

Consultation on the Review of K factors and Supply Margins and Tariff Structure Review

Papers commissioned by NIAUR & CER

NIE Energy Supply's Response

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Summary and Introduction

The Northern Ireland Authority for Utility Regulation (NIAUR) and the Commission for Energy Regulation (CER) have sought responses to the June 2009 publication of two papers that they have commissioned from consultants - Skyplex's "Review of K-factors and Supply Margins in the Single Electricity Market" and Poyry's "Retail Tariff Structure Review".

NIE Energy Limited Supply (NIEES) generally supports the regulatory authorities' strategy on retail competition but has become increasingly concerned by the more detailed discussion of it.

It is obvious that the two reports have been written in isolation but the choice between options in one will affect the conclusions of the other. There does not appear to be a coherent overarching strategy.

The Skyplex paper deals with a complex subject that NIEES has discussed in a number of consultation responses it has made to NIAUR, but the level of analysis of the range of options is, we believe, inadequate.

As regards the proposals for treatment of the correction factor:

Preservation of the status quo (Skyplex's proposal 1) has the attraction that it avoids the cost of change, particularly the accompanying significant rise in supply margin;

A high degree of asymmetry (proposal 2) – penalising over-recovery and making under-recovery permanent - would probably lead to frequent tariff revision, which would be unpopular with customers, unless the margin increase was sufficiently large to turn the price control into a safety net or backstop control. The margin would, in any case, need to be increased substantially by the expected error times the asymmetric percentage plus perhaps as much again to cater for the considerably increased profit risk. Correction factor sums are often much bigger than existing PES¹ profits.

Skyplex's proposal 3 is a particular example of a yardstick price control, one of many possible combinations. It is a pool price yardstick price control with 100% weight on the yardstick and a 100% asymmetric correction factor and is completely unfeasible. It manages to combine the worst of both worlds. The absence of the correction factor would cause PESs to adjust tariffs more frequently to minimise error and require very significant increases in margins. The use of the pool price to determine allowed revenue would ensure that PESs will be unwilling to buy CfDs because this would increase the risk of their costs differing from their revenues.

It is in our view extremely difficult to set a price control where tariffs are determined in advance and there is no subsequent correction. It would require very high margins, perhaps higher than those that would occur in a

¹ ESB Customer Supply (ESBCS) and NIE Energy Supply (NIEES), respectively the Public Electricity Supplier (PES) in RoI and the former PES in Northern Ireland

competitive market. The gross margin in the GB competitive market appears to be 2-3 times the size of PES margins in the AIM and net margins several times the size.

There is a fundamental difficulty in combining price control with offering choice in the balance of risks between suppliers and customers. The present PES system, where a correction factor enables any imbalance between revenue and costs to be collected from customers in general in future years, clearly passes the risk to customers, who enjoy lower prices as a result.

A system that passes the risk to suppliers would result in higher prices and it would be likely that customers would be offered a choice between higher fixed price tariffs and indexed partly-pool-price tariffs that contained their own quasi-correction-factor. There is a spectrum of tariffs with differing risk balances that could be offered. The degree of risk taken by suppliers would depend on the type of customers supplied and the balance of risk chosen by those customers, and, even with a constant mix, may change from year to year. It is difficult to translate such a complex picture into a price control with a fixed expected margin.

An alternative would be a backstop or safety net price control. This would be combined with a continuation of the phasing of the deregulation of tariffs in the non-domestic market, therefore reducing the overall scope for the price control. NIEES views this option as the most practical, and option also follows a course that NIAUR has already embarked upon with respect to deregulation.

The extent of competition in the regulated market need not be large for it to provide a degree of effective restraint on prices. Moreover, comparison between tariffs in more and less competitive markets (normally to larger and smaller customers) can provide protection to the less competitive market through the operation of the anti-discrimination licence condition.

It is unclear why harmonisation of the method of setting tariffs (described in the Poyry paper as harmonising tariffs) should promote competition or provide choice to customers. In any case, tariffs are not regulated in Northern Ireland. They must be consistent with the price control and, where NIEES is dominant, be neither predatory nor discriminatory. We think that tariff micromanagement by the regulator would be a retrograde step and challenge the basic premise of the Poyry paper.

General Observations

Contrasting approaches

The two papers start from contrasting and sometimes conflicting views of the world.

For example, Skyplex's proposal 3, that allowed generation costs in the PES price control to be based on pool prices, would be likely to restrict PES purchases of CfDs and negate the measures to improve liquidity discussed by Poyry.

Skyplex seems to envisage a world where PESs take more risk and behave commercially. "In the case of Proposals 2 and 3, additional freedom to change tariffs would be afforded the regulated suppliers." Poyry, on the other hand, proposes more regulation and common, supervised methods of setting tariffs and allocating costs between them.

Poyry proposes harmonisation and control whereas Skyplex aims to promote competition.

Limited k-factor analysis

The Skyplex paper deals with the complex subject of K correction and related supplier margins, but has not provided any analysis to support the selection of the particular options put forward for consideration.

There is little discussion of the incentives on PESs that would be created by the proposals. The incentive not to purchase CfDs, if allowable costs are determined by pool prices, is the most obvious example of the omission.

There is also little analysis of retail margins under alternative k-factor regimes, and limited consideration of the treatment of k-factors in other markets.

Tariff Regulation in Northern Ireland

The review of tariff structure appears to be designed to regulate individual tariffs and make the method of setting them the same in the two jurisdictions.

However, NIEES's tariffs are not subject to regulatory approval. It is free to set tariffs provided that they are consistent with its licence conditions, particularly those relating to price control and price discrimination.

The rationale underlying the tariff structure review is counter to the way tariffs are regulated in Northern Ireland, is likely to stifle tariff innovation and makes the possibility of competition between the PESs, whether by comparison between markets or directly in the same markets, more remote.

Correction Factors

The general problem

The Skyplex paper does not examine the risks that suppliers generally are exposed to within retail markets, under SEM ;

- Demand forecasting errors, for example, the impact of weather, and changing economic conditions
- Costs forecasting errors, resulting from poor liquidity in the SEM CfD contract market, the limited range of cfd products, unhedgeable capacity charging regime etc

More importantly, there was no examination of the risks PESs are uniquely exposed to in their respective retail markets:-

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- Settlement errors, as a result of wholesale volumes being determined by differencing,
- No natural hedge from vertical integration (and related credit risks), and
- Other situations where PESs are treated differently than other suppliers. A recent example of this is the impact of the legacy currency hedging prohibition which impacted NIEES costs significantly during the 2008/09 tariff year.

NIEES has discussed K-factor considerations in a number of recent consultation responses.

The reduction in risk of a pass-through price control with K correction, permits lower prices. A control that did not allow pass through with correction factors would need to set prices in advance in the form of a tariff basket. The permitted weighted average percentage change would need to be computed on the basis of costs that included full hedging costs so that either costs are determined in advance or, if the supplying company does not purchase a hedge, it is rewarded for taking the risk.

The hedges would not just be against pool price, but possibly also other risks such as of variation in demand. This may well result in calculated prices that were higher than the competitive level and put the incumbent at a disadvantage. This is because competing suppliers may all expect to plan to “over-recover” in the following year² if there are adverse cost shifts but this would not be an option open to a company subject to price control with no correction factor.

The tariff basket formula would probably also need to include a variable indexation component in the tariff such that actual costs incurred are better reflected in the tariffs to customers.

The choice of treatment of the correction factor is intimately connected with:

- The permitted margin; and
- The yardstick used to set tariffs (to the extent that the entitlement is not based on costs incurred).

The problem is devising an alternative to the correction factor without significantly increasing the margin. Experience in GB is that the margin in such circumstances is very much higher.

Skyplex’s proposals

Status quo

The first proposal is to retain the status quo but also for:

- PESs to publish more detail on contract cover and estimated over or under-recovery during the year;
- Regulators to establish more certainty as to when the k-factor would be recovered in future periods; and
- Regulators to undertake a review of licence conditions to ensure that suppliers cannot engage in predatory pricing.

Changes could be made in respect of the first two points but the third is already dealt with.

- NIEES would be reluctant to publish details of its contract cover to its competitors. There would also be issues of counterparty confidentiality. It is, in any case, doubtful how useful details of contract cover would be to competitors making k-factor estimates. As stated earlier, K correction is complex and stems from a complex set of variations. NIEES therefore believes that the details published in connection with the 2009 review of tariffs is adequate, and consistent with the prevailing regulatory framework.

²Figure 8.1 on page 100 of Ofgem’s “Energy Supply Probe – Initial Findings” October 8 2008 shows considerable (but cyclical and auto-correlated) variation in margins and para 8.11 refers to the concept of “‘through the cycle’ profitability”.

- The main criterion used in phasing k-factor recovery is price stability. This could be stated but it is difficult to see how more precise rules could be set.
- Condition 14 of NIEES's licence already deals with predatory pricing etc.

The suggestion is also made, but only briefly and without a clear specification, that a proportion of NIEES over-recovery should be returned to customers in general through a mechanism such as the PSO levy and not to NIEES customers. We assume that NIAUR does not propose to utilise this arrangement in future, as they have rejected the principle of the PSO interacting with NIEES "k" correction in the context of the Oct 2009 tariffs, despite there being a strong argument to do so on the basis of fairness and equity.

Asymmetry

Skyplex's second proposal is that an over-recovery should be more than repaid and an under-recovery less than recovered. In effect, there would be a penalty for error.

The incentive effect would be for PESs to adjust tariffs more frequently to minimise error. It is not clear that this is what customers would prefer. The pricing effect would be that NIEES's margin would need to be increased to allow for:

- The expected value of the under-recovery shortfall and over-recovery penalty; and
- The increase in the cost of capital resulting from the increased risk.

Pool price

Skyplex's third proposal is that the maximum energy revenue should be determined ex post by pool prices but that there should be no correction factor except in the sense that all over-recovery would be removed. It combines a pool price yardstick with the ultimate asymmetric correction factor.

This proposal manages to combine the worst of both worlds. The absence of the correction factor causes:

- PESs to adjust tariffs more frequently to minimise error and
- Increased margins to allow for the expected value of the under-recovery shortfall and over-recovery penalty and the increase in the cost of capital resulting from the increased risk.

The use of the pool price to determine allowed revenue ensures that PESs will be unwilling to buy CfDs because this would increase the risk of their costs differing from their revenues.

It is possible that the proposal might increase competition because other suppliers would have improved access to CfDs and would be in a better position to offer fixed and stable prices to customers but it would do so at the cost of considerable disruption to PES customers.

Other options

There are other possible options but all have disadvantages with the central underlying problem being that, without a correction factor and the degree of market power necessary to ensure that under-recoveries can indeed be collected in later years, there needs to be a substantial increase in margin.

This is necessary in any case if competition is to occur - as is evidenced by experience in GB, the views expressed in responses to the previous consultation and the view of the European Regulators' Group for Electricity and Gas that *"as far as non market-based regulated end-user prices are distorting competition, they should be abolished, or where appropriate, brought into line with market conditions"*.

In the remainder of this section we discuss some of the other options – tariff basket, yardstick and backstop price controls.

Tariff basket

If there is a price control with no correction there must logically be a means of determining prices in advance. Tariffs would be set on the basis of information known at the time that tariffs are set. This is in effect what happens in competitive markets but there are two considerable differences between that situation and a regulatory tariff basket:

- Competitive firms are free to revise tariffs at any time
- The rules they use to set tariffs are fluid and are neither fixed through time nor driven by formulae using observable data.

Tariff basket control is rare when the allowed level of prices depends on factors that are not known before the start of the year. The only clear example in electricity where tariffs were set in advance by a price control where there was a competitive wholesale market is the England & Wales 1998-2000 control mentioned by Skyplex in section 3.1.

This was possible because the domestic market was served by generation contracts based on known coal prices declining from inflated levels and

because use of system prices were falling rapidly. It was therefore possible to set a control for a relatively short period that gave declining RPI-X prices, high supply margins and no risk of fuel price variation.

It is in our view extremely difficult to set a price control where tariffs are determined in advance and there is no subsequent correction. It would require very high margins, perhaps higher than those that would occur in a competitive market.

Yardstick

A yardstick price control determines allowed prices by means of a formula using observable data rather than on the basis of costs actually incurred. It can be argued that some form of yardstick, rather than total cost pass-through, would be efficient because the regulated company would be more incentivised to purchase generation efficiently.

While it is true that all suppliers have to set prices on the basis of a forecast of generation costs, that forecast will in practice be based on a number of factors that may change from year to year and not on a constant formula. Suppliers may revise the forecast, and the basis on which it is made, during the year. It is a wholly different, and far riskier, situation when the forecast is prescribed by a relatively simple yardstick formula. The GB electricity regulator considered introducing a yardstick formula in the 1994 supply price control review but decided against doing so. This was partly because the scope for benefit was limited because a large part of generation costs was set by regulatory and government intervention in the market³ and partly because of “the various difficulties associated with a yardstick”.

It might be argued that similar circumstances apply in the SEM now. Many SEM and CfD costs are set by regulatory action. NIEES's generation costs account for very nearly three quarters of its total charges and purchases at SMP, CfDs and imperfection charges alone account for 65%. The costs in the last group are volatile, partly because CfDs may involve fuel price or currency risk and partly because, like other suppliers, NIEES is unable to obtain anything like complete CfD cover, particularly at the peak when prices are likely to be most volatile.

It would not be feasible to set a yardstick on the basis of ex ante estimates of the pool price (the directed or non-directed contract prices) alone even if, as would be inevitable, the weight on the yardstick was small and that on pass-through large. The yardstick would also need to depend on the ex post outcome for the pool price which, in turn, implies that there would be a correction factor.

Skyplex's proposal 3 is a particular example of a yardstick price control, one of many possible combinations. It is a pool price yardstick price control with

³ Coal-backed CfDs purchased by PESs in a deal brokered by the government.

100% weight on the yardstick and a 100% asymmetric correction factor and is completely unfeasible.

Phased Tariff Deregulation and Backstop

NIAUR has recently decided to reduce the scope of the NIEES price control and thus the extent of NIEES's sales base that "k" correction is relevant. The regulation threshold is now up to 150 MWh annual consumption (c 50% of total market). NIEES believes a further phase of deregulation in April 2010 is appropriate (ie 12 MWh threshold). This would result in "k" only being relevant for c 40% of the market.

It has also been the practice in other jurisdictions for residual price controls to be set at a "safety net" or "backstop" level when retail competition is being initially introduced and the approach is widely advocated⁴. This is not only on the grounds that it might be sensible to make a conscious trade-off between customers' present and future interests in that slightly higher prices now might result in competitive benefits in the future. It also stems from recognition that the existence of competition changes the costs of the errors that are inevitably involved in setting a price control.

Any price control determination involves a number of subjective judgements that result in a particular outcome being chosen from within a large possible range of outcomes. In a competitive system the costs of an error resulting in too loose a control are mitigated by customers' ability to move to other suppliers (and by regulators' ability to compare tariffs to less mobile customers with those to more mobile customers). On the other hand, an error resulting in too tight a control prevents the emergence of competition. The balance of risks where there is competition is different from that under monopoly regulation, where it is much less skewed, and it therefore makes sense to aim off in a more liberal direction.

We therefore support further phased tariff deregulation and back-stop controls.

Supply Margins

Supply margins in competitive markets

NIEES's gross margin this tariff year is likely to be about 6%. This compares with a gross margin of around 7% now allowed for ESBCS and percentage margins in the teens in the competitive market in GB, as reported in Ofgem's 1999 price control review, 2004 review of the retail market and 2008 supply probe.

⁴ Including by the former GB regulator, Professor Stephen Littlechild.

In the 1999 price control review Ofgem reported supply business costs and margins in 1998/99 as accounting for about 13 per cent of a typical domestic customer's annual bill or 17% after Ofgem's transfer of costs from PESs' distribution to supply businesses. There seem to have been further increases in margins in GB after 2000. In April 2004 Ofgem published a review of the residential electricity retail market, which included an analysis of prices. It found that the gross supply margin (including costs) was 26% in electricity but only 13% in gas. Other analysis concluded that an entrant could expect to earn an 8% net margin on a standard credit customer and a 16% net margin on a direct debit customer. However, gas margins were much lower. Any snapshot of this kind is of limited value because margins have been fluctuating by large amounts as wholesale electricity generation prices have moved much more than retail prices. Nevertheless, NI margins appear to be low compared to those in GB since the introduction of retail competition.

Further data became available in the initial findings of Ofgem's energy supply probe, which was published in October 2008. Suppliers in GB are vertically integrated and supply profits have tended to be relatively higher when wholesale prices were low (2000-04) and generation profits higher when wholesale prices were high (2005-07). The net margin averaged 15% from 2000 to 2004. Ofgem estimates the added costs of electricity supply to be 7% so the gross margin would have been of the order of 22%. Chart 8.1 (page 100) shows that the net margin was much lower in 2005-07 and generation more profitable. However, the only figures quoted for supply profitability in those years are an average of 17% gross margin (2% net) for out-of-area electricity supply by the five former PESs, which Ofgem contrasts with their average margins of 24% (10% net) for their in-area supply.

The gross margin in the GB competitive market appears to be 2-3 times the size of PES margins in the AIM and net margins several times the size.

Risk is not constant

There is a fundamental difficulty in combining price control with offering choice in the balance of risks between suppliers and customers.

The present PES system, where a correction factor enables any imbalance between revenue and costs to be collected from customers in general in future years, clearly passes the risk to customers, who enjoy lower prices as a result. A system that passes the risk to suppliers would result in higher prices and it would be likely that customers would be offered a choice between higher fixed price tariffs and indexed partly-pool-price tariffs that contained their own quasi-correction-factor. There is a spectrum of tariffs with differing risk balances that could be offered.

Risk will also differ between types of customers. For example, those with a low load factor will be more exposed to variable and more uncontracted peak

prices: Prepayment systems may mean that recovery of quasi-correction from those customers is less straightforward than it is from other customers. Risk may also differ over time, depending on developments in the SEM and in world fuel and carbon markets.

The degree of risk taken by suppliers would depend on the type of customers supplied and the balance of risk chosen by those customers, and, even with a constant mix, may change from year to year. It is difficult to translate such a complex picture into a price control with a fixed expected margin.

One response to the problem might be to say that there could be control at the level of the individual tariff. Its risk could be assessed and an individual margin set. However, this would be highly intrusive regulation, making the regulator responsible for prices to customers at the most detailed level. It would tend to discourage innovation and tariff development and would probably be prone to error, not least because it would involve contentious allocations of common costs and energy CfD portfolios.

An alternative would be a backstop price control.

A backstop control

Price controls are required to restrain monopoly. As competition increases price control can be relaxed and eventually removed (eg current NI non-domestic market > 150 MWhs). Indeed, there is a presumption that they should be removed to avoid distorting competition.

In GB there was a pass-through average revenue control on supply from 1990 to 1998. Supply revenue was not to exceed the costs of generation, transmission and distribution plus a CPI-X controlled supply business retained revenue entitlement and a correction factor equal to the interest adjusted error in the previous year. The market was fully opened in 1998 but the price control was extended for a further two years for smaller customers using an intentionally high CPI-X tariff basket, rather than pass-through revenue control, on the grounds that generation costs for that part of the market were known in advance and subject to a CPI-X profile. This was because suppliers had, at the instigation of the government, signed CPI-X indexed generation contracts with the two main generators. In 2000 the control was limited to the standard domestic and economy seven tariffs only and in 2002 supply price control was removed.

In the United States and in Australia retail electricity price control is a matter for the individual states and so practices differ. However, there are several cases where a transitional measure, sometimes known as a “standard offer”, is intended to be a transitional measure. There is a general intention of removing retail price control as competition increases and regulation has moved to a backstop or safety net approach in which the incumbent is monitored or required to provide a standard tariff.

As is the case in GB, there are no retail price controls in New Zealand, Norway or Sweden.

The extent of competition need not be large for it to provide a degree of effective restraint on prices. Moreover, comparison between tariffs in more and less competitive markets (normally to larger and smaller customers) can provide protection to the less competitive market through the operation of the anti-discrimination licence condition. Nevertheless, it is true that the degree of competition for small customers in the AIM is particularly low. It may be that PES on PES competition should be encouraged in both NI and RoI markets to enable high margin safety net price controls to operate.

Consultation questions – Skyplex Paper

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

We believe that customers value price stability but other matters should of course be taken into account as well.

In respect of Proposal 1: (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, and in what timescales?

NIEES believes that the level of information published at present is adequate, and consistent with the prevailing regulatory framework.

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

Commercial confidentiality and regulatory costs to suppliers.

(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?

Firstly it is inappropriate to consider an over-recovery scenario in isolation - an under-recovery scenario should be equally relevant. However, it would appear that NIAUR has already strong views on the use of the PSO to channel “k”, and these views have influenced how NIEES’s extraordinary “k” correction associated with the currency prohibition has been dealt with in the context of the Oct 2009 tariff review.

In respect of Proposal 2: (C1) What level of asymmetry should be introduced into the k-factors and how should this vary over time?

Substantial asymmetry would probably lead to frequent tariff revision, which would be unpopular with customers, unless the margin increase was sufficiently large to turn the price control into a safety net or backstop.

(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?

The margin would need to be increased by the expected error times the asymmetric percentage plus perhaps as much again to cater for the considerably increased profit risk. Correction factor sums are often much bigger than PES profits.

In respect of Proposal 3: (D1) Is it feasible for regulated suppliers to apply ex-post tariff corrections in order to avoid an over recovery of revenues?

It is feasible but would cause some administration costs. The greater difficulty would be in applying ex post corrections to avoid under-recovery. As discussed above we regard proposal 3 as a non-starter.

(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?

Since proposal 3 would mean that PESs would need to put their customers on pool price tariffs it is difficult to assess what a sensible margin would be.

Finally, (E) Which, if any, of the proposals put forward in this document should be adopted and why? What alternative proposals should also be considered?

Proposal 3 is an extreme case and not rational. The status quo (proposal 1) is an option because there are costs to other course of action but competition will be difficult unless margins are increased substantially. Asymmetric correction factors will increase tariff revision unless the margin increases are sufficiently large to effectively create backstop or safety net controls.

It would also be helpful to analyse methods of minimising the unique risks that PESs are currently exposed to. One area that could be explored would be the future of the current legacy contracts, and in particular now the Ballylumford contract might be used in a way to provide NIEES with a proxy natural hedge and therefore reduce hedging contract scarcity and credit risks.

Poyry Paper on Tariff Structure

Harmonisation and competition

There seems to have been a logical leap from a) the RAs' January 2008 MoU commitment to consistent and harmonised approach to the regulation of markets to b) Poyry's objective "to harmonise PES tariffs for the purpose of creating consistency and promoting competition through providing choice to customers".

The MoU did speak of "equal treatment of customers regardless of their location" but this need not mean identical treatment but merely non-discriminatory treatment. Customers in different locations will experience differences in UoS charges and PSO levies and, if they are served by different companies, they are likely to experience different levels of supply costs. Poyry's harmonisation proposals do not extend to harmonising allowed PES revenue per customer.

It is unclear why harmonisation of the method of setting tariffs (described as harmonising tariffs) should promote competition or provide choice to customers. It would create consistency but perhaps at the cost of being consistently wrong⁵. It would make the possibility of competition between the PESs, whether by comparison between markets or directly in the same markets, more remote. It would, if the PESs were competing in the same market, reduce choice to customers.

The only argument we can see that might support the view is that competing suppliers might find all-island pricing decisions easier if they faced similar tariffs for each class of customer in each jurisdiction. However, even ignoring the lack of PES on PES comparison and competition, this would not be the case because tariffs would still differ by reason of the unharmonised features mentioned above.

Tariffs are not regulated in Northern Ireland. They must be consistent with the price control and, where NIEES is dominant, be neither predatory nor discriminatory. We think that tariff micromanagement by the regulator would be a retrograde step and challenge the basic premise of this paper.

⁵ It is widely considered that some ESBES tariffs that have been imposed by CER are not cost reflective.

Consultation questions – Poyry Paper

Has the review appropriately described the structure of retail tariffs and their cost allocation methodologies?

The review seems broadly correct but the description is wide-ranging and, since it is not clear that its accuracy is necessary for some further purpose, we doubt whether it would be fruitful for us to check that its detail is correct. Failure to comment here should not be taken as agreement on any particular point. This is particularly the case with section 2.7 on “Network Cost Allocation”, with which NIE Energy Supply is not concerned.

Are there other aspects that should be covered?

NIEES does not support the purpose of this review but, if harmonisation were required, it would be necessary also to address allowed revenue in supply price controls and the operation of PSO levies.

Do you agree with the categorisation of proposals?

There are other possible views on the grouping and the titles but it is difficult to think of circumstances in which the categorisation would matter.

Would an EFA style CfD help liquidity? Would anything else help?

NIEES has put its views on liquidity elsewhere. It strongly supports a move away from the artificial annual round towards a more fluid structure that also includes more longer term and shorter term contracts. However, this would be likely to make harmonisation and detailed regulation of tariff setting more difficult and burdensome.

We do feel that the trading of EFA style products would help. However, we should be interested in further study to test the benefits case, as setting up an EFA style market may need a significant investment.

Would “global aggregation” provide a level playing field for the PES to allocate its costs better?

It is reasonable that PESs should be treated the same as other suppliers and that a form of global aggregation should occur in each jurisdiction. There may be different views on how that should be done.

However, while locational transmission loss factors are applied to supply and not to demand, it is essential that aggregation takes place separately in the two jurisdictions. True global aggregation could introduce a significant and unwarranted subsidy from NI customers to RoI customers.

Would a common metering code of practice help?

There may be advantages to a common code but this is a matter for NIE T&D.

Would common profiles for class demands help?

Global aggregation would require that PES demand be estimated directly and not by residual. This in turn would mean that their non-half-hourly metered customers would need to have their demand profiled for pool settlement purposes. It is difficult to imagine that different sets of profiles could be used for different suppliers but it is an open question as to how many profiles there should be and whether PESs might predominantly use different ones. There could well be an opportunity with the introduction of smart metering, to initially install smart meters in a number of sites associated with each particular customer category. This would provide more accurate profiling data and pick up on any subtleties between the two jurisdictions and PES and non-PES customer bases.

Would further segmentation of the SME sector make PES tariffs more cost-reflective?

The appropriate degree of disaggregation is a difficult question in all sorts of contexts. NIEES would consider disaggregation but would prefer to do so in conjunction with customers and does not think it appropriate for it to be a regulatory requirement.

Would harmonisation of DUoS charges help retail competition? Would a pricing signal for higher voltage help distributed generation locate appropriately?

NIEES is prevented by its licence from having knowledge of the setting of NI DUoS charges.

It is normal for DUoS charges to differ geographically within competitive markets and they would be unlikely to be cost reflective if they did not. We do not know whether the NI and RoI methodologies produce appropriate signals and do not consider the subject to be within the scope of this paper. However, NIEES did find the structural changes to the recent UoS tariffs published for the 2009/10 tariff year somewhat strange (eg peak charges reducing).

Would the separation of charges for energy and UoS result in more choice to customers? Should the PES simply pass on UoS charges?

It should be open to PESs to have innovative tariffs that differ in form from use of system tariffs. NIEES's standard domestic tariff, which has no standing charge even though that is a feature of the UoS charge, has been very popular.

Should customers be permitted to choose from fixed energy contract terms that could vary from 6 months to 2 years and could also include indexation provisions? Should the PES be encouraged to offer such a choice?

Customers should be offered choices where this can be done at reasonable cost and where they would be likely to appreciate the choice. Various terms of fixed price contract have been offered in GB. The extent to which this is feasible in the AIM will depend on the availability of CfDs at different terms.

Would there be merit in adopting a common “cost to serve” model?

Since overall supply costs are not harmonised between PESs, it seems unlikely that an attempt to do this at the individual tariff level would be fruitful. It would be regulatory micro-management in the extreme.

Should the PES be encouraged to offer tariffs with more time of use charges?

As the paper says, the ability to levy time of use charges depends on the availability of appropriate metering or, in the case of seasonally varying charges, willingness by customers to pay for and make facilities available for related meter reading / data collection. One good example where time of use tariffs are offered to customers and no extra cost, is with the successful Keypad “Powershift” tariff.

Would a common Tariff Methodology Statement help?

A common statement presumes a common method, as opposed to merely a similar method. Imposition of a method would be likely to introduce regulatory error and would be detrimental to PES comparative and actual competition.

Are the criteria used to evaluate the proposals appropriate?

The process of setting criteria and attempting to assess each proposal against them does provide some discipline but also imports a degree of spurious accuracy. The most obvious missing criteria are those of acceptability to customers and possible cost to customers.

Do you support the conclusions?

We are generally not convinced that there is a compelling justification to harmonise tariff methodologies across the two jurisdictions.