



**Airtricity Response to**

**Consultation on Proposed Changes to the Retail Tariff  
Structure by ESB PES**

# Consultation on Proposed Changes to the Retail Tariff Structure by ESB PES

## 1. Introduction

In 2004, the Commission published a consultation on alternative tariff structures<sup>1</sup>. In that consultation, the Commission expressed the view that,

*“the tariff charged by the PES tariff will set the benchmark against which other suppliers must compete.”*

In addition to seeking protection of the interests of final customers when setting tariffs, the Commission must also have regard inter alia, to the need both to promote competition and to secure that licence holders are able to finance their licensed activities and it must do so in a way that does not unfairly discriminate between holders of licences.

In reviewing the tariff changes proposed by ESB Customer Supply, we have therefore considered the extent to which the changes themselves, or the process of their introduction, may be discriminatory, undermine competition, or act against the interests of customers. No price levels are proposed for changes proposed for the tariff sector and accordingly we make no comment on price levels.

## 2. Background

Prior to November 2007, ESB PES tariffs reflected the transfer pricing arrangements between the PES and PowerGen divisions of the ESB and a supply cost allocation methodology agreed with the Commission. With the introduction of the Single Electricity Market, PES is much more exposed to the time of day cost signals to which independent suppliers have always been subjected and there is therefore a reasonable rationale for making some structural tariff changes.

In the past the different basis on which market liabilities were calculated meant that what was cost-reflective for the PES was not necessarily so for independent suppliers. For example CER/04/239 described how cost-reflectivity could be over-ruled by other considerations.

*“The tariff-setting step divides the allocated costs by class billing determinants (kWh, billing demand, number of customers, etc.) to determine tariff charges. **These charges are often adjusted because of bill impacts and other policy decisions.**”* [emphasis added by Airtricity]

One example of price distortion by policy adjustment was highlighted.

*“While the day rates of the day/night domestic DUoS tariffs (DG1 and DG2) are higher than the unrestricted 24-hour domestic rate, the PES domestic day rates are the same as the 24-hour rate. The equivalent night rate for PES domestics is a fraction of the day rate.”*

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<sup>1</sup> Electricity Tariff Structure Review: Alternative Tariff Structures, 1 July 2004, CER/04/239

Matching of the 24-hour rate with the day rate of day/night tariffs has also been the case for business customers, on and off, over the years. Nevertheless the fact that regulated PES prices are the market benchmark means that independent suppliers have historically had to acquire customers and operate within the competitive constraints imposed by PES bill impacts, policy decisions and the tilted playing field of generation transfer pricing.

The actual implementation of tariff changes that reflect SEM market pricing is as important as the changes themselves. Historic tariffing decisions have constrained the development of competition, rather than supporting customer acquisitions across all market sectors and customer sizes. For this reason many customers have been unable to benefit from competition. For example, in relation to the proposed marginal costing approach to tariff structuring, the 2004 consultation questioned whether,

*“the differentiation between Domestic and General Purpose customers ... may be reduced if the costs of serving these customers are similar.”*

Rapid elimination of historic pricing distortions may be desirable if viewed solely from the perspective of those customers’ benefitting from the change, but other customers will have to pay more if total PES revenue is to remain unaffected. PES itself may well be indifferent to the effect of changes, since it has the largest customer base in the market and its revenue is guaranteed. However the financial impact on independent suppliers may be severe unless tariff distortions are transitioned-out over one or two years, to allow them profitably to address a more balance cross-section of the market.

### **3. PES tariff proposals**

#### **3.1 LV Seasonal Time of Day (STOD) Tariff for LVMD Customers and LV LLF Customers with Quarter Hourly metering**

Prior to the current tariff year, we made strong representations against the market-distorting implementation of the “Existing Customers” LV MD tariff and we continue to argue that k-factors undermine competition and should be permanently eliminated. The following comments assume that such distortions will not arise in future.

While it is unclear whether the SToD tariff is intended to be the sole option for QH-metered PES customers currently on the Maximum Demand tariff, we believe that this market sector is potentially competitive. It is therefore likely that alternative pricing offers will be available to customers who do not wish to avail of the PES pricing structure. Because it provides a non-bureaucratic means of signalling the need to reduce demand at times of system peak and doesn’t penalise customers for a single excessive demand at such times, this structure benefits customers.

In principle therefore, we support the proposed introduction of a 7-band SToD. However an outstanding issue concerns tariffs for LV MD NQH customers. We assume that there are no plans for meters to be changed to facilitate a compulsory migration to the proposed SToD tariff and that the existing Maximum Demand tariff structure will continue to be offered to this customer group.

#### **3.2 Amend the structure of the GP tariff so as to remove the 2-block structure that applies to the day energy rates in this tariff.**

We agree that a flat tariff structure could be seen as being more cost-reflective but, as the 2004 tariff consultation pointed out,

*“a declining or increasing energy block may be used to reconcile marginal cost revenues with the revenue requirement as such a block would not distort the marginal price signal charged to customers.”*

Although the apparent incentive of the current structure may appear to incentivise higher levels of consumption, the Commission has previously confirmed that a block structure is not inconsistent with cost-reflective pricing.

Of greater concern would be the impact of an instantaneous change from the current block to the proposed flat structure. One anomaly of the current structure is that it concentrates gross margin recovery in the first block, with follow-on units being closer to marginal cost. In order to persuade customers to switch supplier they have to be offered a material saving on their current electricity cost. However, as customer size increases beyond the first block, the average unit price falls and it becomes progressively more difficult for independent suppliers to offer meaningful savings without losing the ability to recover their costs.

The order of magnitude in scale and sector coverage of the PES business means that tariffs designed to recover its allowed revenue will be relatively insensitive to the sectors in which recovery occurs. Together with the unique revenue guarantee afforded to PES and lack of transparency/forecastability in the revenue recovery allocation process, independent suppliers will always face considerable supply-cost risk at the margin of profitable customer size. Therefore, while on average it may theoretically be the case that,

*“Under Commission policy, PES is allowed a profit margin to mirror the profits required by other suppliers to make them willing to enter the electricity supply business in Ireland.”*

in reality independent suppliers must focus on specific customer sectors, where the net margin is higher than average, in order to recover their acquisition costs, offer the necessary discount and manage the k-factor risk of competing with PES.

Unless the forthcoming review ***eliminates the k-factor as a barrier to competition and any change to a single rate for the General Purpose tariff is phased in over two years – by moving the threshold for Block 2 progressively to 100 MWh and then 200 MWh per annum, while reducing the Block 1 premium*** – then the Commission will have failed both to,

- have regard to the need to promote competition, and
- secure that the independent supplier class of licence holders is able to finance their licensed activities.

Due to the disproportionate impact of the proposed immediate tariff change implementation on independent suppliers, compared with that on the PES licence holder for whom it is materially more benign than for any other supplier, the proposed change will be discriminatory unless phased in. Given that there are still two more years before the next PES revenue review, any PES loss or gain resulting from the change will be recovered from, or returned to, other customers. The overall impact of the charging policy on customers will therefore be neutral and independent of the chosen

implementation strategy. The Commission’s previously published tariff review concluded that a block tariff structure is not necessarily non cost-reflective.

We therefore conclude that it is the range of impacts on competitive suppliers in the market that is most relevant to a decision on this proposal. If phased in over the remainder of the current PES revenue settlement, the proposed change would be less open to challenge.

Our comments on the Nightsaver tariff (see Section 3.5 below) reflect the same concerns.

### **3.3 PPPT & LEU’s**

Based on the customer impact analysis presented by ESB, we agree with the principle of this proposal that LEU customers should be allowed to benefit from their individual capability to manage their own load. We also believe that there are no competition issues, as independent suppliers can offer similar, or alternative contract structures and can provide other differentiated services.

### **3.4 Metered Public Lighting Tariff**

The proposal to charge metered public lighting on the basis of the General Purpose tariff may be appropriate, to bring the treatment of this small group of customers into line with that applied to other, similar customers. However it seems counter-intuitive to argue the change on the basis that the charges have already been brought into alignment.

Other changes in this consultation have been proposed on the basis that they introduce greater cost reflectivity. In this case we believe that a more important issue to raise should have been why the load shape of the General Purpose tariff is more applicable for the settlement of a lighting demand, that one that has been derived from the 24 hr public lighting profile.

While we agree that these 28 customers should be treated in the same way as other, similar customers, we do not find the argument in support of this proposed change has any merit. In view of the impact that the treatment of one supplier’s load has on all other suppliers in the market – particularly if global aggregation is introduced – we believe that all public lighting loads should be aggregated on the basis of a profile derived from the unmetered settlement profile. This proposal should be reworked, to produce a metered lighting tariff based on the aggregation principles established for the retail market design.

### **3.5 Nightsaver Tariff**

ESB PES has only proposed that the Nightsaver tariff should be reviewed “in the light of experience” of amendments made last year. We understand that the “amendments” involved postponing the PES proposal immediately to eliminate the then existing block structure for Day kWh and instead to phase in the proposal.

It is Airtricity’s position that the arguments for phasing-in such changes to the Nightsaver tariff are the same as those put forward above for the General Purpose tariff; to move the threshold for Block 2 progressively to 100 MWh and then 200 MWh per annum while reducing the Block 1 premium.

Market participants should be provided with much greater clarity as to the exact nature of the proposed review.

### **3.6 Green / Renewable Tariff**

Introduction of a Green / Renewable Tariff by ESB PES is a logical step in the light of customers' concerns about climate change and the environment generally. However it is essential that any such tariff should be commercially based and not market distorting. In this regard, the energy element of the tariff must be fully paid for by PES and not be supported by PSO. Nor should the energy be allocated from the cheapest AER contracts; it should reflect the current and prospective costs of providing electricity from renewable sources.

We look forward to the provision of further details on the range of tariffs to be offered, sourcing of the renewable energy, the pricing methodology and arrangements to prevent discrimination against PSO payers

### **3.7 Evaluation of status of MV & 38kV connected customers on the GP tariff**

We are surprised, given the Commission's commitment to cost-reflective pricing, that this group of customers should have been allocated to any tariff on the basis that the correct tariff "had high electricity prices". Tariffs are supposed to provide customers with cost signals that encourage them to modify their consumption pattern to the overall benefit of the system. We therefore support the proposal that these customers be moved to a proper charging arrangement that eliminates the historic cross-subsidy.

Based on the information presented, we agree that it would be appropriate for these customers to be placed on the PPPT tariff. In the interests of transparency, we would also welcome an assurance from the Commission that no other special deals remain in place for favoured customers or customer groups.