

# **Power NI's 1 October 2011 Tariff Review**

## **A Regulatory Briefing**

# Power NI's 1 October 2011 Tariff Review – A Regulatory Briefing

## Summary

The Utility Regulator (UR) has verified an 18.6% increase in the Power NI tariff for domestic electricity customers to take effect from 1 October 2011. This paper sets out the background and reasoning behind the increase.

## Background

The electricity supply market has been fully open to competition since 1 November 2007 and since June 2010 a number of suppliers have entered the domestic market. However, in practice, Power NI whilst facing competition from other suppliers is still very much dominant in this sector of the market. The UR therefore takes an active role in scrutinising Power NI's proposed retail tariffs which are the final prices customers pay.

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

| Retail Tariff           | = | Wholesale Costs  | + | SSS Charges                                 | + | PSO Levy  | + | Use of Systems  | + | Supplier Charge  | + | NIRO Costs   | + | Correction Factors  |
|-------------------------|---|--|---|---|---|---|---|---|---|--|---|--|---|---|
| What Customers Pay      |   | Generation costs (cost of procuring electricity), Capacity costs, Imperfections (costs of electricity constraints), and MO charges |   | For system planning, operation and despatch |   | Public Service Obligation costs which must be spread across all customers |   | Costs of transmission and distribution of electricity |   | Costs to supply electricity to customers e.g. meter reading, billing |   | Net costs of NI Renewable Obligation - NIRO costs relate to government obligation to sell a proportion of their output as renewables |   | The difference between allowed revenue and actual recovered revenue (mechanism whereby differences between forecasts for tariff-setting and actuals can be recouped or returned to customers) and first year effect |
| <b>Split 11/12 100%</b> |   | <b>64%</b>   |   | <b>2%</b>                                   |   | <b>3%</b>   |   | <b>20%</b>  |   | <b>6%</b>  |   | <b>1%</b>  |   | <b>4%</b>   |
| <b>Split 10/11 100%</b> |   | <b>63%</b>   |   | <b>2%</b>                                   |   | <b>4%</b>   |   | <b>21%</b>  |   | <b>7%</b>  |   | <b>1%</b>  |   | <b>2%</b>   |

Figure 1: Components of Power NI tariff from 1<sup>st</sup> Oct 11<sup>1</sup>

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

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

| <b>Cost/Tariff</b>                          | <b>Regulatory Approval</b>   |
|---|--|
| <b>Market Operator (MO) Charges</b>         | SEMO Revenue & Tariffs 2011  |
| <b>SSS Charges (System Support Service)</b> | SONI Statement of Charges 2011                                       |
| <b>PSO Levy (Public Service Obligation)</b> | NIE Ltd – approved annually  |
| <b>Use of System Charges (UoS)</b>          | NIE Ltd Statement of charges 2011 and SONI statement of charges 2011 |

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

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

The remaining components of Power NI's tariffs, because of the low level of competition in the market, are subject to regulatory scrutiny.

| <b>Cost/Tariff</b>        | <b>Regulatory Scrutiny</b>  |
|---------------------------|---|
| <b>Generation Costs</b>   | Competitive and regulated wholesale market; approval of Power NI hedging methodology by UR; annual approval of Gt statement (forecast of Power NI wholesale costs). |
| <b>Supplier Charge</b>    | Application of Power NI Supply Price Control (estimate based on 2010 – 2011 Price Control – 2011 – 2013 yet to be approved.)  |
| <b>NIRO Costs</b>         | Audited on behalf of the UR by Ofgem as part of its UK-wide audit.  |
| <b>Correction Factors</b> | Analysis by the UR of variances between forecasts used for setting tariffs and out-turn costs; agreement to the 'first year effect'. <sup>1</sup>                   |

*Table 2: Remaining Components of Power NI tariffs*

## Annual Review

The table below analyses the required revenues of Power NI for all of its regulated customers<sup>2</sup>, by key component, comparing the forecast revenue requirement underlying tariffs for the year beginning 1 October 2011 with the equivalent last year and the equivalent for October 2009 (the last point at which tariff changed).

| Component                                       | Oct 2009/10<br>(12 mths)<br>£m <sup>3</sup> | Oct 2010/11<br>(12 mths)<br>£m | Oct 2011/12<br>(12 mths) | 24 month<br>movement<br>Oct 09 – Oct<br>11<br>%<br>Change | 12 month<br>movement<br>%<br>Change |
|---|---|--------------------------------|--------------------------|---|-------------------------------------|
| <b>Generation</b>                               | 208.5                                       | 229.6                          | 279.1                    | 33.9%   | 21.6%                               |
| <b>Capacity</b>                                 | 51.4  | 55.8                           | 57                       | 10.9%   | 2.2%                                |
| <b>Other (MO,<br/>Imperfections,<br/>NIROC)</b> | 17.2  | 18.9                           | 30.1                     | 75%   | 59.3%                               |
| <b>UoS</b>                                      | 111.4                                       | 99.7                           | 111.9                    | 0.45%   | 12.2%                               |
| <b>PSO</b>                                      | 19.5  | 17.4                           | 14                       | (28.2)%   | (19.5)%                             |
| <b>SSS</b>                                      | 10.4  | 10.6                           | 11.1                     | 6.7%  | 4.7%                                |
| <b>Supply costs</b>                             | 29.9  | 35.7                           | 39                       | 30.4%   | 9.2%                                |
| <b>Correction<br/>Factors</b>                   | 24.8  | 8.8                            | 22.8                     | 8%  | 160%                                |
| <b>TOTAL<br/>ALLOWED<br/>REVENUE</b>            | <b>473.1</b>                                | <b>476.5</b>                   | <b>565</b>               | <b>19.4%</b>  | <b>18.6%</b>                        |

*Table 3: Price increase comparison in Total Revenue terms. Please note, the figures in this table refer only to Power NI costs. Those figures within Annex I (which discusses the change in Regulated Network charges in Northern Ireland and Single Electricity Market (SEM) charges which both RoI and NI suppliers will pay) relate to the Northern Ireland electricity market as a whole.*

As demonstrated in the table above, there have been increases across most of the costs areas. Specifically, attention is drawn to the level of increase in Wholesale costs (comprising of Generation, Capacity and Other costs) which are forecast to increase by almost £62 million from October 2010. These costs alone make up 64% of the total costs associated with the tariff. Furthermore it is important to note that all non-wholesale costs have risen by only £27m from last year and compared to two years ago by only £3M hence over a two year period non-wholesale costs have remained flat nominally but reduced in real terms when inflation is taken into account. As the tariff was not changed last year it is more revealing to assess the 18.6% increase in the unit cost by comparing the costs for this year with two years ago. When this is

<sup>2</sup> Power NI supplies some customers in some sections of the market that are competitive, where tariffs are not reviewed by the UR.

<sup>3</sup> To aid comparison, the 2009/2010 and 2010/11 amounts have been restated for the same demand that Power NI have forecast for October 2011 – September 2012.

done it can be seen the movement of 18.6% is due almost entirely to the increase in wholesale costs which is driven by the cost of gas in the international fuel markets.

It should be noted that whilst Use of System (UoS) has increased by 12.2% in the last 12 months, it has only increased by 0.45% in the 24 month period since the October 2009 tariff change.

With regard to over and under recoveries if Power NI over-recover because underlying costs out-turn lower than forecast, this over-recovery can be returned to customers at the next tariff review. Similarly, if Power NI under-recover because underlying costs out-turn higher than forecast, this under-recovery can be included in customers tariffs at the next tariff review. This process will be in line with Power NIs Tariff Methodology Statement, once it is approved.

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

### **Generation costs**

The table above shows that the forecast generation costs for 2011/2012 have increased by 33.9% in the 24 month period from October 2009 (the last time there was an adjustment to electricity prices) and almost a 22% increase in the 12 months from October 2010.

Forward gas prices for the upcoming tariff year were higher over the contracting period this year than they were last year. In addition to this, the UR (as part of the approval of Power NIs Gt statement which contains the forecast costs of generation) has analysed forecast forward gas prices and forecast forward pool prices and they are higher when compared with the same period this year. Furthermore, Power NI continue to have a low level of hedging this year when compared with previous years (last year at the end of July Power NI had only been able to obtain hedges for 54% and this year at the end of July it was even lower at 40%).

The process which was followed was:

Power NI provided the Utility Regulator with detailed forecast wholesale cost inputs facilitating the Utility Regulator's review. The following information was provided:

- PowerNI's demand forecast (as a proportion of the all-island demand forecast published by the RAs along with the Validated Plexos model for Directed Contracts 2011-12);
- Power NI's SMP forecast;
- Power NI's capacity charges model;
- A breakdown of energy hedging;
- Details of currency hedging;
- Details of losses (PowerNI are acutely sensitive to losses as the Error Supplier Unit); and
- Credit requirements.

The Utility Regulator analysed all the information provided. The forecast SMP was independently verified using the published formula for pricing Directed Contract. Hedges were reviewed to ensure they align with the approach detailed in Power NI's hedging methodology statement. The cost of hedges already entered into was verified, as was the expected premium on hedges expected to be entered into. The capacity charges model was analysed in detail and was deemed to be robust. The remainder of forecast costs, which make up a much smaller proportion of total generation costs than energy and capacity costs were verified by the Utility Regulator and appear reasonable.

### **Capacity costs**

In the SEM generators receive a capacity payment as a contribution to fixed investment and operating costs. The total amount is revised annually to reflect the cost of new peaking capacity and the amount of capacity required to meet security standards. Suppliers in turn pay a capacity charge which is profiled monthly. The total capacity charge for 2011/2012 has decreased by 3%.

However, although the forecast Euro Capacity pot indicates a 3% reduction from 2010/11 levels, this does not materialise when converted to Sterling given the exchange rate movement. So dividing the forecast capacity pot (in sterling) by the central all-island demand forecast gives a very marginal increase in capacity costs for Power NI compared with 2010/11 position.

### **Northern Ireland Network Charges**

In terms of **overall** demand (i.e. total network demand) it is anticipated that there will be a decrease when compared with last year. NIE (NIE Network Business) have forecasted that they expect that **total** demand for 2011/2012 will be 8,228 GWhs compared to the forecast for 2010/11 of 8,446 GWhs. This is a decrease in the overall expected demand of 2.6%. This decrease in demand has the impact of increasing the **average** unit costs (i.e. the overall cost is divided across a lower amount of units)

### **Distribution Use of System (DUoS) Charges:**

In terms of the DUoS charges, the associated maximum amount recoverable has increased by 14.1% (c£20M). Of the £20M increase in DUoS charges, 86% or £17.2M is due to an under-recovery in the 2010/11 tariff year (almost half of this is due to inflation being higher than forecasted for the 2010/11 tariffs, and the rest is due to other forecasting inaccuracies). As well as this, additional capital expenditure was incurred.

To take in account the charges for DUoS, Power NI submitted the tables which form part of the model which calculates the tariffs. The tables detailed the various unit rates which were used across each tariff category. The rates used were checked and agreed to the rates which were published by NIE in their Statement of Charges (effective from 1 October 2011). The charges for DUoS are calculated by estimating the units used in each category and the time of day which they are used which allows an overall charge for each tariff category to be deemed.

### **Transmission Use of System (TUoS ) Charges:**

The maximum amount recoverable has increased by 34.8% (c£10M). The increase is due predominantly to an under-recovery last year (due to demand being less than forecast and so revenue collected being less than forecast) and extra capital spend associated with development of the transmission network and the connection of renewable sources of energy.

The format in which TUoS charges are levied has been changed compared with last year where they were broken down across tariff categories with corresponding unit rates to apply. This year there are only four categories of charges:

- Winter Peak;
- Outside of Peak;
- Evening and Weekend; and
- Supply at all other times.

Power NI submitted the spreadsheets showing how the charges were allocated on a 1/2 hourly basis across each day of the tariff year. The rates used as inputs were checked and agreed to the rates which were published by SONI in their Statement of Charges (effective from 1 October 2011).

### **Public Service Obligation (PSO)**

The Public Service Obligation is a levy which is charged at a flat rate on all units of electricity demand. The maximum amount recoverable under the PSO levy has reduced by approximately 29%. However, the PSO *unit* charges levied on all suppliers have decreased by approximately 28% in 2011/12 compared to the previous year. Whilst the overall amount has reduced by 29%, the overall demand has reduced by 2.6% resulting in the overall amount being allocated across a lower number of units.

There are a number of elements within this charge. Amongst the most notable movements are in relation to Ballylumford Customer Buy-Out (CBO) and Legacy Generation Costs. The Ballylumford CBO costs arose from a buy-out of power purchase agreements in 2003. These costs are due to end in March 2012 therefore they have reduced from £20.7 million in 2010/2011 to £11.68 million in 2011/2012.

In terms of Legacy Generation Costs, these have moved from a cost of £5.6m in 2010/11 to an income of £1.57m in 2011/12. The swing is explained by a number of factors, the most significant of these are listed below:

- PPB is expected to make a profit from selling NI PSO backed generation as hedging contracts and also to the spot market (i.e. the SEM pool) in 2011/12, compared to a loss in 2010/11.

- As part of PPB's risk management strategy they enter into hedges for both the sale of PSO backed electricity and the purchase of gas. PPB is expected to earn a profit from these hedges during 2011/12 compared to a loss in 2010/11.
- In 2011/12 PPB is expected to make a greater profit from the sale of excess carbon credits than in 2010/11, whereas going into the 2009/10 tariff year they expected to have to purchase credits.

Power NI submitted the PSO amount to be included in the tariffs, this was agreed by checking the PSO unit charge used (published by NIE). This rate is charged as a flat rate across all categories. To calculate the overall amount for PSO specific to Power NI, the unit rate is multiplied by the estimated consumption. The Power NI amount for PSO has decreased by circa 28% across the 24 month period and circa 20% in the last 12 months.

### **System Support Services (SSS)**

System Support charges cover the cost of SONI and ancillary services required to operate the transmission system safely and reliably. The maximum amount recoverable for 2011/12 has increased by 3.8%. This is due to Ancillary Services expenditure and a new Price Control for SONI being implemented.

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

**Annex 1 provides further explanation of the reasons for the increases from the 2010/2011 tariff year in the above tariff components (Annex I).**

### **Supply Costs**

Supply costs have increased by 9.2% from the previous tariff year. Whilst the forecast of the allowed revenues associated with the price control have remained largely flat (assumption for forecast based on the current control as the 2011-2013 has yet to be finalised), there has been an increase in the 'pass-through' element of allowed costs due to the need to split previously joint Power NI/NIE systems to comply with European law regarding business separation in the electricity market. The costs relating to the replacement system were part of the tariff submission last year and there are also costs included this year, which is the reason behind the circa 30% increase across the two years. The extra system costs have been approved by the UR as efficiently occurred. Total supply costs make up circa 6% of the overall tariff.

### **Correction Factors**

If the amount of revenue recovered in any one year exceeds or falls short of the amount allowed by the relevant price control formula, the correction factor operates in the following year to give

back any surplus with interest, or to recover any deficit with interest, as appropriate. Energy charges were higher than anticipated in the last year and this is the principal driver of the new under-recovery which accumulated over the last tariff year. Due to the increase in the tariff, the level of First Year effect has increased when compared with last year.

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

In terms of the First Year Effect, Power NI submitted their calculations for determining the amount to be included in the tariff. These calculations and the underlying assumptions were checked for reasonableness.

## Recent Tariff Changes

For Power NI domestic customers using 3,300 kWh per annum on standard credit, this tariff review will see a movement in a customer bill from £496 (incl. VAT) per annum to £588 (incl. VAT), an increase of £92 on an annual bill.

The graph below takes an average customer with average consumption of 3,300 kWh per year, and compares the average bill (ex VAT) for October 2011, October 2010, and October 2009.

This graph shows that wholesale costs have risen significantly since last year and that network costs have also risen since last year but over a two year period have remained flat. The graph also shows the high proportion of a customer bill which relates to generation costs.

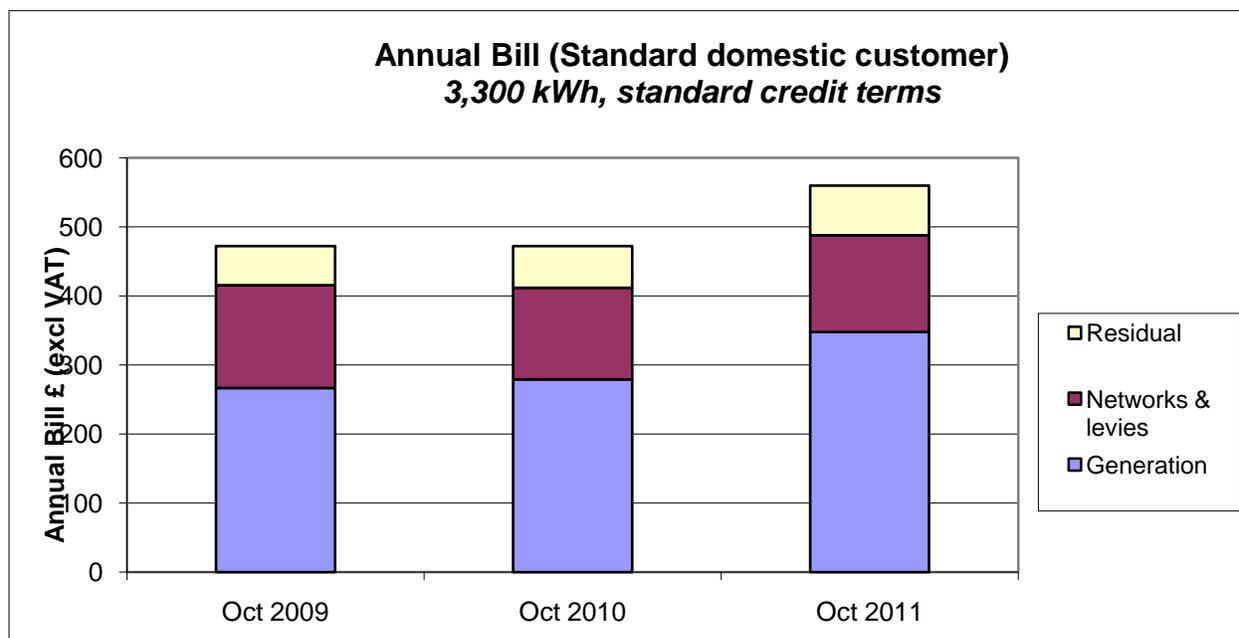


Figure 3: Recent Tariff changes based on an average annual customer usage of 3,300kWh (excl VAT). [Note: in the chart above, "Networks & Levies" includes SSS charges, PSO Levy, Use of System charges, NIRO charges and Supply costs].

## 2011 Comparisons with ROI Suppliers

The October 2011 Power NI domestic standard tariff compares favorably to the equivalent ROI tariff. The latest ESB/Electric Ireland tariff is on average 15.6% higher than the Power NI standard domestic tariff. The table below compares the tariff level for Power NI for October 2011 to the equivalent ESB/Electric Ireland urban and rural charges at October 2011. As with all comparison and benchmarks, there are a number of underlying assumptions which are made. As with prior comparisons shown above, the average consumption assumed for a domestic customer is 3,300 kWh. The prices below include VAT which is at a rate of 13.5% in the ROI when compared with the Northern Ireland rate of 5% on electricity (however this is the end price which the consumer pays). In addition to this, the ROI has a flat 'standing charge'

which customers pay regardless of consumption level. Therefore a customer at a higher consumption level will see the standing charge spread over a higher number of units (making it a lower overall per unit rate), with the transverse also being true with a low consumption user having a higher overall per unit rate as the standing charge is spread over a lower number of units. The exchange rate used to translate the Rol bills to sterling was 1.13.

|  |             | <b>Higher than Power NI £</b> | <b>Higher than Power NI %</b> |
|--|-------------|-------------------------------|-------------------------------|
| <b>Power NI October 2011</b>               | <b>£588</b> |                               |                               |
| ESB/Electric Ireland – urban (April 2011)  | £662        | £74                           | 12.6%                         |
| ESB /Electric Ireland – rural (April 2011) | £697        | £109                          | 18.5%                         |

*Table 4: Domestic Electricity costs based on average annual customer usage of 3,300kWh (including VAT, using a euro exchange rate of 1.13 for October 2011. NB: should note that the VAT on electricity in the Rol is at a rate of 13.5% whereas in NI the VAT on electricity is 5%.*

## Historic Comparison with GB and Rol

| <b>% Price Change</b>       | <b>Effective Date</b> | <b>GB Comparison</b>   | <b>Rol Comparison</b>  |
|-----------------------------|-----------------------|--|--|
| <b>5% decrease</b>          | October 2009          | Following the round of price reductions in GB in spring 2009, NI domestic prices around 12% higher than GB average and 8% higher than comparator GB regions. | NI prices around c 13% lower than the Rol prices (ESB/Electric Ireland).                 |
| <b>0% Price Change</b>      | October 2010          | NI Domestic prices around 11% higher than GB average and 7% higher than GB comparator regions.   | NI prices around 14% lower than Rol prices (ESB/Electric Ireland).                       |
| <b>18.6% Price Increase</b> | October 2011          | NI Domestic prices around 13% higher than GB average and 10% higher than GB comparator regions.  | NI prices are around 15.6% lower than Rol prices (ESB/Electric Ireland standard tariff). |

*Table 5: Historical Power NI price adjustments compared to GB and Rol*

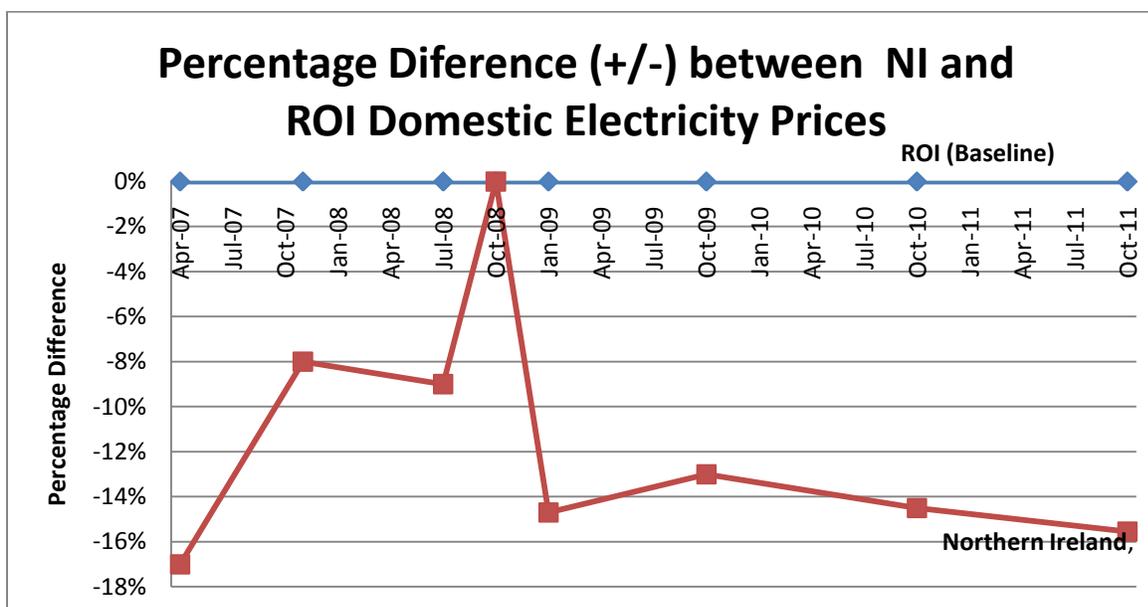
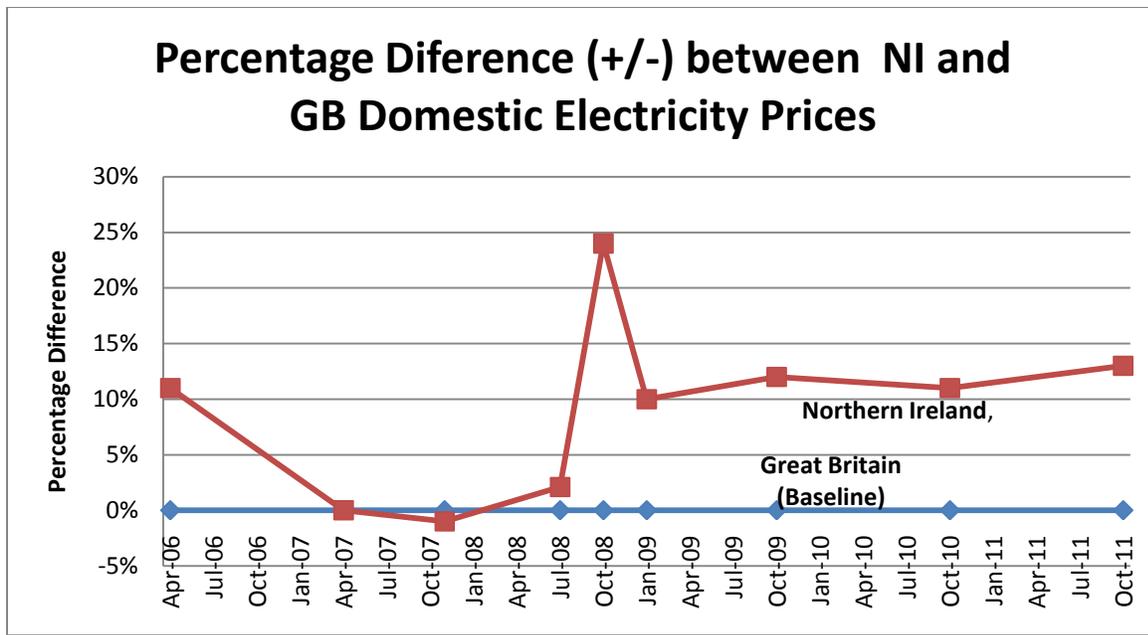


Figure 4: NI v's GB (GB Average) and RoI – ESB/Electric Ireland standard tariff only – comparison is of domestic standard tariffs.

The long-run trend is for electricity prices to be c.10% higher than those in GB (reasons are discussed below in Figure 5). Note that 2007 was an unusual year. The principal cause of the temporary parity between GB/RoI prices in the period April 07 to April 08 was as a result of a significant over-recovery built up by Power NI in the previous tariff year. The graph shows that the difference between RoI and NI is becoming larger when compared with Power NI Price in October 2011.

The following graph compares the October 2011 prices for NI and Rol to the prices from the larger suppliers in GB.

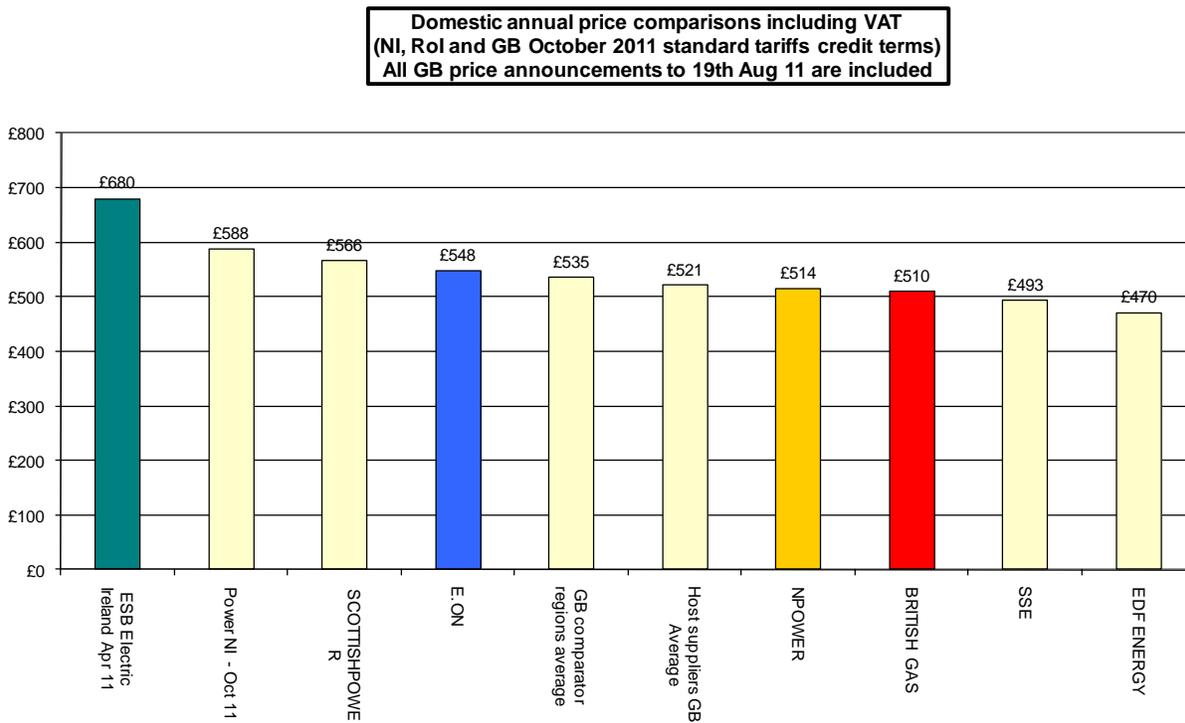


Figure 5: Power NI tariffs per average customer compared to Rol and GB

From the graph it can be seen that Power NI tariff is c.14% higher than the main suppliers in GB (average) and 10% higher than the GB comparator regions.

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

- higher energy transport costs as Ireland is at the end of the supply chain geographically;
- economies of scale in Great Britain owing to the size of the market there compared to Northern Ireland;
- Dispersed Rural network; and
- the different fuel mix in Great Britain (i.e. Northern Ireland has a reliance on gas, Great Britain's generation mix is spread between nuclear, gas and coal).

## Comparison with Europe

The following graph compares the October 2011 prices for NI and RoI to August 2011 prices in GB and to the most recent available data for other countries in Europe (which relates to the second half of 2010).

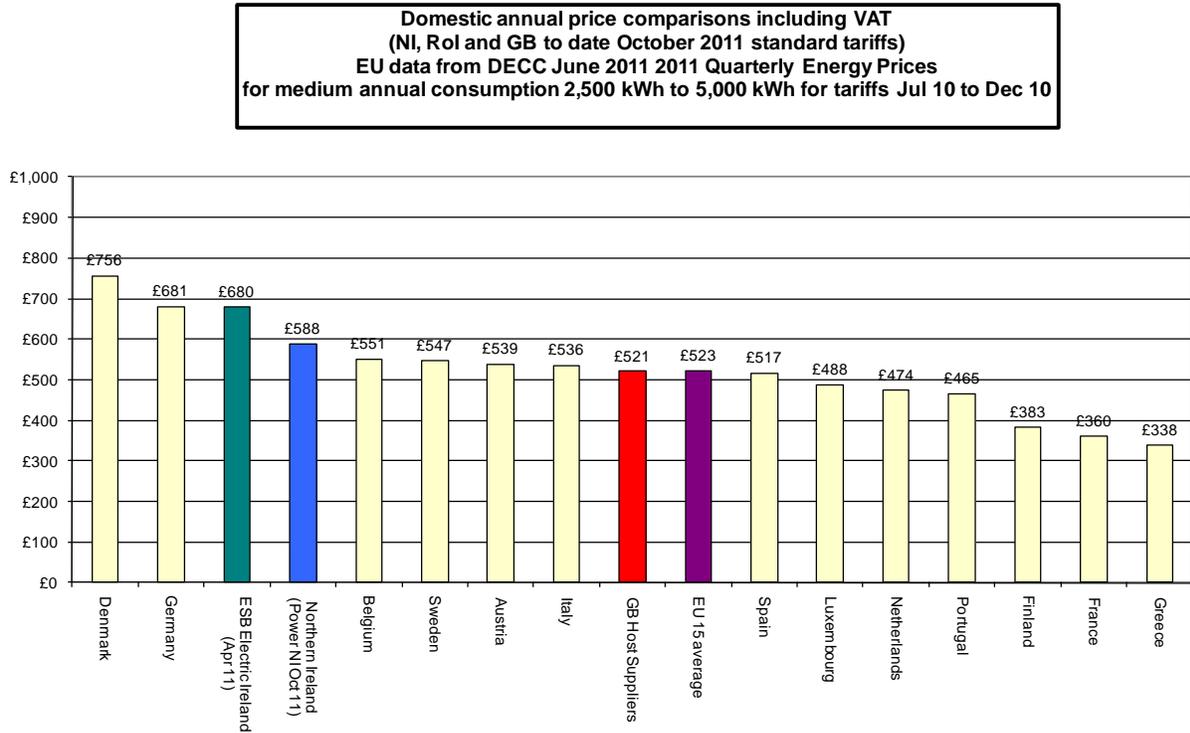


Figure 6: Power NI tariffs per average customer compared to RoI, GB and EU

The data from the rest of the EU relates to the average for the period June 2010 – December 2011 (so figures for Europe is circa 6 months out of date). From the graph it can be seen that NI tariffs are higher than the EU average. There are a number of reasons for this:

- End of supply chain for energy – resulting in higher transportation costs;
- No nuclear energy;
- Less interconnection with other markets; and
- Smaller market – so lower economies of scale.

**ANNEX 1 – Information Note on regulated inputs to the Tariff model (published on 19<sup>th</sup> August 2011)**



## **Regulated Tariff Values**

### **Information Note**

**15 August 2011**

## 1 – Introduction

Electricity Suppliers in Northern Ireland pay a number of regulated charges which they in turn must pass on to their customers. Regulated charges for the use of the electricity distribution network in Northern Ireland and a levy known as the Public Service Obligation (PSO) are set by NIE and SONI, and the maximum amount recoverable is approved by the Utility Regulator. Other regulated charges, including Capacity Payments, associated with the Single Electricity Market (SEM) are set by the Market Operator (SEMO) and the maximum amount recoverable is approved by the SEM Committee. The purpose of this note is to communicate the approved changes which will take effect from 1 October 2011, together with explanations for these changes.

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

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

## 2 - Charges Regulated By the Utility Regulator

The Utility Regulator regulates network charges and a levy known as the Public Service Obligation (PSO). NIE are forecasting a total demand for 2011/12 of 8,228 GWhs compared to the forecast for this year of 8,446 GWhs. This represents a decrease of 2.6%.

### 2.1 Northern Ireland Network Charges

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

#### *Distribution Use of System (DUoS) Charges:*

The maximum amount recoverable has increased by 14.1% (c£20M). Of the £20M increase in DUoS charges, 86% is due to an under-recovery in the 2010/11 tariff year (almost half of this is due to inflation being higher than forecasted for the 2010/11 tariffs, and the rest is due to other forecasting inaccuracies). As well as this, additional capital expenditure was incurred.

### *Transmission Use of System (TUoS) Charges:*

The maximum amount recoverable has increased by 34.8% (c£10M). The increase is due predominantly to an under-recovery last year and extra capital spend associated with development of the transmission network and the connection of renewable sources of energy.

### *System Support Services (SSS) Charges*

These charges cover the cost of SONI and ancillary services required to operate the transmission system safely and reliably. The maximum amount recoverable for 2011/12 has increased by 3.8%. This is due to Ancillary Services expenditure and a new Price Control for SONI being implemented.

**Table 1: Northern Ireland Network Charges**

|                              | <b>2010/11</b> | <b>2011/12</b> |                           |                                    |
|------------------------------|----------------|----------------|---------------------------|------------------------------------|
|                              | <b>£m</b>      | <b>£m</b>      | <b>% Change (nominal)</b> | <b>% Change (real)<sup>4</sup></b> |
| Distribution Charges (DUoS)  | 148.6          | 169.5          | 14.1%                     | 8.1%                               |
| Transmission Charges (TUoS)  | 30.1           | 40.571         | 34.8%                     | 27.7%                              |
| Support Charges (SSS)        | 24.7           | 25.63          | 3.8%                      | -1.8%                              |
| <b>Total Network Charges</b> | <b>203.4</b>   | <b>235.7</b>   | <b>15.9%</b>              | <b>9.8%</b>                        |

Table 1 shows that the maximum amount recoverable for network charges increased by 15.9% (nominal). Given that demand is forecast to decrease by 2.6%, average unit charges will increase by around **17%**.

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<sup>4</sup> RPI has increased by 4.16% in the 9-month period between October 2010 and June 2011. Assuming a similar increase between June and October 2010 would result on year-on-year inflation of 5.55%.

## 2.2 Northern Ireland Public Service Obligation (PSO) Charge

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

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

|                          | 2010/11     | 2011/12      |                    |                 |
|--------------------------|-------------|--------------|--------------------|-----------------|
|                          | £m          | £m           | % Change (nominal) | % Change (real) |
| NFFO/ROF                 | -1.5        | 0.4          | 126                | 125             |
| Landbank                 | 0.1         | 0.1          | 0.0                | -5.3            |
| Ballylumford CBO         | 20.7        | 11.68        | -43.6              | -46             |
| Kilroot FGD              | 1.4         | 0.0          | -100               | -105.6          |
| Legacy Generation Costs  | 5.6         | -1.57        | -128               | -126.6          |
| Market Opening Costs     | 7.1         | 7.2          | 1.4                | -4              |
| NISEP + incentive        | 8.4         | 8.8          | 4.8                | -0.7            |
| IME3 costs               | 0           | 0.15         | n/a                | n/a             |
| Enduring Solution        | 0           | 2.73         | n/a                | n/a             |
| <b>Total PSO Charges</b> | <b>41.8</b> | <b>29.49</b> | <b>-29.4</b>       | <b>-33.2</b>    |

Table 2 shows that the maximum amount recoverable under the PSO levy reduces by 29.4% (nominal). Given that demand is forecast to decrease by 2.6%, average unit charges will decrease by around 28%.

### *NFFO/ROF Charges:*

The Non-Fossil Fuel Obligation (NFFO) contracts and the associated ROFs are managed by Power NI. These are contracts put in place to encourage renewable generation prior to the ROCs scheme being introduced. Any costs associated with these processes are claimed through the PSO. The amount for 2011/12 is £0.4m

#### *CBO and Kilroot FGD Costs:*

The Ballylumford Customer Buy-Out (CBO) costs arose from a buy-out of power purchase agreements back in 2003. These costs are due to end in March 2012.

The Kilroot Flue Gas Desulphurisation (FGD) costs are due to a clause in the Power Purchase Agreement which allowed recovery of these cost since 2007. These costs ended on 1 November 2010.

#### *Legacy Generation Costs:*

The NIE Power Procurement Business (PPB) has Power Purchase Agreements with the power stations owners in Northern Ireland. These contracts (which are backed by the NI PSO) were put in place with privatisation of the industry back in 1992. PPB purchase power under the terms of these contracts and then sells this power in the Single Electricity Market (SEM). Any profit or loss is levied on all consumers in Northern Ireland via the PSO.

The PPB business and the associated generation contracts are forecast to benefit consumers £1.57m in the 2011/12 tariff year. This compares to a net cost of £5.61m in the 2010/11 tariff year. The swing is explained by a number of factors, the most significant of these are listed below:

- PPB is expected to make a profit from selling NI PSO backed generation as hedging contracts and also to the spot market (i.e. the SEM pool) in 2011/12, compared to a loss in 2010/11.
- As part of PPB's risk management strategy they enter into hedges for both the sale of PSO backed electricity and the purchase of gas. PPB is expected to earn a profit from these hedges during 2011/12 compared to a loss in 2010/11.
- In 2011/12 PPB is expected to make a greater profit from the sale of excess carbon credits than in 2010/11, whereas going into the 2009/10 tariff year they expected to have to purchase credits.

#### *NISEP Costs:*

A levy is imposed on all demand to fund the Northern Ireland Sustainable Energy Programme (NISEP). The objective of this programme is to promote energy efficiency with particular regard to vulnerable electricity consumers. The increase for 2011/12 is in line with RPI.

### *Market Opening Costs and Enduring Solution:*

This charge is for the capital and operating costs for the IT systems required to facilitate retail competition.

### **3- Charges Regulated by the SEM Committee.**

The SEM Committee regulates certain charges in the all-island electricity market including charges for generation capacity, the operation of the market and market imperfections (or constraints).

Details of the movements in the maximum amount recoverable for these charges on an all-island basis are set out in table 3 below.

All island forecast demand for 2011/12 is 34,030 GWhs compared to the forecast last year for 2010/11 of 36,990 GWhs, representing a decrease of 8%. This has the effect of increasing average unit costs.

**Table 3: Charges Regulated by the SEM Committee**

|                              | <b>2010/11</b> | <b>2011/12</b> |                    |                 |
|------------------------------|----------------|----------------|--------------------|-----------------|
|                              | €m             | €m             | % Change (nominal) | % Change (real) |
| Capacity Charge <sup>5</sup> | 546.81         | 530.26         | -3%                | -8.1%           |
| Imperfections Charge         | 107.32         | 185.2          | 72.6%              | 63.5%           |
| Market Operator Charge       | 23.62          | 24.86          | 5.2%               | -0.28%          |
| <b>Total Charges</b>         | <b>677.75</b>  | <b>740.32</b>  | <b>9.23%</b>       | <b>3.5%</b>     |

### *Capacity Charges:*

In the SEM generators receive a capacity payment as a contribution to fixed investment and operating costs. The total amount is revised annually to reflect the cost of new

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<sup>5</sup> The capacity charge is calculated and published on a calendar basis, these numbers have been adjusted to tariff year values for comparison with the other SEM charges.

peaking capacity and the amount of capacity required to meet security standards. Suppliers in turn pay a capacity charge which is profiled monthly.

The total capacity charge for 2010/11 is down by 3%.

*Imperfection Charges:*

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

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

The imperfections allowance has increased by 72.6%. This has been due to the rising cost in fuel prices, outages on a number of generators increasing reserve constraint costs and higher than forecast system demand over the winter months causing expensive generation to be constrained on.

*Market Operator Charge:*

SEMO incurs operational costs while carrying out their functions and recovers these costs, as well as capital related costs and a rate of return, through Market Operator tariffs and fees, which are levied on market participants. To facilitate this recovery of costs, the Market Operator Licence requires SEMO to submit proposals on its allowed revenue and the charges required to recover this revenue to the RAs. The current tariff period started on 30 September 2011 i.e. it covers a 36 month period from 1 October 2010 to 30 September 2013.

The allowance for market operations has increased by 5.2% in nominal terms. This has been due to incidence of capital investment projected to the next year. However given the predicted amortization of start up costs incurred in the creation of the market, the tariffs for 2012 onwards should be considerably reduced.

## **4- Other Costs**

### **Energy**

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

Whilst the SEM Committee does regulate bidding behaviour in the spot market, the wholesale energy component of bills is not regulated for most consumers. In Northern Ireland this component remains regulated for customers (mainly domestic) of the incumbent Supplier, Power NI. Further information will be made available from September regarding changes to the Power NI regulated tariff from 1 October 2011.

### **Climate Change Levy (for business only)**

The Climate Change Levy (CCL) was introduced on 1 April 2001. Non-domestic electricity customers pay the levy at a rate of 0.485p/kWh; electricity from qualifying renewable sources is exempt from the Levy. The Utility Regulator issues Levy Exemption Certificates (LECs) as evidence that electricity meets the definition of having been generated from a qualifying renewable source. LECs are issued by the Utility Regulator to generators and are traded with the electricity to suppliers. Suppliers then use the LECs as evidence to HMCE of the amount of qualifying renewable electricity supplied to non-domestic customers.

### **Supplier Costs and Margin**

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

### **VAT**

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