Respondent – NIE Energy Supply

NIE Energy Supply (NIEES) has reviewed the consultation paper on the ESB PES Proposal for a Seasonal Time of Day (STOD) tariff for Large Energy Users and we have detailed comments on a number of specific areas below:

NIEES is very supportive of a move to offer more choice to customers, allowing them the option to fix their energy costs. The consultation paper however does not clarify how ESB CS will hedge the associated wholesale costs. As the annual Directed, Non Directed and PSO auction rounds have now finished and given that there is currently very little liquidity in the contract market, presumably any CfDs will be obtained bilaterally. Where these CfDs are sourced from an independent third party, one would anticipate that they are priced on an arms length basis. However, if they are sourced from ESB PG, it will be vitally important that they are seen to be priced on a transparent basis, in line with the premiums over prevailing fuel prices seen in the NDC process (where contracts were available to other bidders).

The statement in the consultation paper that the "STOD tariff will be offered in conjunction with the PPPT tariff to LEU customers with PES from the 1st October 2008 in order to alleviate the effect of the fuel price increases on LEU customers" appears a little incongruous with the subsequent point made in the paper, stating that "the tariff will be fully cost reflective of the forward prices in the SEM". As such, we would anticipate that the STOD tariff should reflect the substantial increases in fuel prices already seen from last year, but would protect against any further cost increases in the event that world fuel prices rise further.

Respondent – EirGrid

Dear Elizabeth

EirGrid welcomes the opportunity to comment on the Commission's consultation paper on further Seasonal Time of Day (STOD) tariffs for Large Energy Users (LEUs). EirGrid is generally supportive of the concept of STOD tariffing and the implementation of pricing which more accurately reflects the real costs of consumption.

EirGrid believes an appropriate tariff structure which may enable enhancements in security of supply, by reducing or flattening the system peak, without a significant social impact, is generally desirable. However, for such measures to be effective they require close monitoring and the ability to modify the tariffs should unexpected results materialise. EirGrid continues to be willing to play a role in assisting the Commission and others in such tariff design to ensure that the transmission system is capable of meeting the demands which may be placed upon it as a result.

EirGrid believes that the price differentials proposed in the STOD tariffs outlined are in line with historical SMP profiles and are reasonable. In general simple pricing regimes are likely to give the best consistent signal to large consumers to manage demand appropriately and to enable customers to achieve greater levels of demand management and to foster demand flexibility. Going forward, and depending upon the analysis of the effect of the STOD tariffs and degree of consumer acceptance, it may however be appropriate to move to more flexible tariffing approaches such as the Pass Through Pool Price (PTPP).

As the Commission is aware EirGrid has itself, at the Commission's behest, been involved in a number of Demand Side Management schemes such as WPDRS and Powersave which have delivered significant demand responsiveness, especially at system peak. EirGrid believes there continues to be a value in such administered schemes and that any Time of Use tariffs will act as a compliment to the mechanisms already in place. EirGrid is aware the Regulatory Authorities have undertaken to examine the whole issue of Demand Side Management whether through tariffing, administered schemes or the market and EirGrid looks forward to working with the Authorities in the development of this review.

Yours sincerely

Respondent – Irish Estates Management

Dear Ms Farrelly,

We refer to the Commission's consultation paper CER/08/144 in respect of the ESB PES proposal to introduce a STOD tariff for large energy users from 1 October 2008. We would make the following submission and request that it be given due consideration prior to making a decision.

In principle, we support the introduction of a seasonal time of day tariff for large energy users which is cost reflective of forward prices in the SEM.

The reasons for this are as follows:

- It allows LEUs to determine their costs for a twelve-month period and budget for these, thus bringing a level of stability which does not presently exist. (This assumes that the tariff is actually implemented for the twelve-month period and not amended part-way through).

- It sets a benchmark against which other suppliers' offers may be measured.

- It is cost-reflective and transparent to both supplier and user.

- It allows users to control their costs and it provides straightforward and relatively simple signals to users that allows them easily control their consumption profile to the benefit of the user, the supplier and the operation of the network in general.

We do not support the restriction of the STOD tariff, or indeed any LEU tariff, to existing ESB CS customers. We would request that this tariff, along with the individual PPPT and group PPPT tariffs be open to all LEUs, without restriction.

The reasons for this are as follows:

- The restriction was imposed in September 2006 following the assertion that there is a sufficient level of generation capacity in the upper end of the market to allow all customers to receive offers of a competitively priced supply of electricity. This of itself will not ensure that all customers do receive such offers. The bulk of an unusually large number of responses to the consultation paper opposed the restriction. The result of a further consultation, some twelve months later, was that, almost unanimously the again relatively large number of respondents remained opposed to the restriction. The sole exception who was in favour of its continuance was an independent producer enjoying close links with an independent supplier.

- The Commission has proposed that the STOD tariff would be fully cost-reflective of forward prices. Therefore there would be no reason for restricting eligibility to the STOD tariff.

- The PPPT tariffs are fully cost-reflective. Again, there is no reason to restrict eligibility to these tariffs.

- The TUoS, DUoS and SEM pass through tariffs are unduly complex. The capacity charges in particular are excessively complex and though they may be cost-reflective they are acutely lacking in transparency. The STOD tariff in particular eliminates these complexities and lack of transparency.

- If the LEU sector of the market is, in fact, sufficiently mature and contestable to satisfy the requirements of LEUs then LEUs will not choose to switch to ESB CS and the effect of the removal of all restrictions will be neutral. In this event no party could reasonably have any objection to the removal of restrictions.

- If, in fact, this particular sector of the market is not sufficiently mature and contestable to satisfy the requirements of LEUs then the restrictions are anti competitive and should not be in place in any event.

- The restrictions are discriminatory.

We trust that the above observations will be taken into consideration prior to a final decision being made.

Yours sincerely

Respondent – ESB Independent Energy

Dear Elizabeth,

I am writing to outline ESB Independent Energy's position regarding ESB Customer Supply's Seasonal Time of Day (STOD) tariff proposal for large energy users (LEU) and CER's Consultation Paper CER/08/144 on same.

ESB Independent Energy is pleased that the proposal contains many of the restrictions necessary to prevent this new STOD tariff from undermining the independent sector of the market. In particular, ESB Independent Energy re-iterates the importance of the following points:

1. This fixed-price tariff option will expire on 30th September 2009 and ESB PES LEU customers who avail of this tariff will then revert back to a pool price pass-through based tariff. It will then be reviewed for the next tariff year and will not become a regular feature of the retail market without a further full consultation.
2. There is a limited window during which ESB PES LEU customers can elect to fix their price prior to 1st October 2008.
3. The fixed-price tariff is limited to existing ESB PES LEU customers and must be undertaken for the full year 1st October 2008 to 30th September 2009.
4. The full cost of a fixed-price tariff including the risk premium inherent in today's forward energy markets is included.

Yours sincerely,

Respondent – Viridian Power & Energy Limited

Dear Elizabeth,

Thank you for the opportunity to comment on the above proposal by ESB PES. VPE, and our supply arm Energia, recognize the importance of this consultation to the continuation of supply competition in the Large Energy User (LEU) market.
VPE is concerned that a number of aspects of the ESB proposals constitute significant departures from standard practice both in the Irish market and in a broader international context. The key issues for us in this consultation are:

1. The rationale for ESB PES moving from a pool pass-through product, as previously decided by the CER, to a fixed price product has not been explained. There has been no analysis on how such a significant change could affect competition and why such a reversal of policy is necessary.

2. The consultation implies that ESB PES has not entered into hedging agreements to mitigate the risk associated with offering fixed price contracts to customers. In the advent of pool price outcomes that differ significantly from the projected prices, it is not clear how such costs would be recovered by ESB PES. We note that an economically rational supplier would add a premium to their costs to allow for the increased risk of selling fixed price unhedged customers contracts. This premium may still, however, be insufficient to protect against the risk of large wholesale price movements.

3. The schedules provided by ESB PES indicate prices that are lower than would be expected by a blended Directed Contract and Non Directed Contract hedges. The schedules are at around a €5/MWh discount to the DC/NDC contract prices. We assume that these prices will be updated to reflect current commodity prices which are significantly higher than when the schedules were generated.

4. We note that ESB PES does not have a licence condition prohibiting them from acting in a predatory manner, even though all other suppliers in the SEM have such a requirement. Such an oversight in the licensing arrangements is particularly unhelpful in a situation where ESB PES are offering customer contracts that are not cost reflective.

Considering in turn each of the issues as set out above we have the following observations:

1. **Change to previously agreed regulatory position**

The Commission acknowledges in this consultation document there is sufficient competition in the LEU sector to warrant removal of retail tariff regulation (pg 6). With that in mind the Commission made a commitment to replace published tariffs in this sector with Pool Price Pass Through (PPPT) arrangements. The commission stated in last year's consultation document (CER/07/120) "***The Commission believes that the further liberalisation of the market arising from the implementation of the SEM means that competition can be better***

facilitated by the PES offering pool price pass through arrangements for those sectors of the supply market where competition is established".

Such an approach was generally endorsed by industry and government bodies such as Forfas[1]. We also note that last year's decision is consistent with the ERGEG position paper 18th July 2007[2] which states "*maintaining regulated end-user energy prices distorts the functioning of the market and jeopardises both security of supply and the efforts to fight climate change*" and also states "*end-user price regulation is one factor which prevents equal access of suppliers to all customers. This has a negative effect on the functioning of the competitive retail markets".*

The Commission also noted in last year's decision that a PPPT would allow customers to actively manage demand to respond to the price signals in the Pool thus improving overall economic efficiency. VPE endorsed this approach last year and agreed with the pro-competition, economic efficiency and resultant environmental benefits that accrued to the Commission's decision last year.

VPE are unaware of any change in the retail market since last year that could lead the Commission to reach a different conclusion this year. While energy prices have risen significantly since last year, they have not changed the underlying competitive dynamic in the market provided that ESB PES is not given special treatment as a result of the high prices.

Contrary to the Commission's decision last year, which was not time limited, it is now proposed to reverse this policy and that a fixed price STOD tariff be offered to LEU customers from 1st October 2008 to 30th September 2009. This clear inconsistency is explained by the need to alleviate the effect of high fuel prices on LEU customers. There is no economic basis why such customers should receive special treatment in a market that is effectively competitive.

A published STOD tariff, as proposed, sends a clear price signal to the market that forms a benchmark price for the whole LEU sector against which all competing products will be judged. If the tariff is not fully cost reflective, accounting for all the costs and risks it entails, it makes it extremely difficult for the competitive market to compete against an unrealistic incumbent tariff. In this event customers will naturally push to switch to the STOD tariff, which will significantly test the regulations preventing this. It would also create considerable unnecessary discontent among customers and serve as a barrier to entry to the PES sector. For all of these reasons it is crucial that ESB PES receive no preferential treatment and that the STOD tariff is fully cost reflective.

2. ESB PES Hedging Strategy for Tariff

In the ESB PES hedging policy statement of the 13th July 2007, it states that: "*ESB will hedge the demand profile of its retail customer base (excluding those on "pool-price pass-through" pricing terms)*". There is a general perception in the market that hedging contracts are no longer available for the time period being considered for the proposed LEU fixed price tariff from the 1st October 2008.

The ESB PES hedging policy statement states that an updated hedging policy statement will be issued on a yearly basis, although none has been published to date in 2008. It is not clear from the consultation how the proposed change to ESB PES LEU tariff arrangements will be consistent with the hedging strategy. It is also difficult to envisage how the proposed tariff arrangements will satisfy the ESB PES licence requirement that in "the discharge of its obligations to engage in economic purchase of electricity and the financial hedging of associated price and volume risk …it shall conduct its business in a manner which is best calculated to: …(b) provide price stability and price certainty for final customers while, at the same time, **reflecting underlying costs in the Single Electricity Market and accommodating underlying price and volume risk where appropriate**…"

Under the T&SC rules, generator participants bear the ultimate risk of unsecured bad debt in the market resulting from supplier default. As such it is more than an academic interest for generators to understand the risk profile of large suppliers in the market.

VPE estimate that the ESB PES LEU customer annual energy consumption to be circa 700GWh. If this electricity was sold to customers at an energy value of €110/MWh, this would equate to an energy annual turnover of €77m. If energy prices were to rise by 30% then the ESB PES costs would rise to €100m while income from customers would be fixed at €77m. This would equate to a €23m loss for ESB PES, which is a high level of loss against an operating profit of €13m[3]. This level of increase may not be unrealistic given the volatility of SEM wholesale prices over the past 10 months.

VPE note that in theory the level of losses that could be sustained by ESB PES, if unhedged, is limited only by the level to which the pool price can rise. The market price is currently capped at €1000/MWh and prices are contingent on fuel and carbon prices in the market and reductions in generator availability. Predictions of fuel and carbon prices are inherently unreliable.
International precedent has shown that unhedged suppliers have a limited lifespan in volatile energy markets[4]. Leading academics, Frank Wolak and Paul Joskow, have specifically identified this problem in relation to suppliers offering fixed price tariffs whilst simultaneously being exposed to unhedged risk against movements in the spot price of wholsesale electricity. They identify that not only could this drive suppliers to the point of insolvency if wholesale prices rise but it also makes it very difficult for competing suppliers to attract customers or for customers to respond to high prices[5]. VPE reiterate however that it would be a major retrograde step for the retail competition if application of a K factor was allowed for ESB PES to recover extra costs resulting from provision of a fixed price unhedged product for LEU customers. Instead, and again consistent with the findings of Joskow and Wolak, the best solution is to make the set the PES regulated tariff based on the half hourly spot price of electricity which could be easily achieved through a Pool Price Pass Through arrangement as originally decided by the Commission.

3. Non cost reflective tariffs

VPE consider a blend of DC and NDC contracts to be a benchmark for hedging against which tariffs can be accurately priced. Our calculations show that the proposed ESB LEU fixed price tariffs are €5/MWh cheaper than DC/NDC blended prices. We note however that commodity prices have significantly increased recently and we assume that the ESB PES tariff prices will be recalculated to reflect the most up-to-date market information.

VPE contend that no supplier without market power, or special regulatory treatment, would price at the proposed price levels and thus the action could be construed as predatory. The test for predatory action is obviously a matter for the commission in the first instance (where this is a licence condition) and more generally also an area for the competition authority. The issue of market pricing in this case is not solely about the price level applied but also the level of risk a supplier with market power is willing to engage in to reduce competition.

The consultation does not consider how the proposed tariffs will impact on ESB PES market power and retail competition and whether the proposed arrangements facilitate the previously stated joint regulatory objective of harmonising retail tariffs across the island of Ireland.

In conclusion VPE assert that the proposed STOD tariff is inconsistent with the Commission's strategy of regulating in a way that maintains a sustainable supply of electricity, protecting the interests of Irish energy customers and the economic and competitive interests of Ireland. VPE suggests that competition in the retail market would be best served if the Commission decision of last year for pool pass-through tariffs for all ESB PES LEU customers was retained from the 1st October 2008. We suggest also that to the extent that the Commission is still minded to implement a fixed price tariff option for ESB PES customers, then this should be subject to a competitive test. We suggest that similar to previous competitive tests set out by the Commission, access to this tariff should be only allowed where offers from independent suppliers are unavailable, ie. they cannot get offers from two independent suppliers and the offers received are uncompetitive.

We trust that the above observations help identify the various issues impacting on your decision on ESB PES tariffs and please feel free to contact us on any aspect of this consultation response.

Best regards,

[1] Electricity Benchmarking Analysis and Policy Priorities, December 2007, page 16.

[2] E07-CPR-10-03

[3] Based on published ESB 2007 accounts. Regulatory accounts for this period are not available, even though 2006 regulatory accounts were signed in April 2007.

[4] See for example "The Big Retail 'Bust' What Will it Take to Get True competition?" by Theresa Flaim in The Electricity Journal, Vol. 13, Issue 2, March 2000.

[5] See http://ksghome.harvard.edu/~.whogan.cbg.Ksg/empr1298.pdf, and www.hks.harvard.edu/hepg/Papers/CALIF.%20-%20Joskow%209-01-UPDATE.pdf,

Respondent – Airtricity

Introduction

Airtricity notes the proposal by ESB PES to introduce a SToD tariff for LEUs. While we seek some clarifications as to the underlying cost analysis used to derive the proposed prices, we support the principle of offering customers pricing arrangements that offer a degree of protection from the volatility of Pool prices, although this appears to reverse the Commission's previous policy on pricing for this market sector[1]. However, to avoid distorting competition, it is essential that the new tariff is fully cost reflective and complies with the approved ESB PES hedging strategy.

Tariff continuity

Tariff policy continuity is an important issue for customers, but the consultation only describes the proposed SToD tariff as being available for the twelve months commencing 1 October 2008, in the context of alleviating, "the effect of the fuel price increases". It is important for the market, that the Commission clarifies whether a SToD option will continue to be offered in future years, or if the current proposal is a response to the exceptional energy price increases seen over the last year.

We welcome the Commission's confirmation that there will be no k-factor correction for the SToD tariff, as this brings the market risk exposure of ESB PES more into line with that of independent suppliers. As price control is a proxy for competition, we regard this alignment of risk between State and independent suppliers as a key development in progress towards full competition in this market sector in which price regulation is no longer required. In the absence of a guaranteed margin, there is a natural incentive to price cost-reflectively and we look forward to elimination of this inter-year pricing distortion from other market sectors. There is however one issue affecting price competition that has not been addressed in this consultation; cross subsidy.

In its final decision on this proposal, we ask that the Commission's sets out the means whereby costs in the SToD tariff market will be allocated, separated and ringfenced from those in ESB PES's revenue-guaranteed business, to ensure a level playing field for competition.

Cost reflectivity

Our analysis of the proposed tariff suggests that different load profiles have been used in the derivation of prices for each voltage level. In assessing the proposed prices, it is important to understand whether the profiles are representative of the market as a whole, or reflect only the demand shape of ESB PES's remaining LEU customers. We regret that the consultation provided insufficient information for us properly to evaluate the cost reflectivity aspect of the proposal and in its final decision, we ask that the Commission provides the breakdown of consumption across each of the SToD bands for each voltage level.

In order to comply with the approved ESB PES pricing strategy, the new SToD tariff must be substantially hedged. As the DC and NDC auctions have already taken place and as the wholesale contract market is somewhat illiquid, we ask that the Commission's published decision on this consultation includes an explanation of how the tariff energy will be hedged. In the absence of supporting hedge contracts and without guaranteed cost-recovery, ESB PES would be taking on a significantly higher level of market risk than would be prudent for a ring-fenced electricity supply business.

Contract conditions

We have inferred that the SToD proposal is intended to be a 12-month contract, although describing it as a "tariff" might be taken to imply that customers have the option to change supplier part way through the year. We would welcome clarification on this point, but believe that the latter interpretation would be preferable in terms of offering customers wider choice, through the opportunity to change supplier.

With the correct safeguards, we also believe it may be time to review the general prohibition on customers who have left ESB PES being denied the option of returning at some time in the future. It is possible that by creating the appearance of risk for customers leaving ESB PES, the policy is now having the unintended and unfortunate effect of providing a disincentive to switching. As the Commission regards this market sector as sufficiently competitive, "to warrant the removal of retail tariff regulation" and (although re-introducing price regulation via the new SToD tariff) has specifically excluded margin guarantee for this tariff, we believe it would be appropriate now for the Commission to consider measures that would protect competition, but enable restrictions on customer movement to be ended. Regulatory oversight of the LEU sector could then concentrate on monitoring and analysis of customer switching, on the basis of which the Commission could fine-tune aspects of the market found wanting.

However before removing this control, the commission should;

- define how ESB PES allowed revenue can be adjusted and costs adequately identified and ringfenced for the LEU market sector, to incentivise cost-reflective pricing and ensure that absence of a k-factor is not subverted by cross-subsidy from the tariff market,
- insert a licence condition to prohibit below-cost selling by ESB PES; identical to that found in the licences of independent suppliers,
- specifically oblige ESB PES to provide a ringfenced hedge that supports any non-pass-through, or ex-ante Pool price products for LEUs.

Summary

In summary, Airtricity believes;

- that introduction of a SToD product should help customers,
- additional input information is required to aid evaluation of cost-reflectivity
- hedging arrangements for the tariff must be spelled out,
- ruling-out any margin guarantee is a significant step forward, but
- prevention of cross-subsidy to LEUs and adjustment of ESB PES allowed revenue are key issues yet to be addressed,
- confirmation of LEU pricing policy is required for future years,
- the current product should be a tariff rather than a contract, leaving customers to change supplier should they choose,
- arrangements that would safely allow removal of restrictions on customers returning to ESB PES should be investigated.