ESBCS Response to CER Consultation Paper – CER 10/042 - Draft Decision on the ESB PES's Revenue Regulation Framework				
No.	**Question/ Proposal**	**Yes**	**No**	**Comments**

Section 4 – Tariff Cost Elements (4.2.1.2 Option 2 – 50% Allowance for CfDs)				
1	The Commission's proposed decision allows for pass through of hedge contract settlements at a 50% hedge target. Are you in favour of allowing CfD prices to be reflected in PES tariffs?	**Yes**		It is essential that CfD prices be reflected in PES tariffs but that hedges, **up to 85% of outturn demand**, are allowed to avoid costly and excessive tariff resets. While this draft decision paper proposes to allow more frequent tariff changes, the higher the fixed energy price content not subject to half-hourly price volatility, the more stable the tariff. Allowing CfD prices to be reflected in end-user prices corresponds to a competitive deregulated market where suppliers are free to hedge with the purpose of passing the hedge through to customer prices. We welcome the proposal to allow PES to include hedges transacted after the initial tariff setting in the ex post MAR calculation.
2	Is a hedge target of 50% of forecast PES load a reasonable amount of contract cover? If not, what level do you think is appropriate?		**No**	ESBCS is of the opinion that the appropriate hedge level should be **up to 85% of outturn demand**. Our argument for a higher level of hedging is based on the following factors: **1. Tariff stability** PES is predominantly concerned with serving the mass market. ESBCS's experience and recent customer research, reaffirms that a particular feature of the customer base is that it places a high degree of importance on stability and budget certainty for electricity costs. A higher hedging content lessens volatility and therefore the frequency of tariff changes. Also a number of key stakeholders have a vested interest in tariff price stability. **2. Deregulation Objective** In Section 3.2 of the draft decision paper it is stated that the ex post MAR proposal will bring the system of regulation closer to that of a deregulated market. We view an arbitrary ceiling on hedging as being contrary to this principle and therefore unnecessary. In our opinion a prudent supplier in a deregulated market would hedge efficiently to minimise exposure to energy price and demand volatility. **3. Hedge Market Developments** We welcome the SEM information paper "CfDs in the SEM (10-017)" as a decision in favour of a significant widening of the type of CfD products offered in previous years and the availability of hedges closer to tariff-setting time and extending through the tariff year. Hedging liquidity is expected to improve with new products and with shorter durations. This increased availability of hedges, across an extended hedging window, will help to ensure that transient price spikes in commodity markets will not have an exaggerated effect on tariff prices.

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				Furthermore this will allow suppliers to better manage their volume risk and thus improve cost reflectivity in final tariffs. This flexibility allows tighter management and optimisation of hedging positions. **4. Reduced uncertainty in Demand Forecasting** This draft decision paper implies that hedging higher than 50% is risky, based on a presumption that the forecast PES demand could turn out to be overstated. Over the last 12 months the domestic market has moved from a position of no competition to one of intensive competitor activity largely discounting off PES tariffs. The extent of customer movement, accelerated by falling wholesale prices and the prevailing difficult economic environment experienced by customers, was unheralded – up to 25% of customers switching in the period. Consequently, actual PES demands in the current tariff year are well below those forecast at tariff-setting time. However, we believe that the range of possible demand outcomes for subsequent PES forecasts has now reduced, since we are starting from a significantly lower base and can make more soundly-based assumptions on competitor acquisitions using up-to-date customer movement data. Furthermore, these forecasts will continue to be refined throughout the year when we will avail of the more staged hedging opportunities. **5. Reduction in hedging activity** The information paper - CfDs in the SEM (10-017) - outlines the principle of continuing to develop a robust hedging market. The paper states that "risk management is an integral element of the efficient and effective operation of the SEM. The availability of CfDs is also an important means of delivering both wholesale and retail competition to the ultimate benefit of final customers. This is because the ability of generators and suppliers to enter into and access contracts enhances the financial certainty, flexibility and innovation of participants in both the wholesale and retail markets". We would argue that restricting PES to a 50% hedging ceiling will set an artificial cap and may have a detrimental effect on the take-up of CfD volume by all suppliers and discourage the provision of new and innovative products by generators and third-parties.
3	The Commission's proposed decision allows PES to define a set of contracts to meet the hedge target of 50% of forecast PES load on an energy and/or capacity basis for regulated customers. Are you in	**Yes**		ESBCS is in favour of having the flexibility to create a portfolio of contracts to meet its hedging requirements. Flexibility is an important requirement for the following reasons: • Domestic load shape is the most volatile in the market place and is particularly "peaky" in the winter months. This market has a greater requirement for a range of product types to match demand shape. • There is a limited selection of contracts available, so the mix of contracts will need to be constantly adjusted and refined as the results of each round becomes available • In order to ensure that a reasonable price is paid for contracts ESBCS needs the flexibility to bid

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	favour of the Commission's proposal to allow PES the flexibility of combining base load, mid-merit and peak contracts to create a portfolio that meets the 50% target for regulated customers?			for different mixes of contracts depending on suitability, price, and availability However we have an alternative proposal on Hedge Allocation Reporting. Section 4.2.1.2 (pg 21) states that "Any hedges that PES enters into that the Commission is not informed of within one week will not be considered when the MAR is calculated…." The stipulation that hedge allocation must be reported within one week is not practicable given the occurrence of multiple auctions within a week, lower auction volumes consequent on the extended auction window and uncertainty regarding future volumes/products available through the hedging window. With this in mind, ESBCS proposes that within 5 working days of the end of the each month, for the duration of the MAR framework, ESBCS would commit to issuing a report on hedges procured in that month that have been allocated to the regulated sector. This monthly reporting cycle is similar to that proposed for reporting on DC hedge allocation as set out in section 4.2.1.2 (pg 21) and would sit well with the schedule of quarterly auctions that have been proposed.
4	It is ESB PES' current practice to shape contract costs in each half-hourly period to reflect the shape of the SEM half-hourly price curves prior to attributing contract costs to customer tariffs. Are you in favour of this practice?	**Yes**		The current model allows PES to shape prices in a way that best reflects the wholesale price risk in each trading period and ensures that correct economic price signals (night/day, weekday/weekend and summer/winter differentials) are incorporated in the tariffs.
Section 6 – Regulatory Processes (6.2 Ex Ante approvals; 6.3 Within-period Data Provision)				
5	The Commission is proposing that ESB PES have full flexibility to set tariffs at the levels it deems appropriate. The CER would only intervene if it observed abusive pricing practices by	**Yes**		We are in favour of this proposal. However this draft decision paper does not appear to deliver the proposal effectively as ESB PES has only full flexibility to set tariffs within a +/-3% of forecast MAR, subject to cost reflectivity (see Q6). Outside of +/- 3% ESB PES must change its tariffs.

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	ESB PES. Are you in favour of the Commission's proposal?			
6	The Commission is also proposing to require ESB PES to adjust tariffs if outturn costs and revenues or forecast costs and revenues diverge by fixed threshold. Are you in favour of this approach, which would require ESB PES to change tariffs when they are no longer cost-reflective?	**Yes**		We interpret this question to mean that, <u>within tariff period</u>, ESB PES is <u>required to immediately</u> change tariffs if, at any time during the tariff year, the projected MAR goes outside the thresholds whatever the may be (in this instance in Q8 +/-3%) We agree with the principle of changing tariffs to reflect under/over recoveries.
7	The Commission's proposed decision provides for asymmetric k-factor recovery outside of a tolerance band, while providing PES an opportunity to minimize any k-factors through full pricing flexibility. Are you in favour of asymmetric recovery?	**Yes**		There are two asymmetric positions: The 1st asymmetry is where the over/under-recovery is within a +/-3% tolerance band of MAR. CER treats the zero to +3% over-recovery as extra revenue to PES while the zero to -3% under-recovery is recoverable by PES. CER's argument, in the draft decision paper, is that "Given that this approach strongly incentivises PES to set tariffs to recover a revenue within 3% above the MAR the Commission proposal is to keep the margin at its current 1.3%" (Also see Note below) This is acceptable to ESBCS. The 2nd asymmetry is where the over/under-recovery is greater than the +/-3% tolerance band of MAR. CER treats the >+3% over-recovery as subsequently refundable by PES while the >-3% under-recovery is treated as a loss to PES. CER's argument here is that the PES will never suffer a >3% loss as it is required to increase its tariff (Q6). This is acceptable to ESBCS. *Note - We have a further comment on the application of the proposed 1.3% margin:* It is proposed that the margin of 1.3% be based on outturn costs (i.e. SMPs, capacity, network, SEM and PSO charges) excluding allowed Supply costs. This is inconsistent with the manner in which margin is applied to other regulated energy utilities in Ireland. This approach does not offer any

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				extra incentive for PES to control its Supply costs as suggested in the paper , as the allowed Supply costs to be included in regulated tariffs will be determined by the CER and if this level is exceeded the extra costs will be borne by PES.
8	The Commission's proposed decision fixes the tolerance band at +/-3%. Do you believe that this is a reasonable range for the band? If not, what level do you think is reasonable?	**Yes**		We interpret this question to mean that the requirement to adjust tariffs, within tariff period, tolerance band is set at +/-3% for the purpose of the MAR formula relating to Q6 above. This is acceptable to ESBCS.
Section 6 – Regulatory Processes (6.4 Ex Post Review)				
9	The oversight process proposed by the Commission anticipates:	**Yes**		
	a limited ex ante review of PES tariffs,			We agree with the limited ex ante review of initial PES tariff changes, but with a CER 2 week turnaround time allowing us to transact more cost reflective hedges closer to tariff setting times
	quarterly reports from PES to the Commission,			We agree with the requirement to prepare quarterly reports in a timely manner following the quarter end. It should be noted, for these reports, that due to the frequency of meter reading and bi-monthly billing for domestic customers, sales and demand will be based on three months of estimated demand.
	a review by the Commission of any changes made to the tariff, and a			We agree with the limited ex ante review of ongoing PES tariff changes, but with a CER 1 week turnaround time allowing us to transact more cost reflective hedges closer to tariff setting times
	detailed ex post review. Are you in favour of the Commission's proposal? If not, what alternatives would you propose?			We are in favour of an ex post review.
10	Are the data sets that the Commission proposes to review in detail in its ex post review appropriate? If not, what alternatives	**Yes**		The proposed ex post review of PES's tariff revenues requires that specific actual data should be provided within two months of the end of the tariff period. However due to the frequency of meter reading and bi-monthly billing for domestic customers, sales and demand include three months of estimated demand, while due to settlement terms, other costs are based on up to one month of estimates.

	would you propose?			Accordingly it is proposed that to provide the specified tariff revenue information for the ex post review within two months of the end of the tariff period, it will include estimates as specified below: • Actual revenues by tariff class by month – This data will be based on actual data plus three months of estimated data. • Contract details for DC, NDC and any other hedge portfolio (profile, quantity, price, delivery period) - This data will be based on actual data plus one month of estimated data. • Loss factors – In the absence of global aggregation the cumulative loss factor will be based on actual data plus three months of estimated data. • Outturn demand by half-hour and by tariff class - This data will based on actual data plus three months of estimated data. • MIC data for any relevant tariffs - This data will be based on estimated data as MIC data is only available 3 months after the year end. • SEM Capacity charges by tariff - This data will be based on actual data plus one month of estimated data. • Outturn SOLR demand by half-hour and by tariff class - If this data is provided to ESBCS then it will be available, otherwise we will make an estimate. • PSO by tariff class - This data will be based on actual data plus three months of estimated data. • Any SEM fees or other costs applied to PES - This data will be based on actual data plus one month of estimated data. • Unaccounted for energy attributed to the PES - There is not yet clarity on how this data is to be calculated or on who will calculate it prior to Global Aggregation being implemented. See also our comment on "unaccounted for energy" in Q11.
Section 6 – Regulatory Processes (6.5 Treatment of Excess/Deficit)				
11	The Commission's proposed decision provides that differences between ex post allowed revenues and revenues collected from customers be applied to future period MARs. This means that the tariffs for future periods will carry over a small amount of prior period k-factors. Are you in favour of the Commission's proposal to	**Yes**		We are in favour of applying historic differences to future MAR periods. However there are inconsistencies proposed in the treatment of two elements of it. **1.** Under the interim regulatory framework PES cannot actively compete. Competitors, in an effort to gain market share, will continue to discount off PES tariffs. Therefore customers will continue to leave PES and there will be a dwindling PES customer base. Applying historic MAR differences to future tariff periods will unfairly affect this smaller PES customer base. **2.** In a similar vein CER states in Section 4.2.4 (Error Supply Unit): "The total MAR adjustment [for "unaccounted for energy"] will be allocated to the MAR for individual categories on a pro rata basis".

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	apply differences to future period MARs?			The allocation of unaccounted for energy costs to PES customers is inherently inequitable. These costs are derived from a total market calculation and should therefore be applied to the total market.
	Would you favour a one-time charge or credit?		**No**	
	Would a one-time charge or credit be administratively feasible?		**No**	
12	The Commission proposed a tolerance band of +/-3% as a measure for the treatment of over- or under-recoveries. This is proposed as a transitional tool, giving PES pricing flexibility and incentives to keep prices at the cost-reflective level. Do you think the 3% is appropriate? If not, why not?	**Yes**		We interpret this question to mean that the ex post tolerance band is set at +/-3% for the purpose of the MAR formula. This is acceptable to ESBCS.
13	Would you be in favour of an alternative treatment of over-recoveries that allows PES to retain revenues in excess of MAR within the 3% tolerance band? If so, why or why not?		**No**	