



12th February 2007

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Belgard Square North
Tallaght
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Lisa Mullan
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14 Queen Street
Belfast
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Our Ref : R2007118

**Re: Response to Consultation Paper
"PES Retail Tariff Period Alignment in Both Regulatory Jurisdictions"
(AIP/SEM/07/04)**

Dear Caroline,

EirGrid welcomes the opportunity to respond to the Regulatory Authorities' consultation paper concerning the tariff period alignment under the new market arrangements. EirGrid's response seeks to address the potential impact on EirGrid's business and also the potential impact on a well functioning Single Electricity Market for participants. In earlier correspondence to the Regulatory Authorities, in conjunction with NIE and SONI, of last August when EirGrid intimated it wished to see the enduring tariff arrangements addressed three general issues were raised:

- (i) whether the Regulatory Authorities considered that wider consultation on the issue of tariff harmonisation is appropriate;
- (ii) which tariffs are to be harmonised on an all-island basis for the commencement of the single market; and
- (iii) for any tariffs that are to be harmonised, the process and timescale by which consideration of the appropriate tariff year will be determined.

This consultation paper is to be welcomed as airing these issues and will help move the debate forward. In the paper the Regulatory Authorities have indicated that their preferred approach is to align tariffs on an October – September basis, commencing 1 October 2008. EirGrid does not believe the basis for such a decision is well made in the Authorities' paper. Instead EirGrid suggests two alternatives, neither of which have been examined in any detail by the Authorities in their paper. The first is the possibility of

intra-year tariff adjustment which would have the potential to improve cost reflectivity for the consumer while providing for annual tariffing for certain components of the retail tariff less prone to fluctuation and variation. This would also facilitate the retention of the existing tariff setting timetables and processes in some instances. The second is for tariff alignment on a calendar year basis (i.e. January - December – not considered in the Authorities’ paper, but which EirGrid believes, if alignment is deemed appropriate, is the most suitable. This is on that basis that the calendar year is, in EirGrid’s view, the natural financial planning horizon basis for the majority of companies in both jurisdictions, as well as requiring no amendment to the current tariffing timetable in the Republic. In the remainder of this response EirGrid demonstrates why it believes both these options to be worthy of further consideration and potentially preferable to those considered in the Authorities’ paper.

Is Harmonisation Necessary - An Analytical Framework

In EirGrid’s previous correspondence with the Regulatory Authorities we urged them to undertake a full exploration of the potential costs and benefits of tariff alignment on an all island basis. We argued this was important not only in respect of the potential impact upon regulated businesses, including EirGrid’s, but also for the effects upon market participants. Should market participants wish to engage in annual contracting full tariff alignment would facilitate them by reducing, or eliminating, any risk or exposure they might otherwise have. In assessing the extent of such risks EirGrid felt that the potential variations in actual tariffs, or tariff components, as compared to earlier forecasts – and therefore the potential risk to suppliers and to the regulated tariffs being out of line with cost components - was a suitable framework through which such analysis could be undertaken. EirGrid is disappointed that the current paper appears to be light on any such analysis and there appears to be a presumption by the Authorities that tariff alignment is indeed a pre-requisite for operation of the market. While this would also have been EirGrid’s *a priori* expectation, given the not inconsiderable costs involved to unregulated businesses, EirGrid believes the scale of the potential problems such risks pose would have merited more detailed consideration.

Intra Year Tariff Adjustment – an alternative approach?

The Authorities’ argument for alignment appears to hinge entirely on whether or not retail tariffs are out of line with underlying cost components. This is a valid consideration. However, it would be EirGrid’s expectation that the potentially most volatile element of tariffs might arise from variation in fuel costs. This is already a potential concern for both regulators in annual retail tariff setting within a single jurisdiction. The risk of being out of line with current costs as a result of spot fuel price variation will not alter with the introduction of the single market or with alignment of tariff setting on an all island basis. It is just such movements in underlying fuel costs which have seen a revision to previously announced Public Electricity Supply tariffs in the Republic of Ireland in the last quarter of 2006.

EirGrid believes that if the Authorities' primary concern is about the cost alignment of tariffs, the possibility of intra year, or more frequent, adjustments to tariffs, or various components of tariffs, should once again be considered. The possibility of intra year tariff adjustment is something EirGrid has previously advocated in respect of the management of unanticipated constraints costs. The potential for more rapid tariff adjustments would have the potential to reduce the working capital required to be held to meet any such variation and this would ultimately result in such savings being passed on in lower costs for final customers. Similar adjustments for other elements – for example fuel cost variation - would have the potential to increase cost reflectivity of tariffs across the board. Under the Single Market such adjustments – for example semi-annual or quarterly adjustments – in addition to improving cost reflectivity could potentially deliver the further benefit of facilitating the retention of the existing tariffing regimes in both jurisdictions for certain elements of the tariffs thus reducing the need to incur additional costs in amending billing and other systems. EirGrid believes that even if tariff year alignment transpires to be the preferred approach there remains a sound argument for intra year tariff adjustment for the reasons outlined above.

The Case for An Alternative Option – Calendar Year Alignment

EirGrid recognises that the cost reflectivity of retail tariffs on the one hand – as potentially facilitated through more frequent tariff adjustments - must be balanced with a degree of certainty for customers on the other. However, EirGrid is not sure the impact on final customers has been fully considered by the Authorities in arriving at their proposed decision in this paper. In particular EirGrid is surprised that the paper does not address the possibility of tariff harmonisation on the basis of the calendar year. EirGrid believes that the calendar year is a natural financial planning horizon for many companies in both jurisdictions and in addition provides the current tariffing framework for the Republic of Ireland market. In addition, the calendar year is the basis upon which the financial systems for the SMO have been specified.

EirGrid wrote to the Regulatory Authorities concerning this matter in December following an indication from the Regulatory Authorities that they were not minded to consider the possibility of a harmonisation of tariff year North/ South on a January – December basis in their paper. The reason given in the paper for not doing so is as a result of 'billing impact'. EirGrid understands this 'billing impact' concerns the overall changes in bills likely to be seen by customers as result of tariff adjustment – that is that consumption is higher in the winter period and therefore the total increase/ decrease in the bill is greater at that time. EirGrid does not believe this to be a material consideration in respect of determining something as fundamental as the tariffing year – the net impact of annual adjustments regardless of when in the year they occur being ultimately the same. However, regardless of the validity of the 'billing impact' consideration the impact of adjusting tariffs in October, as proposed, when consumption is rising into the winter period will have an even more pronounced 'billing impact' in times of rising tariffs than a change mid-winter.

EirGrid believes, prior to any decision being taken, consideration should be given to the possibility of alignment of tariffs on a calendar year basis. There are clearly some disadvantages of such an approach in respect of the Northern Ireland utilities – although EirGrid would contend this does not necessarily extend to final customers in Northern Ireland – but such disadvantages also apply for the proposed decision of tariffing from 1 October. Any disadvantages would have to be countered against the benefits outlined above. EirGrid does not believe the Authorities have demonstrated the advantage of aligning with the gas year nor is EirGrid aware of any particular difficulties caused by the current non-alignment of the gas and electricity tariffing years. It appears to EirGrid from the paper that this has been a foremost consideration for the Authorities in arriving at their proposed decision. Rather EirGrid believes spot fuel prices may have at least as significant influence on the overall market and EirGrid believes the materiality of this effect, which is heavily relied upon by the Regulatory Authorities, requires further development and demonstration of its importance.

Issues Relating to EirGrid's Business

While the comments above are considered in the context of the overall impact on market participants EirGrid has one or two comments to make in respect of the impact on the TSO and SMO. EirGrid presumes in arriving at any decision that:

1. A full allowance of any costs which may be incurred by EirGrid – both in its role as TSO and SMO as a result of any decision which results in cost being incurred; and
2. That the Authorities can confirm the existing understanding that the TUoS tariffing year – whereby all island TUoS tariffs are calculated will come into effect on 1 January 2008 in line with the long standing assumptions under the Readiness programme;

EirGrid also seeks clarity from the Authorities on precisely what is intended in respect of the various components of retail tariffs, and in particular for the TUoS tariffs, and whether these are automatically expected to align with final retail tariffs. In addition should it be intended that the transmission tariffing regime were to be amended EirGrid seeks clarity on whether it is the Authorities' intention that the transmission revenue year would also be amended. In the absence of such clarity it is difficult for EirGrid to comment on the precise implications of any decision for its business. EirGrid requests that the Authorities dialogue with EirGrid concerning its revenue and tariff year prior to reaching a final decision;

In Conclusion

EirGrid once again welcomes the timely publication of this consultation paper and believes it is important in commencing the process of a fuller debate of the issues among all relevant parties. EirGrid trusts the Authorities will take into account its views as expressed in this paper in determining the next steps towards reaching a decision. EirGrid wishes to urge the Authorities to make any decision in the context of a full Regulatory

Impact Assessment being carried out on the potential impacts of such in line with best regulatory practice such as that set out in the Republic of Ireland under the Taskforce on Better Regulation or the UK equivalent.

EirGrid wishes to summarise the points it has raised in this paper as follows:

1. While EirGrid is not necessarily opposed to the idea it believes more analysis is required in order to make a case for tariff year harmonisation. Further engagement with industry will facilitate this and EirGrid believes this consultation therefore represents a welcome first step in that process;
2. EirGrid believes if harmonisation is determined to be preferable then other options, most notably the option of harmonisation on the basis of the calendar year, ought to be considered more fully before a final decision is made;
3. In addition, and as well, EirGrid believes intra year tariff adjustments should be considered both as a potential alternative approach, and complimentary to any tariff harmonisation. Intra year tariff adjustment can make a significant contribution to the Authorities' goal of cost reflectivity in final tariffs.
4. EirGrid seeks additional clarity on the Authorities' precise intention for the components of retail tariffs and in particular the transmission tariffs. EirGrid also seeks clarity on whether it is the intention that any change in the tariffing year will give rise to a corresponding change in the revenue year. .

EirGrid looks forward to further dialogue with the Authorities on these matters and to the next stage in the debate and process of arriving at a regulatory determination. In the meantime should either I or any of my colleagues be able to assist you in your decision, or to further elaborate on EirGrid's position please feel free to revert to us.

Yours sincerely,

Bill Thompson
Commercial & Regulation
EirGrid