Viridian Power and Energy’s Response to ESB PES Tariffs and the Transition to the SEM – Report on the Consultation and Draft Decision Paper

Executive Summary

The decisions on how to structure tariffs for 2007 depends on how the CER decide to allow the electricity market in Ireland to reflect current fuel costs and whether to facilitate an immediate increase in tariffs in 2006. The general European trend for significant tariff increases this year has been driven by the fundamental movements in international fuel prices, a factor the CER rightly recognises in the recent top-up report as a primary determinant of wholesale prices. VP&E appreciate that the CER could not have anticipated the large increase in fuel prices at the time the tariff for 2006 was set in 2005. Increasing the tariff this year, in response to the unanticipated large increase in fuel prices, would allow a more incremental approach, rather than exposing customers to a large shock.

We understand that CER intend to calculate tariffs in the first half of 2007 on an average cost basis. It is crucial that any tariffs, for this or other periods, reflect the costs faced by gas fired generators.

We accept that the CER approach for the second half of 2007 appears more consistent with fundamental economic theory, ie on a marginal cost basis. It does however require a very accurate projection of underlying pool prices, at an early stage. To the extent that the CER decide to adopt a mid-year tariff change in 2007, then it will be critical that this accurately mirrors the underlying costs impacting on price setting generators.

VP&E would welcome a fuel price variation clause, but caution that it would require a careful approach to implementation, should be fully transparent to customers and easily hedgible. Given that the majority of price setting plant are run on gas, and that a large liquid market is available for this fuel, this should be the basis for a fuel variation clause.

The PSO timetable should closely track the tariff timetable for hedging purposes.

VP&E are encouraged that the CER are considering removing tariffs for large customers, and we would support the Commission in doing this.
Tariff to Reflect ROI Generation Costs for First Half of 2007

VPE are most concerned that if the BNE is to be used in setting prices for contracts that the PES hold, then it is important that an accurate BNE assessment is used reflecting prevailing gas forward prices at the time of setting the BNE. To the extent that CER assume that a BNE is going to hedge fuel prices, this assumption must be clearly communicated to the market in sufficient time to allow market participants to take similar action.

Tariff for Second Half of 2007 Based on Anticipated Pool Prices

We do not understand what is meant by:

“Tariffs for the second period of 2007 will be calculated on the basis of PES third party contracts, residual purchases from the pool and other market related payments”.

The CER and NIAER are in the process of designing a pool-based market. How can customer prices be based upon anything other than an expectation of pool prices? Any other approach would negate the impact of the pool and call into question the entire process the CER and NIAER have embarked upon.

On this basis why is the tariff for the second half of 2007 to be calculated in Q3 and Q4 2006. If the tariff, as the market expects it to be, is based upon an expectation of pool prices the closer the calculation is to the second half of the 2007 tariff the greater the chance of it being accurate. This decision does not have to be made until well into 2007. This is particularly important if the Regulatory Authorities decide to align tariffs with Northern Ireland, given the possible extension into 2008.

Fuel Price Variation Clause

VP&E would welcome a fuel price variation clause if carefully implemented. There are three aspects to this:

1. The fuel must vary from a reasonable base; it will not work if the base is not anchored to market fuel prices
2. It has to be transparent and easily explainable to customers
3. It has to be hedgible

The previous fuel variation proposal was based upon a submission from ESB PG who, from the CO5 competition through VIPP and the previous fuel variation, have produced an unworkable and unhedgible formula. We would therefore request that an ESB PG submission is not used as a starting point for any consultation.
PSO Timetable

VPE note that the PSO timetable was issued today for consultation, but we reiterate our ongoing concern that where the CER intends to use BNE as a market reference that prevailing gas forward prices at the time of setting the BNE are used, not some other fuel price assumption.

Removing Tariffs for Large Users

We are encouraged that CER are considering removing tariffs for the LEU sector. This has obvious implications for gas purchasing for 2007 (i.e. customers will want to have a greater input into when the fuel is purchased for their contract) and it would be beneficial if this decision was made earlier rather than later.

Extension of the Second Period

Given the All island aspect of the SEM, consideration of the alignment of the tariff setting timetable in NI and ROI is appropriate at this stage. To this end an extension of the second period from 31 December 2007 to 31 March 2008 would achieve this. This alignment will be difficult to accurately assess in 2008, where this projection is being carried out in 2006. We suggest that this projection would more likely to be correct if carried out later. An alternative approach would be to create a third tariff period, from 31 December 2007 to 31 March 2008, and this would allow the tariff to be set closer to the time, but will increase the level of change for customers. VPE look forward to further discussions on this issue.