the k-factor would eliminate the need for this information to be made public.

- B3. *What proportion of any over-recovery should be returned in the following year to customers in general rather than only to customers of the regulated supplier?*

Endesa Ireland considers that any over-recovery should only be returned to the customers of the regulated suppliers. Conversely, any under-recoveries of the regulated suppliers should only be collected from their customers. Endesa Ireland has concerns that as regulated suppliers' customer pools shrink, there may be attempts to recover the k-factor via network tariffs. This must not be permitted.

- C1. *What level of asymmetry should be introduced into the k-factors and how should this vary over time?*

In setting prices too low, the regulated supply business makes it more difficult for new entrants to compete. The regulated businesses should not be permitted to carry over k-factors year-on-year. Full recovery should be included in the tariffs for the year following the posting of the accounts.

K-factors for under-recovery should only permit the regulated businesses to recover 75% of their revenue shortfall. Any over-recovery should be fully rebated to customers from the prior year, immediately upon completion of the accounts via electronic payments or checks, rather than lower tariffs. This will ensure that the monies are paid directly to the customers who paid the additional costs, rather than to the changing customer pool. It will also ensure that the annual prices reflect current costs and are not depressed due to over-recovery in prior years.

In the short-term, k-factors should be eliminated and the regulated supply businesses should be allowed to set their own prices. Endesa Ireland considers that the regulators should set a minimum tariff for all customer categories to ensure that the regulated businesses are not able to undercut new market entrants. However, the final tariffs should be set by the regulated supply businesses without regulatory intervention.

- C2. *What level of additional margin should be afforded the regulated suppliers to give them a reasonable expectation of recovering their costs? Quantitatively, how should this vary with the level of asymmetry and the expected frequency with which tariffs can be changed?*

Endesa Ireland is not convinced of the need to continue regulating the prices of the regulated supply businesses. A minimum tariff should be set by the RAs. The margin should be commercial decision for these companies.

D1. Is it feasible for regulated suppliers to apply ex-post tariff corrections in order to avoid an over-recovery of revenues?

Yes, rather than including a k-factor in the tariffs, any over-recovery should be rebated, immediately upon closing of the books for the year, to all customers with the regulated supplier for the year (even if only for one month).

D2. What level of additional margin should be afforded the regulated suppliers to give them a reasonable expectation of recovering their costs? How should this vary with the frequency with which tariffs can be changed?

If the regulated suppliers are permitted to recover an additional margin, the increase should be sufficient for the regulated businesses' to accept risks of over/under-recovery with no within-year tariff changes.

E1. Which, if any, of the proposals put forward in this document should be adopted and why? What alternative proposals should also be considered?

Rather than a maximum allowable revenue, Endesa Ireland considers that the RAs should set minimum tariffs for the Regulated Supply businesses. This would ensure that they were not able to undercut new entrants in the market, but would grant them the flexibility to include the costs associated with volatility of price and demand in the tariffs. There is sufficient pressure from competitive suppliers to ensure that prices are kept at a reasonable level.

While a competitive market in the domestic sector of the supply market in Northern has not yet developed, the implementation of such a policy will foster competition.

Endesa Ireland recognises that there may be exceptions where regulated tariffs are required for certain groups of domestic customers (SOLR customers, elderly, customers benefitting from social welfare, etc). This could work in conjunction with unregulated tariffs or government support mechanisms could be developed to work alongside unregulated tariffs.

Retail Tariff Structures

1. Has this review appropriately described the various features of the structure of retail tariffs and their underlying cost allocation methodologies?

Yes. The review of the features of the tariff structure and their underlying cost allocation methodologies is comprehensive and well presented.

2. Are there other aspects that should be covered by this review to the extent that it impacts PES retail tariff structure?

It would be interesting if the review included some examples of tariff methodologies utilised in other markets and whether they offered benefits above the current methodologies employed in Ireland and Northern Ireland.

3. *Do you agree with the categories suggested for these proposals?*

Yes. The categories suggested for the proposals are appropriate.

4. *In the context of the all island market structure, do you think the introduction of an EFA style CfD would assist in bringing liquidity to the CfD market? What other arrangements would help in this regard?*

The current market rules and the level of regulatory uncertainty in the market limit the potential for the development of a forwards market. A forwards market would require that the current highly regulated market is replaced by a competitive market that would allow market participants to react to signals from the forwards market – this is not possible with the current bidding rules. It would also require surety that the market would not undergo significant change in future – surety that does not exist in the SEM.

Endesa Ireland sees little benefit in the introduction of an EFA-type CfD until the market becomes more competitive and generators and suppliers are able to react to market signals.

5. *Would “global aggregation” provide a level playing field for the PES to better allocate its costs within its tariff structures?*

Yes. Global aggregation is an important step in the move toward a more competitive supply market, ensuring a level playing field for all suppliers. This will become particularly important as we move toward a regional electricity market.

6. *Would the creation of a common code of metering practice across both regulatory jurisdictions help in providing a basis of measurement that would facilitate harmonising retail tariff structures?*

Yes. It will be difficult to harmonise tariff structures if the metered data is not harmonised. Endesa Ireland welcomes the move towards an all-island retail market and supports a common metering code of practice.

7. *Do you agree that the use of common profiles for class demand in both jurisdictions would help ensure the same allocation of wholesale costs when deriving retail tariffs, and provide the same incentives for the structures offered?*

Endesa Ireland agrees that common all-island demand profiles would help to ensure a common allocation of wholesale costs and common retail tariffs across the island.

8. *Would the further segmentation of the SME sector of the electricity market and the creation of class profiles for these segments make PES tariffs more reflective of the underlying costs and also encourage competition in supply to these customers?*

Endesa Ireland considers that further segmentation of the SME sector would result in more cost-reflective tariffs. The result, however, is likely to be politically unpalatable, as there would be some segments whose costs would increase. While it can be argued that the economic outcome would be appropriate – tariffs would reflect the actual cost to serve – it will be difficult to implement. Furthermore, this segmentation would have the potential to segment classes by geographic area, which would be contrary to the requirement of “equal treatment of customers regardless of their location”.

9. *Would the harmonisation of distribution use of system charges better facilitate competition in supply? Would the introduction of a pricing signal for higher distribution voltages provide a useful signal to encourage the appropriate location of distributed generation?*

Endesa Ireland does not consider that the harmonisation of DUoS charges will better facilitate competition in supply. Different DUoS charges in Ireland and Northern Ireland are similar to different taxation rates. Like charges for VAT, DUoS charges should be set out separately in the bill.

10. *Do you agree that the separation of charges for the provision of energy and the use of transmission and distribution networks would create an opportunity for customers to be offered more choice in the term of the energy component of its contract and the manner in which price levels could be revised? Should PES simply pass on the network charges it incurs to its customers?*

Separation of charges for energy and UoS would significantly increase transparency for customers. Endesa Ireland considers that UoS charges should be pass-through charges that are included as a separate line item on customer bills. XXXXX

11. *Should customers be permitted to choose from fixed price energy contract terms that could vary from 6 months to 2 years and which could also include indexation provisions that would help align retail and wholesale energy prices? Should PES be encouraged to offer such a choice?*

Endesa Ireland considers that the regulated suppliers should continue to offer annual tariffs. 6 month or 2 year contracts could be offered in addition to the annual tariffs. However, this could raise issues with customer switching. Customers might sign up for a lower-priced 6 month tariff for Spring/Summer and then switch to another supplier for an annual tariff that includes the higher-priced winter months. In addition, 2 year tariffs

may raise issues with customer switching rights. In theory, customers would be offered lower prices that would be locked-in for 2 years. If the electricity price drops after one year, these customers will look to move to a lower-priced supplier or will look to renegotiate their contract. They will only remain with the supplier if it is in their favour to do so.

Endesa Ireland does not consider that the regulated suppliers should be encouraged or discouraged from offering such a choice. The Regulatory Authorities should allow the regulated suppliers to make their own commercial decisions, provided these decisions are non-discriminatory and do not undermine competition in the market.

12. Would there be merit in adopting a common “cost to serve” model in both jurisdictions for allocated the regulated costs of supply between different customer classes?

A common cost to serve model will increase the level of harmonisation of tariffs in Ireland and Northern Ireland, This is, generally speaking, a measure that will facilitate the move to an all island retail market. However, the proposal should be examined more closely to determine if the costs to serve the customers of the regulated suppliers are common – different population profiles in each jurisdiction, coupled with historic costs that must be recovered may result in different costs to serve. Endesa Ireland does not consider that a common cost to serve is necessary in order to achieve an all island market.

13. Should PES be encouraged to offer tariff structures with more time of use rates that reflect the underlying movement in wholesale costs and thus provide the customer with the choice of when it would be most economic to take its supplies of electricity? Would you support the replacement of maximum demand charges and block kWh structures in existing tariffs by a time of use tariff structure?

Time of use tariffs that reflect baseload, mid-merit and peak usage would be valuable to allow customers to manage their electricity costs. Endesa Ireland considers that the existing tariff structures should continue, but customers should have the option to move to time of use tariffs.

14. Would the publication of a common Tariff Methodology Statement that would apply to each PES be helpful in bringing a convergence in the practices and cost allocation methodologies used by each PES?

Endesa Ireland considers that a common Tariff Methodology Statement would be helpful in bringing about convergent practices and cost allocation methodologies that would be utilised in the regulated supply companies, facilitating an all island retail electricity market.

15. Do you think the criteria chosen to evaluate the various proposals in Section 3 are appropriate? Are there other criteria that should have been considered?

Endesa Ireland considers that the criteria chosen in the various proposals in Section 3 are appropriate, however, when evaluating these proposals it is important to take into account the impact they may have on customers. This should be added as an additional criterion.

16. Would you generally support the conclusions of the evaluation? If not, how would your view differ from those expressed here?

Endesa Ireland supports some conclusions of the evaluation. In the advent of an all island retail market, Endesa Ireland supports the proposal that the regulated suppliers should utilise a common template for describing their tariff methodologies. Furthermore, we agree that distribution use of systems charges should be reflected separately.

Customers looking to reduce their electricity bills will benefit from seasonal time of day tariffs, however, this will require active customers. Endesa Ireland considers that the regulated supply business should offer these tariffs to their customers in conjunction with the current tariffs, which could gradually be phased out.

Endesa Ireland is not convinced that it is necessary to implement a common cost to serve model. Common tariff methodologies and structures are needed; common pricing is not a requirement to facilitate an all-island market.

This review and the proposals therein seem to imply that these companies will continue to be regulated in the longer-term. Endesa Ireland would encourage the Regulatory Authorities to allow NIE and ESB to set their own tariffs with the freedom to introduce additional products / new methodologies as they see fit, provided they maintain their tariffs above a regulated minimum price so as not to undercut independent suppliers.