

## **Proposed High-Level Methodology for Calculating the PSO Levy for 2007**

**CER/06/026**

### **Response by Airtricity**

#### **Introduction**

The issue of setting the PSO levy is extremely important as it is the balancing subsidy to PES, paid for by customers of all Suppliers, for the purchase of energy from contracts at prices that are higher than BNE. Thus PES is held indifferent to the level of BNE whereas, as price takers, independent Suppliers must live with the competitive consequences of the decision on their relative values. Although there is a mechanism in place to correct over/under-recovery of PSO levies from year to year, based on collection vs required, this has not so far been used to revise the PSO revenue actually required. Under the SEM, the PSO will continue to be set on the basis of an ex-ante forecast of Pool price, so the actual amount of PSO required will require an ex-post adjustment to correct for forecasting error and this should be addressed when necessary legislative changes are being considered.

For 2007, Airtricity believes that five criteria should form the basis of assessment of the options;

1. does the methodology represent the best practical approximation to reality,
2. does it utilise the best available, or potentially available, market information,
3. it should minimise tariff disturbance,
4. is it consistent with the methodology likely to be used for 2008 and beyond, and
5. is it compliant with the law.

Our comments on the options set out by Commission are based on these criteria

#### **The options**

##### **option 1 – two levies**

This option is certainly the best approximation to reality and will use the best available market information, but it is likely to lead to a mid-year change in levy and therefore to some level of tariff disturbance. However, as energy prices have continued to rise over the last year and as the forward curve shows little softening, the required level of PSO is likely to remain low and any tariff impact consequent on a mid-year price change is therefore also likely to be low. In regard to the future PSO-setting process, option 1 is acceptable since use of an SEM price forecast is likely to be an enduring feature.

As the Consultation recognises, although it complies with the EU Decision, this option does not conform to National law.

##### **option 2 - single-year levy**

In theory this option should offer the best approximation to reality and would also avoid any mid-2007 charge dislocation but, because the timetable requires the PSO to be set before SEM modelling for 2007 has been completed, this option would not utilise the best potentially available market information. Implicitly option 2 utilises a forecast of SEM price and so is likely to be consistent with the future PSO-setting process.

The Commission is concerned that this option does not comply with paragraph 5.10 of the Notification, but it could also be argued that this option is a special case of option 1; with the total PSO revenue for the year being calculated by summing the two levies, based on BNE and the respective market prices applicable to the periods pre- and post SEM.

If any legal adjustments are contemplated to support and amended PSO calculation methodology for 2007, then we believe these should relate to the timetable for publication of the PSO; allowing more time for SEM modelling to be completed and incorporated into the final decision.

### **options 3 & 4 – single-year levies based on SEM or BNE**

Aside from the legal issues recognised in the Consultation, Airtricity believes that both of the options 3 and 4 fail our suggested criteria of representing the best practical approximation to reality and use of the best potentially available, market information.

Notwithstanding ease of implementation or otherwise, we consider that the non-representative nature of these options should rule them both out of further consideration.

### **fuel price variation**

In our response to CER/06/022, we indicated that Airtricity did not favour a fuel price variation component in PES tariffs for 2007, on the basis of the complexity this would introduce in the short period prior to introduction of the SEM. Similarly for calculation of the PSO applicable to the first half of 2007, we consider that the additional complexity of a fuel price variation adjustment is not warranted.

## **Discussion**

On the basis of the foregoing, we believe that the chosen option should be either option 1 or option 2. We believe that option 2 is preferable because it would hold off any change in PSO charge until reconciliation in the subsequent year. In response to the earlier consultation, we indicated that we did not favour an implementation solution for tariffs if it involves an explicit mid-year adjustment, as this could lead the SEM to be blamed for underlying energy cost issues; decimalisation and Euro introduction being similar scenarios. Any adverse change that, in retrospect, was found to be unnecessary or adjusted in the wrong direction would compound this situation.

The key distinguishing issue between these two options relates to the availability of SEM forecast results and the timetable requirements of SI 217 of 2002; a change to this could be delivered.

## **Conclusion**

Airtricity believes that, with a timetable change to the requirements of SI 217 of 2002, the Commission could deliver a fixed PSO levy that would apply for the whole of 2007. As the Notification allows for adjustment of the required levy amount as well as correction of any over/under-recovery, any error in setting the PSO could be remedied in subsequent levy years. The advantage of a single levy for 2007 outweighs any supposed benefit from a supposedly more accurate, two-levy approach, when both will be subject to subsequent correction and the latter carries the additional risk of a mid-year change causing adverse customer comment. The only reason for selecting option 1 would be based on a belief that the mid year tariff and PSO changes would act in opposition to each other and result in more stable headline prices.