Tariff Methodology Statement

Prepared by

NIE Energy Supply

30 July 2008

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1 Executive summary

In setting tariffs NIE Energy Supply (NIEES) must abide by various conditions of its licence, particularly those controlling its prices and preventing undue discrimination between customers or cross-subsidy.

This tariff methodology statement explains how NIEES intends to calculate its tariffs for 2008-09 given the information that will then be available to it on the likely costs of supply.

NIEES intends to maintain the categories of its existing domestic and SME tariffs except for the addition of a new multirate tariff category for below 1 MW[1] customers supplied at extra high voltage (EHV) i.e. at 33 kV.

NIEES is permitted to recover an amount equal to its wholesale generation, transmission costs, distribution costs, renewable obligation costs, any correction factor and plus an allowed revenue for the supply business itself[2]. The charges on each tariff will be set so that there is an expectation that, at the forecast demand, they will recover an amount equal to the expected costs and allowed revenue allocated to that tariff.

The process of allocating transmission, distribution and supply costs, which are governed by their own price controls, is relatively simple. Wholesale, or generation costs, will be allocated between half-hours according to a Portfolio Supply Tariff (PST) for all time periods from which, given the load shape assumed for the tariff category, the generation component of the charge can be calculated. The half hour PST will be calculated using generation contract costs, forecast pool costs and other generation items[3] that are mainly preset by the regulators or market operators. It is expected that, using NIEES's base forecast for demand, pool prices, contract costs etc., forecast revenue from the wholesale price component of the tariff will equal forecast generation costs.

In the all-island market there may be errors in the forecasts of demand and of the costs of serving it. These may stem from a number of factors including variations in customer numbers and their electricity consumption, inaccuracy of loss factors, weather, electricity pool and fuel prices, plant availability and exchange rates. NIEES's policy towards abating these risks is set out in its hedging policy statement. However, this will not result in their complete removal. NIEES will therefore monitor their impact over the year. If they cumulatively lead to a likelihood of an error exceeding ± 2.5% in any year, NIEES will consider the introduction of a tariff adjustment within the year.

NIEES's will modify this Statement if the scope of the future price control leads to a change in the extent of regulated tariffs.

[1] Maximum demand below 1000 kW
[2] See Appendix 1
[3] including without limitation; capacity charges, imperfections charges, currency exposure costs, market operator charges, CfD associated costs, NFFO and de minimis generation costs

2 Introduction and regulatory requirements

A number of conditions of NIEES's licence affect how it may set its tariffs. In particular it is required to:

- Use its best endeavours to ensure that the average charge per unit supplied does not exceed a price control maximum, which is calculated by adding the average cost of its purchases of electricity generation, transmission etc to an allowed supply business charge;
- Ensure that it does not sell electricity to any customer on terms which are materially more or less favourable than those on which it sells to other comparable customers;
- Avoid cross-subsidising other businesses.

In order to assist the Northern Ireland Authority for Utility Regulation in scrutinising its adherence to these and other licence conditions, NIEES provides information to the Authority. This includes advance notice of the tariffs themselves and forecasts of what it expects to be its average charge and average costs.
This tariff methodology statement precedes the provision of information on tariffs and forecasts of average revenues and costs. It explains how, at a later date, NIEES intends to set its tariffs for 2008-09 given the information that will then be available to it on its likely costs of supply.

3 Background

NIEES intends to maintain the categories of its existing domestic and SME tariffs except for the addition of a new multirate tariff for below 1 MW[4] customers supplied at extra high voltage (EHV) i.e. at 33 kV.

In addition, it will split its MV customers into large MV and small MV categories. Large MV customers tariffs will now have a 100% energy price adjustment applied to them, while small MV customers will remain on a 50% energy price adjustment. HV and EHV customer tariffs will also have 100% energy price adjustment applied to them.

While there is some market growth and there will be customer migration between suppliers after market opening, NIEES does not expect major changes in the number of customers served on each tariff in 2008/09.

3.1 Tariff structure

NIEES expects to set 13 tariffs, in addition to serving some customers on discontinued tariffs such as the "off-peak" preserved tariffs.

These are:

- Domestic
    - Home energy – a per unit price with no standing charge. As will, to some extent, be the case on any tariff its structure does not entirely match that of the cost drivers, since there are some fixed costs. However, the tariff is; socially progressive, popular and matches the price structure of most goods and services purchased by customers.
    - Eco-energy – a similar tariff to home energy
    - Power-shift tariff – utilising keypad metering time of day functionality.
- Economy 7 – a tariff with more disaggregated charges, i.e. a standing charge and separate day and night unit rates
- Small business
    - Popular – a standard tariff with a standing charge and a unit rate
    - Weekender – a standing charge and separate day and evening/weekend rates
    - Nightsaver – standing charge and separate day and night rates
    - Farm popular – a standard tariff with a standing charge and a unit rate
    - Farm nightsaver – standing charge and separate day and night rates
- Large business[5]
    - Multi-rate medium voltage
    - Multi-rate high voltage
    - Multi-rate extra high voltage
    - Maximum demand

[4] Maximum demand below 1000 kW
[5] All such tariffs will have a level of pool price indexation

The terms of all tariffs differ slightly depending on whether payment is made by quarterly credit, direct debit or keypad prepayment meter. Such differential pricing is reflective of the underlying cost to serve for each payment type.

3.2 Customer numbers and demand

NIEES will project the number of customers on each tariff based on previous years' recorded numbers and projections of household formation, economic activity and customer migration.

The demand on each tariff will also be projected based on previous years' recorded numbers, projections of customer numbers and economic activity, This will be done over the entire load shape resulting in a projected demand in each half hour.

3.3 Risk treatment

There will be risks to the forecasts of demand and to the costs of serving demand from a number of factors including variations in:

- Customer numbers
- Electricity consumption, including as a result of weather changes
- The effect of the "differencing" settlement method (i.e. Error Supply Unit calculation)
- Pool prices – affecting unhedged demand (including that resulting from demand variation)
- Fuel price variation – affecting unhedged contracts
- Plant availability - affecting non-firm contracts
- Exchange rates – affecting non-sterling contracts.

NIEES's policy towards abating these risks is set out in its hedging policy statement. However, this will not result in their complete removal. NIEES will therefore monitor their impact over the year. If they cumulatively lead to a likelihood of an error exceeding ± 2.5% in any year, NIEES will consider the introduction of a tariff adjustment within the year.

4 Components

NIEES is permitted to recover an amount equal to its wholesale generation, transmission costs, distribution costs, renewable obligation costs, any correction factor and plus an allowed revenue for the supply business itself[6]. The charges on each tariff will be set so that there is an expectation that, at the forecast demand, they will recover an amount equal to the expected costs and allowed revenue allocated to that tariff.

4.1 Wholesale

4.1.1 Construction of a Portfolio Supply Tariff (PST)

Wholesale, or generation costs, will be allocated between half-hours on a portfolio supply charge for all time periods. This will be derived by calculating the cost per unit averaged over groups of time periods. Given the load shape assumed for a particular tariff category, the generation component of the tariff can be calculated. It is expected that, using NIEES's base forecast for demand, pool prices, fuel prices etc., forecast revenue from this component will equal forecast generation costs.

While the wholesale price for the load to be served at the pool price indexed tariff has been modelled in the PST, it will in reality be based on the ex post pool price plus other relevant TSC charges. Hence any changes in SMP cost should be fully reflected through the energy price adjustment mechanism.

Capturing all generation related costs in the Portfolio Supply Tariff (PST), which is in many ways a proxy for the old BST, enables NIEES to maintain consistency in its tariff setting process.

4.1.2 Contracts for Differences

NIEES will examine its contract (i.e. CfD) portfolio and allocate costs to each time period. The precise method of doing so will depend on the details of the contract portfolio but NIEES expects that:

- Where there is a two-way contract or hedge the cost of the demand covered by the contract assessed at the contract strike price will be largely allocated to that period.
- Where there is a one-way contract or hedge the allocated cost will be the demand covered by the contract assessed at the expected price, which is the expected value of the distribution of pool prices truncated by the strike price of the contract at the upper end.
- Where there is a premium payment, it will be allocated to the time periods covered by the contract. The allocation between periods may depend on the perception of the degree of risk in each period.
- Where there is expected over-contracting, perhaps because it was not economic to tailor the portfolio precisely to forecast demand, any expected cost of the

[6] See Appendix 2

overcontracting in overcontracted periods is likely to be allocated to other periods covered by the contract.

Normally, i.e. unless there are particularly skewed risk distributions, NIEES will calculate the cost of its contract portfolio using expected values of customer demand, pool prices, fuel prices etc.

4.1.3 Pool

Uncovered demand will be assumed to pay the expected pool price.

4.1.4 Bilateral Purchases

NIEES may purchase energy on a bilateral basis. Examples of this may include, but not be limited to, de-minimis generation and purchases of energy over the interconnector. NIEES will apply the costs of any bilateral trades, after taking into account any applicable associated costs (e.g. interconnector capacity costs), using the same methodology as outlined for CfD costs.

4.1.5 Capacity charge

NIEES use the capacity payment period sums, which are set in advance, to forecast capacity charges on a half hour by half hour basis. These capacity charges are then allocated to demand in the relevant time periods through the PST.

In the event that final capacity payment period sums are not published at the time of preparing tariffs, NIEES will use the best information available at that time for the purposes of tariff setting.

4.1.6 Other charges

Imperfections and market operator charges are also set in advance and will be allocated to the appropriate period. The currency charge has an expected minimal value and will be charged on a simple per unit allocation.

There may also be an adjustment for expected losses.

In the event that final imperfections and market operator charges are not published at the time of preparing tariffs, NIEES will use the best information available at that time for the purposes of tariff setting.

4.1.7 Load management

The allocation of the charges described under 4.1.2 to 4.1.5 will result in a Portfolio Supply Tariff, but NIEES may consider further adjustments if it considers that they are necessary to manage load and prevent it migrating with consequent changes in the pool price in the time periods from and to which the load migrates.
Economy 7 night charge rates may be an example where a load incentive may be warranted.

4.2 Transmission

An element representing transmission charges will be included in each tariff. Expected receipts on the tariff will normally equal expected transmission charge payments. Where the tariff contains charge elements (e.g. standing charge, unit charge, maximum demand charge) that are similar to those under which

transmission charges are levied, the structure of the tariff charge element will normally mimic that of the transmission charge.

4.3 Distribution

An element representing distribution charges will be included in each tariff. Expected receipts on the tariff will normally equal expected distribution charge payments and any distribution services charges (i.e. common services transaction charges). Where the tariff contains charge elements (e.g. standing charge, unit charge, maximum demand charge) that are similar to those under which distribution charges are levied, the structure of the tariff charge element will normally mimic that of the distribution charge.

4.4 Levies

PSO and SSS levies are expected to continue to be charged on a tariff basis (i.e. delivered unit basis), aligning with the UoS tariff categories.

4.5 NIEES's own costs and margin

An element representing NIEES's own costs and net margin will be included in each tariff. Expected receipts on the tariff will normally equal expected allowed revenue. Where the tariff contains charge elements both a standing charge and a unit charge, the structure of the tariff charge element will be related to the extent to which supply business costs are customer or unit driven.

4.6 Correction factor

There will be an allocation of recovery correction to each tariff, based on an estimate of the proportion of the error that is related to the tariff.

5 Other terms

The terms of all tariffs will differ depending on whether payment is made by quarterly credit, direct debit or keypad prepayment meter.

6 Other supply obligations

6.1 Supplier of last resort

NIEES will maintain a supplier of last resort tariff in the form of a pool price tariff for larger customers. In the event of a supplier of last resort event being triggered, NIE will consider whether the option of other tariffs can also be offered to the customers in question (e.g. standard tariff for smaller customers until the next review point).

6.2 Universal service obligation

NIEES's tariffs are available on a contractual basis to all customers that are connected to the network. This effectively discharges its Universal Service Obligation, which relates to the right of customers to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable and transparent prices. However, depending on the credit situation, NIEES may require an individual customer to be supplied on particular credit terms.

6.3 Northern Ireland Renewables Obligation (NIRO)

In common with all other electricity suppliers operating in Northern Ireland, NIEES is obliged to purchase a portion of the electricity it sells from renewable sources. For year ending March 2009 NIEES must present Ofgem with Renewables Obligation Certificates (ROC's) to the value of 3% of electricity supplied, by using a buy out payment of £35.76/MWh for any shortfall or a combination of both.

For the next financial year this obligation increases to 3.5%. NIEES's tariff year straddles both financial years.

7 Reporting

NIEES's licence requires it to provide a forecast of its allowed average revenue and the average cost components no later than fourteen days before any change in supply charges or, if there is no change in charges, within three months of the start of a year[7].

To support this forecast NIEES will provide a statement of the hedges that it has purchased in advance of the period together with its expectation of the average cost

[7] A relevant year as defined in the price control.

of generation in the groups of time periods that it uses to calculate its tariffs (i.e. the Portfolio Supply Tariff).

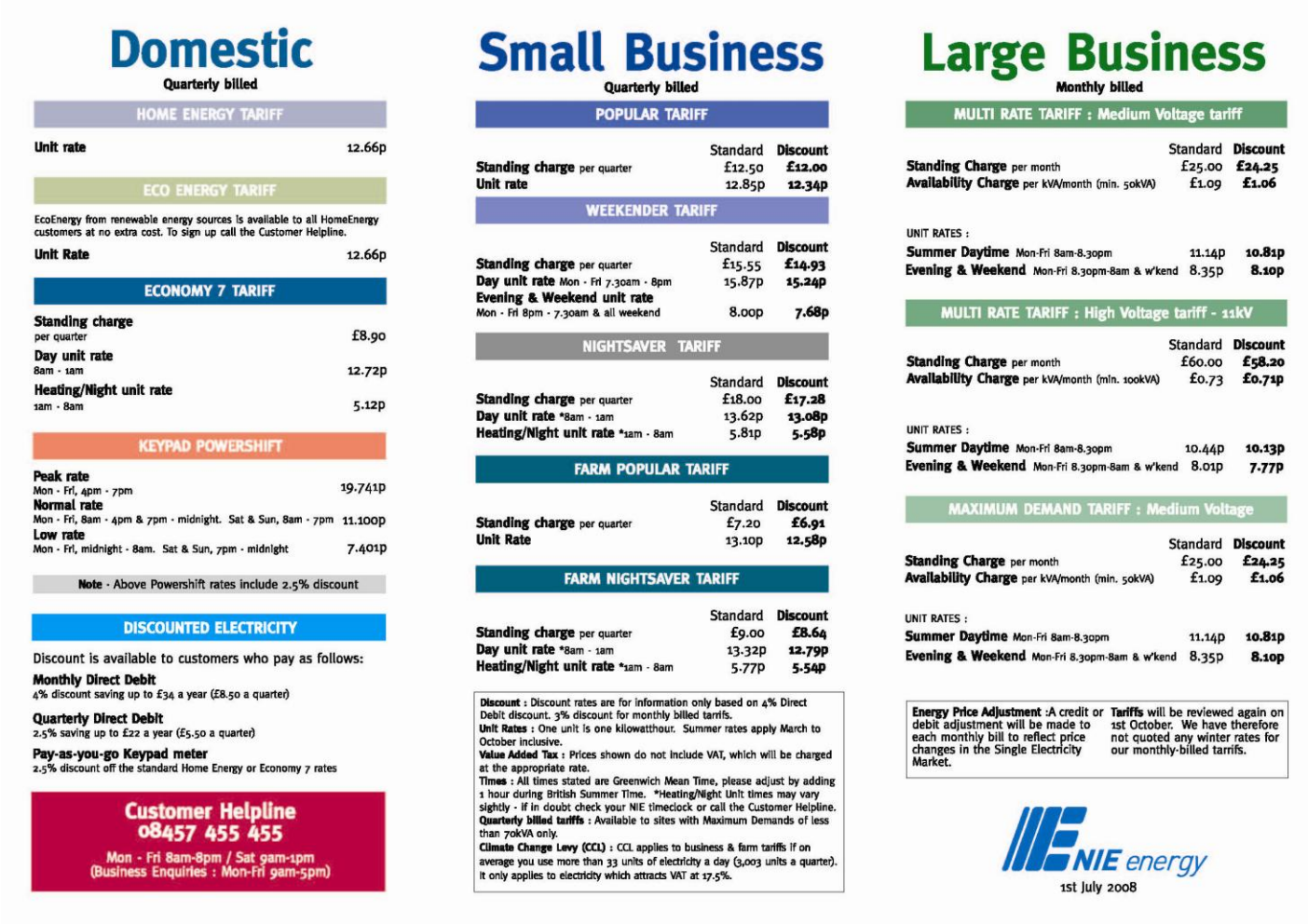
The licence also requires that NIEES send a statement of the average cost that has been incurred in each component within three months after the end of the price control year. NIE will additionally provide a statement of its purchases and sales of all hedges affecting that cost.

8 Price Control

NIEES's current price control is scheduled to run to 31 March 2009. NIAUR has indicated that it will initiate a price control review process later in 2008. If the outcome of this process should lead to a change in the scope of any price control going forward, with specific regards to regulated tariffs, NIE Energy Supply will update this Statement accordingly.

9 Appendix 1

Current Domestic and Non-Domestic Tariffs



Domestic

Quarterly billed

HOME ENERGY TARIFF

Unit rate	12.66p

ECO ENERGY TARIFF

EcoEnergy from renewable energy sources is available to all HomeEnergy customers at no extra cost. To sign up call the Customer Helpline.

Unit Rate	12.66p

ECONOMY 7 TARIFF

Standing charge per quarter	£8.90
Day unit rate 8am - 1am	12.72p
Heating/Night unit rate 1am - 8am	5.12p

KEYPAD POWERSHIFT

Peak rate Mon - Fri, 4pm - 7pm	19.741p
Normal rate Mon - Fri, 8am - 4pm & 7pm - midnight. Sat & Sun, 8am - 7pm	11.100p
Low rate Mon - Fri, midnight - 8am. Sat & Sun, 7pm - midnight	7.401p

Note - Above Powershift rates include 2.5% discount

DISCOUNTED ELECTRICITY

Discount is available to customers who pay as follows:

Monthly Direct Debit
4% discount saving up to £34 a year (£8.50 a quarter)

Quarterly Direct Debit
2.5% saving up to £22 a year (£5.50 a quarter)

Pay-as-you-go Keypad meter
2.5% discount off the standard Home Energy or Economy 7 rates

Customer Helpline
08457 455 455
Mon - Fri 8am-8pm / Sat 9am-1pm
(Business Enquiries : Mon-Fri 9am-5pm)

Small Business

Quarterly billed

POPULAR TARIFF

	Standard	Discount
Standing charge per quarter	£12.50	**£12.00**
Unit rate	12.85p	**12.34p**

WEEKENDER TARIFF

	Standard	Discount
Standing charge per quarter	£15.55	**£14.93**
Day unit rate Mon - Fri 7.30am - 8pm	15.87p	**15.24p**
Evening & Weekend unit rate Mon - Fri 8pm - 7.30am & all weekend	8.00p	**7.68p**

NIGHTSAVER TARIFF

	Standard	Discount
Standing charge per quarter	£18.00	**£17.28**
Day unit rate *8am - 1am	13.62p	**13.08p**
Heating/Night unit rate *1am - 8am	5.81p	**5.58p**

FARM POPULAR TARIFF

	Standard	Discount
Standing charge per quarter	£7.20	**£6.91**
Unit Rate	13.10p	**12.58p**

FARM NIGHTSAVER TARIFF

	Standard	Discount
Standing charge per quarter	£9.00	**£8.64**
Day unit rate *8am - 1am	13.32p	**12.79p**
Heating/Night unit rate *1am - 8am	5.77p	**5.54p**

Discount : Discount rates are for information only based on 4% Direct Debit discount. 3% discount for monthly billed tariffs.
Unit Rates : One unit is one kilowatthour. Summer rates apply March to October inclusive.
Value Added Tax : Prices shown do not include VAT, which will be charged at the appropriate rate.
Times : All times stated are Greenwich Mean Time, please adjust by adding 1 hour during British Summer Time. *Heating/Night Unit times may vary slightly - if in doubt check your NIE timeclock or call the Customer Helpline.
Quarterly billed tariffs : Available to sites with Maximum Demands of less than 70kVA only.
Climate Change Levy (CCL) : CCL applies to business & farm tariffs if on average you use more than 33 units of electricity a day (3,003 units a quarter). It only applies to electricity which attracts VAT at 17.5%.

Large Business

Monthly billed

MULTI RATE TARIFF : Medium Voltage tariff

	Standard	Discount
Standing Charge per month	£25.00	**£24.25**
Availability Charge per kVA/month (min. 50kVA)	£1.09	**£1.06**
UNIT RATES :		
Summer Daytime Mon-Fri 8am-8.30pm	11.14p	**10.81p**
Evening & Weekend Mon-Fri 8.30pm-8am & w'kend	8.35p	**8.10p**

MULTI RATE TARIFF : High Voltage tariff - 11kV

	Standard	Discount
Standing Charge per month	£60.00	**£58.20**
Availability Charge per kVA/month (min. 100kVA)	£0.73	**£0.71p**
UNIT RATES :		
Summer Daytime Mon-Fri 8am-8.30pm	10.44p	**10.13p**
Evening & Weekend Mon-Fri 8.30pm-8am & w'kend	8.01p	**7.77p**

MAXIMUM DEMAND TARIFF : Medium Voltage

	Standard	Discount
Standing Charge per month	£25.00	**£24.25**
Availability Charge per kVA/month (min. 50kVA)	£1.09	**£1.06**
UNIT RATES :		
Summer Daytime Mon-Fri 8am-8.30pm	11.14p	**10.81p**
Evening & Weekend Mon-Fri 8.30pm-8am & w'kend	8.35p	**8.10p**

Energy Price Adjustment : A credit or debit adjustment will be made to each monthly bill to reflect price changes in the Single Electricity Market.

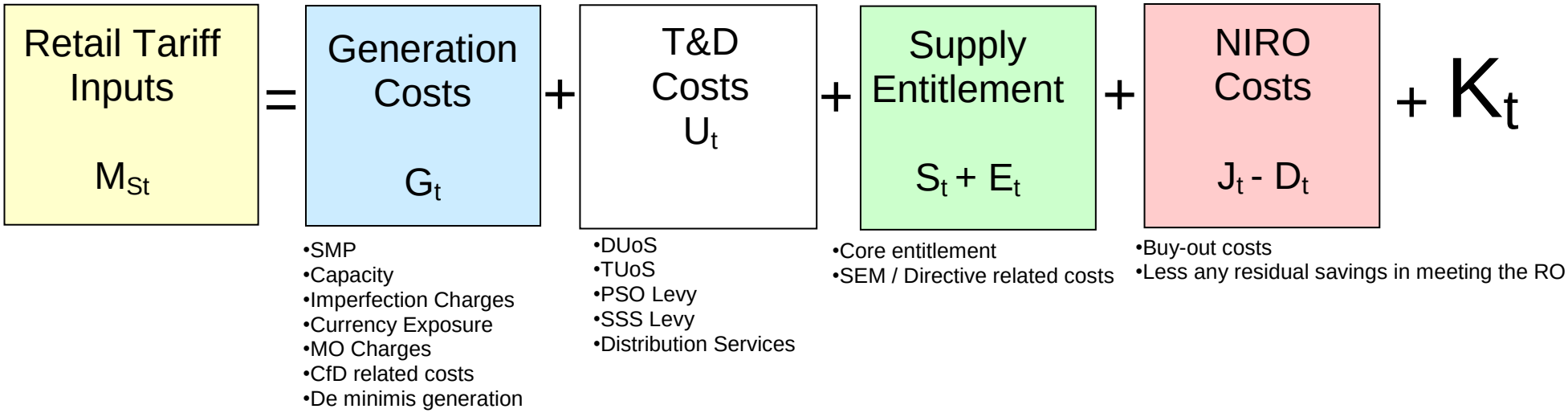
Tariffs will be reviewed again on 1st October. We have therefore not quoted any winter rates for our monthly-billed tarrifs.

NIE energy

1st July 2008

10 Appendix 2

NIEES's Key Tariff Inputs



The **Portfolio Supply Tariff (PST)** will be constructed reflecting these input costs.