ESB PG response on 2007 tariffs CER 06/022

Summary

ESB PG welcomes the opportunity to comment on the draft decision on 2007 tariffs. ESB PG remains committed to the timetable for introducing the new Single Electricity Market (SEM). Our previous submission still reflects our view that the best practicable option is to use a single tariff for 2007 and introduce the SEM from July 2007 on an extended market trialling basis. This will allow parties the best mix of price certainty and market familiarisation.

As an alternative the 2007 tariff process should have a built-in mechanism to allow for a later implementation of SEM for live trading. In the event that all the processes needed were not ready and robustly tested by March 2007 then a decision to extend the tariff to all 2007 could be easily implemented.

The current CER proposal for a new Option E has significant implementation difficulties. These are acknowledged by CER in section 3.4 of its draft decision. The proposal to include fuel-indexation will require significant consultation, resources and time. The justification for having indexation before SEM but not after SEM is not explored. The issue of k-factors is also not discussed. These are fundamental risk-management issues and should be addressed before any commitment to tariffs is made.

ESB PG would welcome the views of the regulators on the timetable for tariff setting in NI. A co-ordinated approach at this early stage would enhance market confidence.

Discussion of CER option E

The CER gives three reasons for choosing this new option.

1. The SEM start-date is July 2007;
2. The realities of the tariff timetable and the availability of required information;
3. The need for tariffs to be reflective of underlying market conditions;

For these reasons they have chosen option D as the basis for the new option E. The new option has the following new features;

4. Fuel Cost Variation (FCV), consulted on during summer 2006
5. Potential to extend the tariff beyond 2007 to align with NI tariff timetable
Taking each of these five points in turn;

1. **SEM start-date**

CER have used robustness to SEM slippage an assessment criterion of for all options. Based on this criterion the option E does not score well. Option E would need to be amended to include a mechanism to cope with slippage.

2. **The realities of the tariff timetable and the availability of required information**

Because of the large volume of work in assessing all the factors that make-up an annual tariff submission CER must start work on the tariff at least nine months before it is to take effect. The first ESB submission to the tariff timetable is the global technical assumptions on 31st March. All the financial data must be prepared by May of each year. Then CER commence the detailed assessment of the submissions before a tariff is decided by CER in September.

The information on the costs and revenues in SEM will not be ready before October 2006. The information required will include the contract details, pool prices and capacity payments. This means that a tariff would probably be finalised in April 2007 to be applied from July 2007. However the market value of contracts and the market income from pool and capacity may not be known with sufficient certainty at this stage. The rules, testing and modelling will be at a very early stage in October. Robust modelling and credible prices forecasts will most likely take several months. This creates the real possibility that tariffs for the second half of 2007 will not be ready in sufficient time.

3. **The need for tariffs to be reflective of underlying market conditions**

ESB PG strongly believes that tariffs should reflect underlying costs. The misalignment between an annual tariff and the seasonal cost may lead to unexpected and undesirable consequences that would impact on ESB PG recovering the regulated allowed sum of monies.
4. **Fuel Cost Variation (FCV), consulted on during summer 2006**

Designing and getting agreement on a suitable fuel cost variation to published tariffs is a considerable task. There is a significant challenge involved to convince both participants and final customers that monthly price changes are an advantage. Undertaking this process would divert resources away from SEM implementation and could lead to knock-on delays in the programme to achieve the new market.

5. **Potential to extend the tariff beyond 2007 to align with NI tariff timetable**

As stated in point 3 above ESB PG believes that tariffs should be cost-reflective. Extending the tariffs into a new year will mean that the tariffs no longer reflect the underlying costs.

It is unacceptable to ESB PG that the tariffs set for 2007 should extend into 2008. It is also unrealistic to expect that ESB PG’s costs will remain at the same level in 2008 as 2007 thus possibly exposing ESB PG to the risk of significant under recovery.

The costs for 2008 will be different to those in 2007 and, to recover these, the tariffs should reflect the expected costs. The risk of not recovering costs would be unacceptable to ESB PG.

**ESB PG proposed amendments to CER option E**

ESB PG’s preferred option is to use its alternative option of a single 2007 tariff and an extended trialling period for SEM from July to December 2007. In the absence of that option we recommend the following modifications to CER’s new option E.

**Mechanism to extend 2007 tariff to all 2007**

We propose that there is a cut-off date in 2007 at which time a decision is made to extend the 2007 tariffs past July 2007. Any adjustments or k-factors will be decided in advance.

**K-factors instead of Fuel Cost Variation**

Due the uncertainties of the new market there are likely to be increased variations between the estimated costs used to set the tariffs and the actual costs. Fuel will not be the only variable. Therefore FCV may not solve all the problems.
No extension of tariffs into 2008

The tariff must reflect the underlying costs. Extending the tariff into 2008 based on 2007 costs will distort the market.