Conclusion of the Utility Regulator's Review of the NIE Energy Supply Ltd Tariff

December 2008

Review of NIE Energy Supply Ltd Electricity Tariff

Summary

On 7th November in response to a significant fall in forward fuel prices the Utility Regulator initiated a review of NIE Energy Supply Ltd tariffs, specifically the Public Service Obligation (PSO) Levy component of the tariff. This has resulted in a 10.8% reduction in domestic and small business tariffs. This reduction is largely due to a PSO rebate which leads to a reduction in costs to all suppliers and hence customers.

Background

The current tariff reduction is a result of falling forward gas, coal and carbon prices and the effect this has had on the Public Service Obligation (PSO) Levy which is one component of tariffs. The PSO is a charge which is included in tariffs to all customers on a flat rate in P/Kwh. It includes various costs such as the cost of maintaining the land bank for future generation sites, the excess costs of the Non–Fossil Fuel Obligation (NFFO) contracts and the out of market costs of the Power Purchase Agreements (PPAs) which were put in place in 1992 by government prior to privatisation. It is the out of market costs of the PPAs which form the bulk of the PSO levy.

However if market prices are higher than the PPA costs then the Power Procurement Business (PPB) will have a surplus which will be passed back to customers via a PSO rebate.

Comparison with most recent tariffs

Effective from date	1st July 2008	1st October 2008	1st January 2009
Approved Tariff (per Kwh)	12.66p	16.88p	15.06p
% Change		33.3%	-10.8%

The process and rationale for agreeing this decrease is detailed below.

Process

On 7th November 2008 the Utility Regulator initiated a tariff review on the basis that forward wholesale fuel prices had fallen significantly since the beginning of September. The expectation was that a reduction would be possible to the PSO component of the overall tariff. Forward fuel prices continued to drop during the review period. Thus the revised PSO component of the NIE Energy tariff was approved on 12th December 2008 to be applied on 1st January 2009.

This new tariff will be applicable for the period 1st January until 30th September.

Rationale

In the new Single Electricity Market (SEM) PPB sell around 80% of the energy they forecast they will be purchasing under the PPA contracts on a forward basis to suppliers in the market (including NIE Energy Supply but also other suppliers). Therefore 80% of the revenue they will receive from the market for the tariff year is fixed (and fixed on the basis of forward fuel price curves as fuel determines the cost of generation). However PPB currently does not hedge (or fix) the cost of the fuel and carbon purchases that it will make throughout the year to generate the energy under the PPAs.

The fuel prices used in the determination of the PPB portion of the PSO levy approved for 2008/09 were based on the forward fuel price curves in a period when forward prices remained relatively stable and persistently high. Forward fuel prices showed some slight movement during July and August, initially falling but these moved upwards again and remained there. The PPB amount was approved by NIAUR at the beginning of September.

PPB continually monitors commodity and energy price movements and since September, forward fuel prices have reduced significantly. As PPB has no fuel hedges, if fuel prices outturn in line with current forward curves, PPB will have lower costs than it originally forecast whereas its income is 80% fixed. The net result is that in the absence of a revision to the PPB portion of the PSO amount, PPB could accrue a significant over-recovery by September 2009 if fuel prices outturn as currently forecast. There is another forecast rebate from the proceeds from the sale of NFFO ROCs (sold by NIE Energy on the ROC market) which are due to be given back to customers through the PSO rebate – this however makes up only a small proportion of the rebate.

Outcome

The revision of the PSO component of the tariff will therefore give back to customers the over recovery that PPB is forecast to make in the next nine months to the end of September. The resulting change to the domestic customer tariff is a decrease of 10.8%. If fuel prices in the coming nine months were to be higher than the forward curves indicate then the over recovery would diminish due to PPB costs being higher. In order to "lock in" this forecast rebate to customers the Utility Regulator will, in the coming days, give PPB permission to hedge its fuel and carbon purchases for the next nine months. Hence with fixed costs and fixed revenues (from PPB forward energy sales) the forecast rebate will be secured. Any differences between forecast and actual revenues relating to the un-hedged sales that PPB will make to the SEM pool over the next nine months (whether positive or negative) will flow into next years PSO tariff.