



**PES RETAIL TARIFF PERIOD ALIGNMENT  
IN BOTH REGULATORY JURISDICTIONS**

**DECISION PAPER**

**3rd April 2007**

**AIP/SEM/07/93**

## Table of Contents

1	Executive Summary .....	3
2	Background .....	4
3	Decision on Retail Tariff Alignment Period.....	6
4	Comments Received and Responses .....	10
	4.1 Capacity Mechanism Payment ‘Year’ .....	10
	4.2 TUoS charges .....	10
	4.3 Transmission Loss Adjustment Factor (TLAF) .....	11
	4.4 Billing impact to Northern Ireland customers .....	11
	4.5 Tariff Period out of line with financial & accounting year.....	12
	4.6 Resetting Directed Contracts .....	12
5	Next Steps.....	14

# 1 Executive Summary

As a consequence of the introduction of the SEM in November 2007 key cost component periods underlying the PES retail tariff in both regulatory jurisdictions of Northern Ireland ('NI') and Ireland ('IRL') will be out of line with the overlying retail tariff period. This has the undesirable effect of significantly increasing the risk of tariff revenues not recovering costs, a situation which lends itself to the need for k-factors which can significantly hinder the development of competition in both retail markets.

To avoid this situation, the Regulatory Authorities published a consultation paper in January with a proposal to align the PES retail tariff period, and by implication, all underlying cost component periods, in both regulatory jurisdictions. Two different alignment 'periods' were considered by the Regulatory Authorities in this paper:

Option 1: **1st Apr. – 31st Mar.**

Option 2: **1st Oct. – 30th Sept.**

In consideration of comments received, this paper sets out the Regulatory Authorities' decision to align the PES Retail tariff period in both jurisdictions to:

**Decision:** 1st Oct. – 30th Sept.

In both Ireland and Northern Ireland, this decision involves setting an 11-month PES retail tariff (1<sup>st</sup> Nov. 07 to 30<sup>th</sup> Sept. 08) and 12-month tariff thereafter to align with a 1<sup>st</sup> Oct. – 30<sup>th</sup> Sept. tariff period.

## 2 Background

On the 23<sup>rd</sup> January 2007, the Regulatory Authorities published consultation paper on aligning the PES retail tariff period in both regulatory jurisdictions of Northern Ireland ('NI') and Ireland ('IRL') in the SEM (AIP/SEM/07/04). This paper examined the merits of aligning the two retail tariff periods to correspond with the SEM wholesale-related cost periods and put forward two different alignment 'periods' for consideration:

Option 1: **1st Apr. – 31st Mar.**

Option 2: **1st Oct. – 30th Sept.**

The advantages and disadvantages of each 'period' were identified for both jurisdictions as well as the associated implications in respect of both the All Island Project ('AIP') work stream deliverables and non-AIP deliverables. The Regulatory Authorities put forward a favoured alignment period of '1<sup>st</sup> Oct to 30<sup>th</sup> Sept' and invited comment by 12<sup>th</sup> February 2007.

Six responses to the consultation paper were received from the following parties:

- Viridian
- Synergen
- ESBIE
- ESB PES
- NIE (Northern Ireland Electricity)
- EirGrid

This Section of the paper sets out the background to this decision paper and identifies the respondents to the consultation paper. Section 3 presents the Regulatory Authorities' decision on PES retail alignment period, including the basis of this decision, transition tariff period arrangements in both jurisdictions at the start of the SEM. Also identified are the high level implications for the cost components underlying the PES retail tariff in respect of aligning these cost periods to the retail tariff alignment period. Comments received to the

consultation paper are summarised in Section 4 with the Regulatory Authorities' response. Next steps are identified in Section 5.

### **3 Decision on Retail Tariff Alignment Period**

#### ***Regulatory Authorities' Decision***

In consideration of comments received the Regulatory Authorities have decided to align the PES retail tariff period in both regulatory jurisdictions to a **1<sup>st</sup> Oct to 30<sup>th</sup> Sept** period.

#### ***Basis of decision***

This option allows for accurate forecasting of SMP or wholesale costs due to increased proximity of tariff period start date (1st October) to winter period when prices are most uncertain. This has the important advantage of minimising the need for, or the magnitude of, k-factors thereby aiding the development of retail competition in both jurisdictions. A secondary advantage of a 1<sup>st</sup> Oct to 30<sup>th</sup> Sept period is its alignment with the gas year. Although this is not a significant advantage, it nevertheless is likely to aid suppliers by allowing them to fix retail prices in line with gas purchase arrangements or hedges around such arrangements.

#### ***Transition Retail Tariff Period from 1st Nov 2007***

In order to align with a 1<sup>st</sup> Oct – 30<sup>th</sup> Sept period, in both Ireland and Northern Ireland an 11-month PES retail tariff (1<sup>st</sup> Nov 07 to 30<sup>th</sup> Sept. 08) will be initially set and a 12-month retail tariff thereafter.

#### ***Implications for All-Island Project and non-AIP Deliverables***

The following list identifies a number of implications for both AIP and non-AIP deliverables in respect of aligning the PES tariff period to '1<sup>st</sup> October – 30<sup>th</sup> September':

- **Directed Contracts**

The initial Directed Contracts will run for a period of 11 months (1<sup>st</sup> Nov 07 to 30<sup>th</sup> Sept 08). Thereafter, from 1<sup>st</sup> Oct 08, Directed Contracts to run for 12-month periods.

- **IRL PSO tariff**

PSO levy of zero for 1<sup>st</sup> Nov 07 to 31<sup>st</sup> Dec 07 is already determined. PSO levy to be formulated over an interim 9 month recovery period, 1<sup>st</sup> Jan 08 to 30<sup>th</sup> Sept 08, and then an annual PSO recovery period based on 1<sup>st</sup> October start date.

- **NI PSO tariff**

In Northern Ireland the PSO levy will be set initially for an 11 month period from 1 November 2007 until 30 September 2008, and then an annual PSO will be set starting from 1 October 2008.

- **IRL Transmission tariffs**

IRL Demand TUoS tariffs to be formulated on the basis of an interim 11 month period (1<sup>st</sup> Nov 07 – 30<sup>th</sup> Sept 08) and then an annual tariff based on 1<sup>st</sup> October start date

IRL Generator TUoS tariffs will be determined for the period 1<sup>st</sup> Nov 07 to 31<sup>st</sup> Dec 07. All-Island Generator TUoS tariffs to be formulated on the basis of an interim 9 month period (1<sup>st</sup> Jan 08 – 30<sup>th</sup> Sept 08) and then an annual tariff based on 1<sup>st</sup> October start date.

- **IRL Distribution tariffs**

IRL DUoS tariffs to be formulated on the basis of an interim 11 month period (1<sup>st</sup> Nov 07 – 30<sup>th</sup> Sept 08) and then an annual tariff based on 1<sup>st</sup> October start date.

- **NI Transmission and Distribution tariffs**

All-Island Generator TUoS tariffs to be formulated on the basis of an interim 9 month period (1<sup>st</sup> Jan 08 – 30<sup>th</sup> Sept 08) and then an annual tariff based on 1<sup>st</sup> October start date.

In NI, a combined tariff for transmission and distribution has already been approved through to 31 March 2008. This will need to be amended as of 1 November 2007 such that charges for transmission are levied by SONI and for distribution by NIE T&D. It is proposed thus that:

- (a) a distribution tariff will be set that runs from 1 November 2007 to 30 September 2008;
- (b) a transmission tariff for demand will be set that also runs from 1 November 2007 to 30 September 2008;
- (c) a transmission tariff for generation will be set that also runs from 1 November 2007 to 31 December 2007, with the All-Island generator TUoS tariffs applying from 1 January 2008 to 30 September 2008

All UoS tariffs will thereafter be determined annually for the period 1 October to 30 September, starting on 1 October 2008

- **NI SSS Tariffs**

SSS Tariffs in Northern Ireland will run for an initial 11 month period (1 Nov 07 – 30 Sept 08) and annually thereafter. However these charges will become part of the NI Demand TUoS from 1<sup>st</sup> November 2007.

- **SMO tariffs**

Proposed SMO charges (market establishment and operational costs etc.) and Imperfections charges (constraints costs) charged by the SMO to be formulated on the basis of an interim 11-month period (1<sup>st</sup> Nov 07 – 30<sup>th</sup> Sept 08) and then an annual tariff based on 1<sup>st</sup> October start date.

### **SEM Trading and Settlement Code**

For clarity, determining the interim retail tariff period in each jurisdiction, i.e., from the commencement of SEM to the start of the tariff year alignment period decision (i.e., from 1<sup>st</sup> Nov 07 to 30<sup>th</sup> Sept 08), will still be feasible within the current calendar-year defined timescales of the SEM Trading and Settlement Code. For further clarity specifically on the Capacity Payment Mechanism and Transmission Loss Adjustment factors (TLAF) please see section 4.1 and 4.3 respectively of this paper. For retail PES tariffs set from the 1<sup>st</sup> Oct 2008, amending the calendar-year timescales within the Code to exactly align with the 1<sup>st</sup> Oct – 30<sup>th</sup> Sept tariff alignment period may be considered later this year.

***Time periods of underlying cost components at start of SEM (transition periods):***

	IRL	NI
<b>PES retail tariff period (at SEM start date)</b>	1st Nov 07 – 30th Sept 08	1 Nov 07 – 30 Sept 08
<b>Supply Tariff Cost Components</b>	<b>Underlying Cost Component Period (as at SEM start date)</b>	
	IRL	NI
<b>Demand TUoS</b>	1st Nov 07 – 30th Sept 08	1st Nov 07 – 30th Sept 08
<b>DUoS</b>	1st Nov 07 – 30th Sept 08	1st Nov 07 – 30th Sept 08
<b>Directed Contracts &amp; Market Contracts</b>	1 <sup>st</sup> Nov 07 – 30th Sept 08	1st Nov 07 – 30th Sept 08
<b>Capacity Charges</b>	1st Nov 07 – 30th Sept 08	1st Nov 07 – 30th Sept 08



<b>SMO charges</b>	<b>1st Nov 07 – 30th Sept 08</b>	<b>1st Nov 07 – 30th Sept 08</b>
<b>PSO contracts</b>	<b>1st Nov 07 – 30th Sept 08</b> 1 <sup>st</sup> Nov 07 – 31st Dec 07 2007 PSO already determined (€ zero) & 1st Jan 08 – 30th Sept 08 PSO recovery period	<b>1st Nov 07 – 30th Sept 08</b>
<b>Supply Overheads</b>	<b>1st Nov 07 – 30th Sept 08</b>	<b>1st Nov 07 – 30th Sept 08</b>

For the period beginning 1<sup>st</sup> Oct 2008, all PES Retail tariff periods and underlying cost components periods to align with '1<sup>st</sup> Oct – 30<sup>th</sup> Sep' period.

## **4 Comments Received and Responses**

This section summarises comments received to the consultation paper and sets out the Regulatory Authorities' response.

### **4.1 Capacity Mechanism Payment 'Year'**

#### **Respondents Comments**

A number of respondents expressed concern that the Capacity Payment year (assumed to be a calendar year) may be "hard wired" into the SEM market system and thus will be out of line with 1<sup>st</sup> Oct – 30<sup>th</sup> Sept. This will create commercial risks; the setting of **capacity values** will be important for suppliers in assessing forward prices and thus tariffs.

#### **Regulatory Authorities' Response**

For clarity, the Capacity Payments and Mechanism will be based on a calendar year. However, the capacity payments will also be determined on a monthly basis. Therefore, setting PES retail tariffs for a period that straddles two calendar years will involve reflecting the appropriate monthly capacity payment values that correspond to the months of the particular retail tariff period. For example, initially, the IRL PES retail tariff period will set for an interim 11-month period, from 1<sup>st</sup> Nov 2007 to 30<sup>th</sup> Sept 2008. This tariff will reflect the 11 monthly capacity payment 'pots' or values covering this period (i.e., a capacity payment for each of the last two months of 2007 (Nov & Dec) and the first 9 months of 2008 (Jan – Sept)). Similarly, for 12-month PES tariffs set from 1<sup>st</sup> Oct 2008, the capacity values reflected in these tariffs will correspond to the monthly capacity payments for the last 3 months of 2008 and first 9 months of 2009.

### **4.2 TUoS charges**

#### **Respondents Comments**

Two Respondents commented that the TUoS charges are not aligned with the proposed retail alignment period of 1<sup>st</sup> Oct – 30<sup>th</sup> Sep. One of these Respondents also sought 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.

### **Regulatory Authorities' Response**

In respect of aligning TUoS tariffs to the proposed PES retail alignment period, in Ireland, as outlined above in Section 3 of this paper, IRL (Demand) TUoS tariffs will be formulated on the basis of an interim 11 month period (1<sup>st</sup> Nov 07 – 30<sup>th</sup> Sept 08). Thereafter, annual IRL TUoS (Demand) tariffs will be set on 1<sup>st</sup> October start date to align with the 1<sup>st</sup> Oct – 30<sup>th</sup> Sept. PES retail period. Similarly, in Northern Ireland, (Demand) TUoS and DUoS tariffs will initially be set for an 11 month period (1 Nov 07 – 30 Sept 08) and annually thereafter.

With regard to changing the TUoS revenue year, for clarity, the TUoS tariff periods in each jurisdiction will reflect the revenue requirement corresponding to the same period. Thus, the 'revenue' year underlying these tariffs will also 'shift' to align with the tariff period.

## **4.3 Transmission Loss Adjustment Factor (TLAF)**

### **Respondents Comments**

One Respondent commented that the setting of TLAFs have a significant bearing on market participant bid prices and thus the timetable for setting them could have bearing on the accuracy of tariff setting. The Respondent sought further clarification on the timetable for the TLAFs in the SEM.

### **Regulatory Authorities' Response**

The TLAFs for both Nov and Dec 2007 and 2008 will be determined before the 1<sup>st</sup> Nov 07 and therefore will facilitate PES retail tariffs to be set from 1<sup>st</sup> Nov 07. To clarify, draft all-island TLAFs have already been published to apply from 1 November 2007 to 31 December 2007. A decision on these TLAFs will be made shortly. All-island TLAFs will then be determined for the period 1 January 2008 to 30 September 2008, and thereafter annually for the period 1 October to 30 September, starting on 1 October 2008.

## **4.4 Billing impact to Northern Ireland customers**

### **Respondents Comments**

An Oct-Sept PES retail tariff period would present, one Respondent highlighted, billing issues to NI customers due to (a) adverse reaction from quarterly billed customers (c 600k) in NI who would feel the first impact of annual tariff increases in their January bills (high

consumption period) and (b) at present NIE Supply in Northern Ireland apply a price change from the next actual meter reading after a price change to avoid the use of 'estimated reads'.

### **Regulatory Authorities' Response**

OFREG accepts that the first impact of tariff changes may be in the winter period however across a tariff year customers will pay the same amount for their consumption regardless of the dates when the new tariffs are introduced. This impact would not occur if tariffs were to fall as was the case this year.

## **4.5 Tariff Period out of line with financial & accounting year**

### **Respondents Comments**

One Respondent pointed to the complexity of calculating k-factor under an 'Oct-Sep' tariff period as current method is based on regulatory accounts which are based on calendar-year financial accounts. The same Respondent also voiced concern over the requirement to have calendar-year based tariff cost inputs (TUoS, DUoS etc.) available and transposed in time to develop PES tariffs.

### **Regulatory Authorities' Response**

The Regulatory Authorities recognise that there will be extra complexity involved in aligning both the PES tariff and underlying cost component periods to a period that is out of line with existing financial or accounting years. However, it has not been indicated to date to the Regulatory Authorities that transposing calendar-based, or otherwise, PES tariff cost components will be an insurmountable issue for retail tariff setting for 1<sup>st</sup> Nov 07.

## **4.6 Resetting Directed Contracts**

### **Respondents Comments**

The Apr-Mar tariff alignment period, one Respondent commented, would mean that the initial directed contracts would be set for 5 months. Given the potential for inaccuracy in setting the price of directed contracts (in the absence of any pool price history and participants' actual bidding behaviour) and in the absence of any published plans to benchmark the Plexos modelling against the market clearing engine), there could be merit, the Respondent argued, in having the ability to reset the price of directed contracts after a relatively short

period. Whilst the subscription window for the second set of directed contracts would begin in November 2007, in making their choices, Suppliers would have the benefit of (i) the period of shadow running pre November and (ii) up to 20 business days of experience of “real-life” market prices (under the 5% daily allocation rule).

### **Regulatory Authorities’ Response**

The Regulatory Authorities are confident, given the bidding principles requirements, and the validation of the Plexos model and input data, that a good estimate of the market price can be provided. Further, a commitment to tune the model to market outcomes would undermine the rationale for directed contracts, that is, it may give generators an incentive to raise the price in the tuning period.

## **5 Next Steps**

In Ireland, proposed PES retail tariffs (1<sup>st</sup> Nov 07 – 30<sup>th</sup> Sept 08) will be published by the CER at the end of August 07 with the final determination on PES tariffs to be published at the end of September 07. Proposed and final IRL DUoS, IRL TUoS, IRL PSO levy tariffs will similarly be published in the same time frames.

In Northern Ireland, proposed PES retail tariffs will be published by Ofreg in September 07. Proposed and final Demand TUoS, DUoS and PSO will be published in August 07 and September 07 respectively.

The proposed and final SMO tariffs (1<sup>st</sup> Nov 07 – 30<sup>th</sup> Sept 08) will also be published at the end of August 07 and September 07 respectively. The final all-island TLAFs for the 1<sup>st</sup> Nov 07 – 31<sup>st</sup> Dec 07 are expected to be published in April 07. The proposed and final all-island TLAFs for 1<sup>st</sup> Jan 08 – 30<sup>th</sup> Sept 08 period will be published at the end of August 07 and September 07 respectively. The Capacity Payments for the 2007 and 2008 will be published during May and August 2007 respectively.

The Directed Contracts and other wholesale market related contracts procured by the PES in each jurisdiction are expected to be completed by end of July 2007.