

Regulated Entitlement Values

2016 / 17 Tariff Year

September 2016



About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our Mission

Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

Electricity suppliers in Northern Ireland pay a number of regulated charges which they may in turn recover from their consumers. This information paper, which we produce each year, details each regulated charge that makes up a portion of electricity bills for both business and domestic consumers. The purpose of this information note is to communicate the changes to the regulated entitlement values for each charge which will take effect from 1 October 2016.

The paper covers the charges associated with electricity networks, electricity market operation, SEM and the PSO levy.

Audience

Electricity customers, businesses, suppliers and consumer groups.

Consumer impact

This paper provides information on each element of the regulated entitlements which make-up a portion of the cost of electricity paid by business and domestic consumers. The reasons for the changes are discussed within the paper.

Contents

| | | |
|-----|--|---|
| 1 | Introduction | 1 |
| 2 | Charges regulated by the Utility Regulator..... | 2 |
| 2.1 | Northern Ireland network charges | 2 |
| 2.2 | Northern Ireland Public Service Obligation (PSO) charge..... | 5 |
| 3 | Charges regulated by the SEM Committee..... | 7 |
| 4 | Other costs..... | 9 |

1 Introduction

Electricity suppliers in Northern Ireland pay a number of regulated charges which they may in turn recover from their customers. The Utility Regulator approves Network charges and PSO charges whereas the Single Electricity Market Committee (SEMC) approves SEM charges. In this information note we refer to the regulated entitlement values for each charge which can be recovered over the next tariff year (1 October 2016 -30 September 2017).

Network and PSO charges are collected by: NIE Ltd. (Northern Ireland Electricity Transmission and Distribution (NIE T&D)); and by SONI Ltd. (System Operator Northern Ireland (SONI)), whereas the SEM charges are collected by the Single Electricity Market Operator (SEMO). The purpose of this information note is to communicate the changes to the regulated entitlement values for each charge which will take effect from 1 October 2016, together with explanations for these changes.

NIE T&D, SONI and the SEMC create tariffs to collect the entitlements over the forthcoming tariff year, based on cost/revenue allocation assumptions and consumption forecasts. The changes in regulated entitlement will affect individual customers in different ways. The relevant tariffs are published on the NIE T&D¹, SONI² and SEM website³ which we have referenced in the footnotes below.

This paper has been authored and published before outturn costs have been collected or verified for the tariff year 2015/16 (1 October 2015 – 30 September 2016), therefore, the comparisons made below are between two forecasted revenue entitlements. For the sake of simplicity and transparency we have not updated the 2015/16 forecast from last year⁴, however, we have accounted for the latest available information to us, in our forecasts for 2016/17.

In addition, we would add that electricity bills also include other costs, such as: wholesale energy costs; the climate change levy (for businesses only); the carbon reduction commitment; supplier charges; and VAT. The most significant of these other costs is the energy costs, and these will vary greatly between suppliers and customers, largely depending on the timing and extent of hedging contracts.

¹ <http://www.nie.co.uk/About-NIE/Regulation/Regulatory-documents>

² <http://www.soni.ltd.uk/InformationCentre/Publications/>

³ <https://www.semcommittee.com/publications/topics/tariffs-8>

⁴

http://www.uregni.gov.uk/news/view/information_note_on_regulated_entitlement_values_2015_16_tariff_year/

2 Charges regulated by the Utility Regulator

2.1 Northern Ireland network charges

Details of the movements in the maximum amount recoverable from network charges are set out in Table 1 below, but first we make some comments on the individual items which make up the network charges.

Transmission & Distribution Use of System (TUoS/DUoS) charges

The use of system charges are derived from the price controls (and cost/revenue recovery models) put in place for NIE T&D. In 2012, our RP5 price control proposals were rejected by NIE T&D and therefore in April 2013, we referred the matter to the Competition Commission (CC) which has subsequently been replaced by the Competition and Markets Authority (CMA). We have reflected the CC's final determination⁵ in the use of system entitlements.

We are continuing our work on RP5 licence modifications to accurately reflect the RP5 final determinations. The tariffs reflect our best estimate for the 2016/17 tariff year by utilising the approach suggested by the CC that the entitlement for any tariff year (October - September) should be 50% of the entitlement for the two financial years (April - March) which it spans.

Specific comments on DUoS charges

DUoS charges have increased from the 2015/16 charge of £182.4 million to £190.2 million.

The increase is mainly due to growth in the RAB (Regulated Asset Base) from increased capital expenditure plus movements in K factor. The charges also reflect revised connection cost and depreciation allowances (50% allowance in year of spend) based on the draft licence modifications.

The net effect of these factors is that the DUoS entitlement increases by 1.3% in real terms.

Specific comments on TUoS charges

TUoS charges have decreased from the 2015/16 charge of £36.5 million to

⁵ See here: <https://www.gov.uk/cma-cases/northern-ireland-electricity-price-determination>.

£30.1 million.

TUoS charges are also impacted by reflecting the draft licence modifications. 2016/17 charges also include an adjustment for staff that transferred to SONI as well as the latest data on capital additions. These forecasts show reductions in windfarm clusters, medium term capex and D5 spend.

The net effect of these factors is that the TUoS entitlement decreases by 19.5% in real terms.

System Support Services (SSS) charges

These charges cover the cost of SONI and ancillary services required to operate the transmission system safely and reliably.

The SSS charge has increased from the 2015/16 charge of £34.3 million to £48.76 million. This has been partly due to the expansion of ancillary services. Furthermore, the Local Reserve Services Agreement has increased due to payments now extending to a full year rather than nine months in the 2015/16 year.

Collection Agency Income Requirement (CAIR)

The Moyle Interconnector came into service in 2002. Up until tariff year 2012/13, Moyle Interconnector waived its entitlement to recover costs through the tariff as the sales of capacity covered Moyle Interconnector costs. However, since then a shortfall has occurred which has been met through CAIR payments.

Under the terms of its licence, SONI collect the money to cover this and then pass it onto Moyle Interconnector Ltd. The amount to be collected has reduced from £24 million last year to £12.5 million for the 2016/17 tariff year. This is mainly due to cable repair costs having been paid for before the 2016/17 CAIR tariff year hence reducing eligible pass through costs.

Overall network charges

To summarise: Table 1 below shows that the maximum amount recoverable for network charges will increase by 1.6% (nominal) and decrease by 0.8% (real) between 2015/16 and 2016/17.

Network charges are estimated to be 26% of the final electricity bill and therefore if we assume all else remains equal we estimate the combined effect on final bills to be an increase of 0.4% (nominal).

The precise impact on individual customers will depend on various factors including: the consumption profile; consumption quantity; and historical consumption. Customers should refer to company tariff tables. Links have been provided in section 1 of this paper.

Table 1: Northern Ireland network charges

| | October 2015 - September 2016 | October 2016 - September 2017 | % Change (nominal) | % Change (real) ⁶ |
|------------------------------|-------------------------------------|-------------------------------------|--------------------------|------------------------------------|
| Distribution charges (DUoS) | £ 182.4 m | £ 190.2 m | 4.3% | 1.8% |
| Transmission charges (TUoS) | £ 36.5 m | £ 30.1m | -17.5% | -19.5% |
| Support charges (SSS) | £ 34.3 m | £ 48.8 m | 42.2% | 38.8% |
| CAIR | £ 24.0 m | £ 12.5 m | -48.0% | -49.2% |
| Total Network Charges | £ 277.2 m | £ 281.6 m | 1.6% | -0.8% |

⁶ This 'real' change accounts for the forecast of inflation. This has been estimated by the Office of Budget responsibility at **2.4%** (See here:<http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2016/>) (supplementary economy tables , RPI for 2017).

2.2 Northern Ireland Public Service Obligation (PSO) charge

Details of the movements in the maximum amount recoverable from PSO charges are set out Table 2 below, but first we make some comments on the individual items which make up the PSO charges.

Landbank

NIE Land Bank business was established to protect the land surrounding existing power stations for future electricity generation development. The Land Bank sites were vested and the NIE Land Bank business currently manages these sites in accordance with Condition 23 of NIE's Licence and directions issued by the Utility Regulator.

The sale of some land has resulted in a refund to customers via the PSO in 2015/16 and 16/17.

Legacy generation costs

The Power Procurement Business (PPB) has power purchase agreements with the power station owners in Northern Ireland. These contracts were put in place with privatisation of the industry back in 1992. PPB purchase power under the terms of these contracts and then sells this power in the SEM. Any profit or loss is levied on all customers in Northern Ireland via the PSO.

The PPB and the associated generation contracts are forecast to save customers £1.96 million in the 2016/17⁷ tariff year. This compares to a net saving of £6.2 million forecast for the 2015/16 tariff year.

Northern Ireland Sustainable Energy Programme (NISEP) costs

A levy is imposed on all demand to fund the Northern Ireland Sustainable Energy Programme (NISEP). The objective of this programme is to promote energy efficiency with particular regard to vulnerable electricity customers. There is no material difference between the forecasted costs for 2016/17 compared to the forecasted costs for 2015/16.

K factor

If the amount of revenue recovered in any one year exceeds or falls short of the amount allowed, the correction factor operates in the following year to give back any surplus with interest, or to recover any deficit with interest, as appropriate.

⁷ Please note that, as we noted above for the DUoS and TUoS charges, we have changed our approach to calculating the entitlement for the tariff year, such that, the entitlement for any tariff year (October - September) is 50% of the entitlement for the two financial years (April - March) which it spans.

Rounding

In agreement with NIE we included a rounding amount within PSO for the 2015/16 year to bring the charge to zero. Without this the PSO tariff would have been a very small negative (0.011 p/kwh). No rounding has been applied during 2016/17.

Overall PSO charges

To summarise: Table 2 below shows that the maximum amount recoverable for PSO charges will increase from zero to £3.0m for 2016/17.

Table 2: Northern Ireland PSO charges

| | October 2015 - September 2016 | October 2016 - September 2017 | % Change (nominal) | % Change (real) |
|-------------------------------------|--|--|-----------------------------------|--------------------------------|
| Landbank | £ 0.3 m | £ -0.2m | -10.7% | -12.8% |
| Legacy generation costs/income | £ -6.2 m | £ -2.0m | -68.4% | -69.2% |
| NISEP + incentive | £ 9.1 m | £ 9.2m | 1.4% | 1.0% |
| K factor (negative = over recovery) | -£ 3.5m | £ -4.0m | 16.8% | 14.1% |
| Rounding | £0.9 | - | -100% | -100% |
| Total PSO charges | £ 0.0 m | £ 3.0 m | | |

3 Charges regulated by the SEM Committee

The SEM Committee regulates certain charges in the all-island electricity market including charges for generation capacity, the operation of the market and market imperfections (or constraints).

Details of the movements in the maximum amount recoverable for SEM charges on an all-island basis are set out Table 3 below, but first we make some comments on the individual items which make up the SEM charges.

Capacity charges

In the SEM, generators receive a capacity payment as a contribution to fixed investment and operating costs. The total amount is revised annually to reflect the cost of new peaking capacity and the amount of capacity required to meet security standards. Suppliers in turn pay a capacity charge which is profiled monthly.

The total capacity charge for 2016/17 has decreased by 2.3%. The main driving influence in this reduction is the Annual Capacity Payment Sum (ACPS) deduction for higher System Services revenues that will be available in 2017 for generation providers under the DS3 programme.

Imperfection charges

Actual dispatch on the all-island transmission network differs from the optimal dispatch derived for the market schedule. This is because constraints are introduced due to network bottlenecks (including the North-South interconnector) and due to the need for the system operators to maintain reserve for operational security.

The imperfections charge is mainly to cover the cost of the variance between actual dispatch and the unconstrained economic dispatch reflected in the market schedule.

The imperfections entitlement has decreased by 53.4% in nominal terms from the current tariff year. A major reason for the lower forecast entitlement is the decrease in forecast fuel prices and also as a result of new dispatch balancing costs mitigation measures introduced by the TSOs. Further information is available from the semcommittee website⁸.

⁸ <https://www.semcommittee.com/publications>

Market Operator charge

SEMO incurs operational costs while carrying out its functions and recovers these costs, together with capital related costs including a rate of return, through Market Operator tariffs and fees, which are levied on market participants. To facilitate this recovery of costs, the Market Operator submits proposals on its allowed revenue and the charges required to recover this revenue to the Regulatory Authorities (RAs). The 2016-19 SEMO Price Control was published on 3 August 2016 and covers the period from 1 October 2016 to 31 March 2019⁹.

SEMO have submitted their market operator revenue requirement for tariff year 2016/17 which has been approved by the Regulatory Authorities. This revenue requirement matches the amount provided to SEMO within the 2016-19 Price Control, with an adjustment to reflect the K factor over recovery from the 2014/15 tariff year. The market operator tariff has decreased by 37.8% in nominal terms. The decrease in tariffs reflects the winding down of the SEM and lower capital and operational requirements as we move into the new market.

Overall SEM charges

To summarise: Table 3 below shows the maximum amount recoverable, under the SEM charges in 2016/17, has decreased by 14% (nominal) or 16% (real).

Table 3: Charges regulated by the SEM Committee

| | October 2015 - September 2016 | October 2016 - September 2017 | % Change (nominal) | % Change (real) |
|--|--|--|-----------------------------------|--------------------------------|
| Capacity charge ¹⁰ | € 531.0 m | € 519.0 m | -2.3% | -4.6% |
| Imperfections charge (provisional) | € 149.0 m | € 69.24m | -53.4% | -54.5% |
| Market operator charge (provisional) | € 16.1 m | € 10.0m | - 37.8% | -39.3% |
| Total charges | € 696.0m | € 598.3 m | -14% | -16% |

⁹ <https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-16-043%20SEMO%20Price%20Control%20Decision%20Paper%20for%20period%20commencing%201%20October%202016.pdf>

¹⁰ The capacity charge is calculated and published on a calendar basis, these numbers have been adjusted to tariff year values for comparison with the other SEM charges.

4 Other costs

Energy

The largest component of electricity bills is the cost of purchasing energy from the wholesale electricity market (the SEM). In order to offer fixed energy prices supplier often enter into forward hedges and final prices between suppliers will vary between suppliers and customers, depending on the extent, timing and duration of hedging contracts.

Whilst the SEM Committee does regulate bidding behaviour in the spot market, the wholesale energy component of bills is not regulated for most customers. In Northern Ireland this component remains regulated for customers (mainly domestic) of the incumbent supplier, Power NI.

Climate Change Levy (for business customers only)

The Climate Change Levy (CCL) was introduced on 1 April 2001. Non-domestic electricity customers pay the levy at a rate of 0.559 p/kWh from 1 April 2016 and 0.568 p/kWh from 1 April 2017.

Supplier costs and margin

Electricity bills will also include a component to cover supplier costs and margin.

VAT

Value added tax (VAT) is applied to electricity at a rate of 5% for average consumption (fewer than 33kWh per day). Above that level of consumption, the standard rate of 20% is applied.