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Electricity tariffs: components and legislative underpinnings

1 Introduction

The following paper provides a brief outline of the legislation which underpins the Northern Ireland electricity market. The latter part of the paper provides a breakdown of Power NI's retail tariff and outlines the reasons for the recent increase in these component parts.

The focus on Power NI's retail tariff is due to that fact that it is the only tariff upon which all details are publicly available since it is a regulated tariff.

2 Legislative underpinnings

Three pieces of legislation underpin the Northern Ireland (NI) electricity market. These are:

- The Electricity (Northern Ireland) Order 1992 (the 1992 Order);
- The Energy (Northern Ireland) Order 2003 (the 2003 Order); and
- Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 (the 2007 Order).

The purpose of this section is to provide a brief overview of these pieces of legislation. It should be noted, however, that whilst these Orders set out the functions and powers of the various actors in the NI electricity market (the Department for Enterprise, Trade and Investment, the Utility Regulator, etc.), the intricacies of how the various regulated firms operate are set out in the licences relating to those firms.

In addition to the above, European Directives impact upon the electricity market in Northern Ireland. For example, the Renewable Energy Directive has led to Northern Ireland's adoption of 40% renewable target of electricity consumption, or, as noted below, the package of directives known as the Third Package of legislative proposals for electricity and gas is directly influencing the design of the Single Electricity Market (SEM). European Directives are transposed into Northern Ireland law through primary or secondary legislation, or through specific licence changes.

2.1 The Electricity (Northern Ireland) Order 1992

The 1992 Order made provision for the restructuring of the Northern Ireland electricity market towards a privatisation and for the regulation of the newly privatised industry.

The first element of this involved two phases:

- The sale of Northern Ireland Electricity's (NIE) four generating units to three private companies; and
- The flotation of the remainder of NIE (transmission, distribution and supply of electricity) on the London Stock Exchange.¹

The second element saw the appointment of a Director General of Electricity Supply for Northern Ireland (DGESNI). The DGESNI was supported by the Office of Electricity Regulation for Northern Ireland (Offer NI, which became the Office for the Regulation of Electricity and Gas (OFREG) in June 1996).²

2.2 The Energy (Northern Ireland) Order 2003

The 2003 Order, which applies to electricity and gas markets, makes '*substantial amendments to*' the 1992 order. With regard to the electricity market, it:

- Established the Northern Ireland Authority for Energy Regulation, which would later become the Utility Regulator (the Regulator), and transferred powers previously held by the Director General for Gas Northern Ireland and the Director General of Electricity Northern Ireland to the new body;
- Set out the powers of the Regulator and Department in relation to gas and electricity. This includes the principal objective in relation to electricity, which is to

¹ Northern Ireland Audit Office *The Privatisation of Northern Ireland Electricity* (26 October 1994) <http://www.official-documents.gov.uk/document/hc9394/hc06/0667/0667.pdf>

² http://www.bath.ac.uk/management/cri/pubpdf/Industry_Briefs/Electricity_Gillian_Simmonds.pdf

‘protect the interests of consumers of electricity supplied by authorised suppliers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity’ (the powers of the Regulator and Department are set out in more detail in Annex 1 of this document);

- Created an energy group within the General Consumer Council for Northern Ireland which would: regard the interest of certain disadvantaged groups; have the power to carry out investigations, provide and publish advice and information; set out the Council’s right of access to information from the Regulator and energy companies; and provided the Regulator with reciprocal rights of access to information from the Council;
- Made changes to the licensing regime in Northern Ireland including: making provision for more than one electricity transmission licence to be granted in a particular area where the licence holders are carrying out different functions; allowed for the separation of system operation and asset ownership roles; clarified *‘certain obligations’* which may place in electricity company licences; enhanced the role of the Competition Commission in determining licence modifications; and gave the Department powers to alter licensable activities;
- Gave the Regulator power to impose financial penalties, of up to 10% of turnover, on licence holders for contraventions of their licence conditions.
- Gave the Regulator powers to obtain documents and information in connection with the investigation of suspected contraventions; and
- Provided the Department with powers in relation to renewable energy, enabling them to oblige electricity suppliers to ensure a proportion of electricity is from renewable sources and introduces the concept of Renewable Obligation Certificates.³

2.3 The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007

The 2007 Order provides for the creation of the Single Electricity Market (SEM) by amending existing NI legislation to provide mechanisms for regulating the single market in Northern Ireland. Parallel provisions were introduced in the Republic of Ireland. Specifically, the Order:

- Enabled the Department or Regulator to modify the conditions of licence for the generation, transmission or supply of electricity within the SEM;
- Introduced a licencing regime in respect of the function of market operator of the SEM;
- Created the SEM Committee and set out its powers; and,

³ The Energy (Northern Ireland) Order 2003 – Explanatory Memorandum
<http://www.legislation.gov.uk/nisi/2003/419/memorandum/contents>

- Imposed new SEM-related duties on the Department, Regulator and SEM Committee.⁴

3 Power NI Tariff components

The Regulator reviews the Power NI's tariff as part of its functions. This review process includes examining the reasoning behind any changes to the retail tariff. The tariff is made up of a number of components. These components equate to various the costs to the company for supplying electricity. Power NI is permitted to accrue an approved amount of revenue (total allowable revenue) to meet these costs and to provide it with an approved margin. This revenue is gathered from customers via their electricity bills.

The components that make up the regulated tariff (Power NI's retail tariff) are outlined in Figure 1, which covers the period 2013/14. The figure is based upon the Utility Regulator's '*Power NI's 1 July 2013 Tariff Review – A Regulatory Briefing*'. As is evident from the figure wholesale cost is the largest component of the tariff, representing 58% of the total.⁵

It should be noted that whilst the components below show the makeup of Power NI's regulated tariff, several of these components are common to all electricity suppliers – market operator charges (which form part of wholesale costs, see below), system Support Service charges (SSS), Cair_t charges (see Section 5.4); Public Service Obligation (PSO) charges, and Use of System (UoS) charges. All of these components are subject to regulatory review and scrutiny – for example, UoS are regulated via NIE Transmission and Distribution's Price Control, and the System Operator for Northern Ireland's Price Control.⁶

The remaining components of Power NI's tariff are also subject to regulatory scrutiny and are approved by the Regulator; through for example, Power NI's price control and the Regulator's approval of the company's forecast wholesale costs.

⁴ The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 Explanatory Memorandum <http://www.legislation.gov.uk/nisi/2007/913/memorandum/contents>

⁵ The Utility Regulator '*Power NI's 1 July 2013 Tariff Review – A Regulatory Briefing*' (1 July 2013) http://www.uregni.gov.uk/uploads/publications/Retail_Tariff_Background_Briefing_May_2013.pdf

⁶ *Ibid*

Figure 1: Power NI Tariff Components 2013/14 as a percentage of total allowable revenue⁷

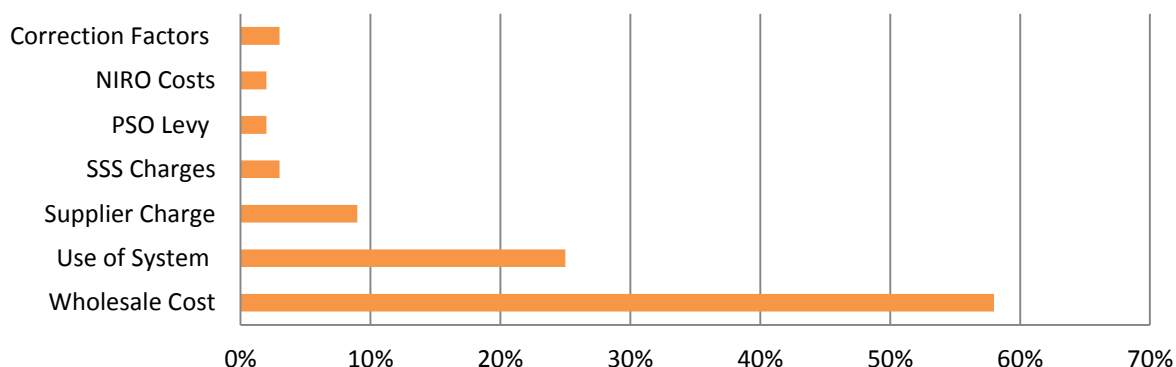


Table 1 provides a monetary breakdown of the components which make up Power NI's total allowable revenue. It should be noted that the first three elements in the table – generation, capacity and other – correspond to wholesale cost in Figure 1.

Table 1: Monetary value of tariff components and year-on-year movement⁸

Component	Oct 2012/13 (£m)	Oct 2013/14 (£m)	% Change
Generation	168.7	186.6	11%
Capacity	39.2	42.6	9%
Other	22.5	25.5	13%
Use of System	92.3	93.3	1%
Public Service Obligation	7.5	6.7	(10%)
System Support Services	11.2	9.9	(12%)
Cairt	-	6.7	100%
Supply Costs	32.5	36.5	12%
Correction Factors	(7.7)	12	225%
Total allowed revenue	336	420	15%

It is evident from the Table 1 the Power NI's total allowed revenue has increased by 15% from 2012/13 to 2013/14. The total allowed revenue period covers the period October 2013 to September 2014, known as the October 2013 tariff.

The Power NI tariff increase, announced in July 2013, of 17.8% includes both the October 2013 tariff increase and a forecast under recovery to September 2013 over £23.1m. Therefore, the 17.8% increase includes the 15% increase in total allowed revenue plus the increase necessary to recover the £23.1m⁹ under recovery.¹⁰

⁷ *Ibid*

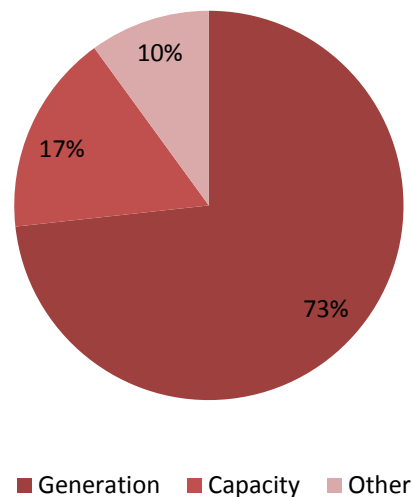
⁸ *Ibid*

⁹ As noted in section 7 this £23.1m under-recovery noted in Section 3 is the cumulative under-recover for the period October 2012 to September 2013. This figure includes the £12m under recovery from October 2012 to April 2013, the £5.4 Cairt

4 Wholesale cost

As noted above wholesale costs make up the bulk of the regulated tariff. Wholesale costs include a number of elements – generation costs, capacity costs and other costs – as illustrated in Figure 2.

Figure 2: Wholesale cost components 2013/14¹¹



As the figure shows, generation costs are the largest component of wholesale cost for the year 2013/14. Total estimated generation costs are £186.6m for the year, which represents 73% of wholesale cost for the year and 44% of Power NI's total allowed revenue for the period (note: generation costs are the single largest component of total allowed revenue).

4.1 Generation cost

Generation costs refer to the cost of procuring electricity. Power NI purchases electricity from the Single Electricity Market (SEM). The SEM operates as a mandatory gross pool which all generators with a capacity of over 10MWs are obliged to bid into. Generators sell electricity to the pool at the marginal cost of producing each unit of electricity. Suppliers purchase electricity at the System Marginal Price (SMP) which is determined by the most expensive plant needed to meet demand in each half hour period. Generators receive the SMP for the quantity of electricity sold to the system in a half hour period. Their profit is the difference between marginal cost and the SMP.¹²

not included in 2012/13 (see Section 5.4) and an additional figure for under recovery for the period April 2013 to September 2013 – i.e. £5.7m

¹⁰ *Ibid*

¹¹ *Ibid*

¹² The Electricity Association of Ireland *The Single Electricity Market* m <http://www.eaireland.com/electricity-in-ireland/the-single-electricity-market.369.html>

Underpinning the generation cost of electricity is the cost of the fuel used. The marginal cost generators sell to the SEM for is determined by fuel costs (fixed costs, i.e. capital costs are recovered via capacity charges, see below).¹³

Forecast generation costs for Power NI increased by 11% between the period October 2012 to September 2013 and October 2013 to September 2014, this is linked to changes in the cost of wholesale gas. The Utility Regulator explains:

*Forward gas price for the upcoming tariff year (October 2013 to September 2014) over the contracting period this year than they were for last year (October 2012 to September 2014). As part of the approval of Power NI forecast generation cost, the UR [Utility Regulator] has analysed forecast forward gas price and forecast forward SEM pool prices. The tariff year (October 2013 to September 2014), these costs are 11% higher when compared with the same period last year.*¹⁴

This link to wholesale gas is particularly problematic to Northern Ireland given geographical position and reliance on imports. As noted in the Strategic Energy Framework:

*Our position on the western periphery of Europe with few fossil fuel sources creates a near 100% dependence on imports to meet our energy needs. This dependency creates uncertainty in terms of security of supply and exposes Northern Ireland to the volatility of world energy prices.*¹⁵

Hedging may enable suppliers to insulate themselves and their customers from future cost rises resulting from wholesale gas price volatility by buying on a forward basis at a fixed price. However, the Regulator has noted that Power NI's level of hedging is low. They state:

*Power NI continue to have a low level of hedging this year. Last year at the end of July, Power Ni had obtained 30% of their forecast customer demand and this years as of April it was below 30% for the period October 2013 to September 2014.*¹⁶

Hedging will be explored in more detail in a forthcoming RaISe paper.

Power NI's generation costs are subject to regulatory scrutiny via the competitive and regulated whole sale market, the Regulator's approval of Power NI's hedging

¹³ *Ibid*

¹⁴ The Utility Regulator 'Power NI's 1 July 2013 Tariff Review – A Regulatory Briefing' (1 July 2013) http://www.uregni.gov.uk/uploads/publications/Retail_Tariff_Background_Briefing_May_2013.pdf

¹⁵ DETI the Strategic Energy Framework for Northern Ireland (July 2010) http://www.detini.gov.uk/strategic_energy_framework_sef_2010_-3.pdf

¹⁶ *Ibid*

methodology, and by the Regulator's approval of Power NI's forecast wholesale costs.¹⁷

4.2 Capacity cost

Capacity costs refer to payments made to SEM generators to contribute to fixed investment and operating costs. These payments are determined by a Capacity Payment Mechanism, which collects a pre-determined amount of money – known as the Annual Capacity Payment Sum – from suppliers (in the form of a capacity charge which is profiled monthly) and pays these funds to generation in accordance with rules set out in the Trading and Settlement Code. The value of the Annual Capacity Payment Sum is determined by two elements:

- The capacity requirement which is equal to the amount of capacity required to exactly meet an all-island generation security standard; and
- A price – which is determined by the annualised fixed cost of the best new entrant peaking plant.¹⁸

As shown in figure 2, capacity costs represent 17% of Power NI's wholesale costs for 2013/14. They are equivalent to 10% of the firms total allowed revenue. The actual cost to Power NI of meeting capacity requirements for 2013/14 is £42.6m. This represents a 9% increase from 2012/13 when the capacity cost was £39.2m.

The Regulator attributes this rise to two factors:

- An increase in the total capacity charge across the entire island market of 3% since 2012/13; and
- The weakening of Sterling against the Euro resulting in an increase in capacity charges of 5.3%.¹⁹

Capacity costs are subject to regulatory scrutiny, the competitive and regulated whole sale market and by the Regulator's approval of Power NI's forecast wholesale costs.

4.3 Other

The other charges which contribute to wholesale cost include: market operators costs; NIRO; and the cost associated with imperfections. These charges came to £25.5m in 2013/14, which represents 10% of wholesale charges and 6% of total allowed revenue for the period.

¹⁷ *Ibid*

¹⁸ All Island Project, *Single Electricity Market : Capacity requirement and Annual Capacity Payment Sum for Calendar Year 2014 – consultation paper* (May 2013) <http://www.allislandproject.org/GetAttachment.aspx?id=a6e4610b-29f7-44b7-b175-73dc58aefcac>

¹⁹ The Utility Regulator 'Power NI's 1 July 2013 Tariff Review – A Regulatory Briefing' (1 July 2013) http://www.uregni.gov.uk/uploads/publications/Retail_Tariff_Background_Briefing_May_2013.pdf

Between 2012/13 and 2013/14 other charges rose from £22.5m to £25.5m. This was equivalent to a 13% increase.²⁰

4.4 Issue to note – Changes to the Wholesale market

The EU's Third Package of legislative proposals for electricity and gas contains measures which aim to create an internal market for electricity. To this end a 'Target Model' for cross border capacity allocation and congestion management, which seeks to harmonise cross border trading and national market designs, has been established.

The Target Model presents challenges to the SEM. The Target Model proposes a model of market design which is close to the prevailing arrangements across Europe, that is, a form of decentralised bilateral trading. The SEM is, by contrast, designed around mandatory gross pool market with centralised dispatch.²¹

Furthermore, the Target Model proposes that the markets throughout Europe should facilitate day ahead and intra-day trading. The SEM does not allow the former and only facilitates the former at prescribed times.²²

As a result of the above a process of SEM redesign has begun. The SEM Committee consulted on options for redesign during January 2012, and has since made a number of high level recommendations which will govern the redesign of the SEM with a view to meeting the target model. These included commitments to ensuring: security of supply; stability; efficiency; practicability and cost; equity; competition; and renewable promotion. The relevant Departments in NI and RoI have accepted these recommendations and confirmed that the Regulatory Authorities shall now begin work on the redesign of the SEM high level design that best meets these objectives.²³

Whilst this implies that final design of the SEM has not been established the SEM Committee's decision paper makes a number of commitments. For example, it states that the redesign will be based on the assumption that:

...the SEM high level design will continue to be based on transparent, centralised trading arrangements with least-cost dispatch of total system load and centralised unit commitment. It will not rely on a process whereby market participants are required to enter into matched physical bilateral contracts and where there are financial penalties imposed for not doing so.

Significantly for this paper a redesign of the SEM will result in implementation cost which will impact on the cost of electricity, and will ultimately be borne by the

²⁰ *Ibid*

²¹ SEM Committee *Proposals for Implementation of the European Target Model for the Single Electricity Market* (24 January 2012) <http://www.allislandproject.org/GetAttachment.aspx?id=55ea759a-d769-4ed5-99d2-20d8ed10652a>

²² Eolas Magazine Alex McLean on regional electricity market reform (28 May 2012) <http://www.eolasmagazine.ie/alex-mclean-on-regional-electricity-market-reform/>

²³ SEM Committee *Implementation of the European Target Model for the Single Electricity Market Next Steps Decision Paper* (15 February 2013) <http://www.allislandproject.org/GetAttachment.aspx?id=c23bdd02-bc49-4e21-af67-16bc0b30d994>

consumer. Neither the SEM Committee's 2012 consultation paper nor the subsequent 2013 Next Steps Decision Paper includes costs for all the options under consideration. The latter paper does, however, state that:

...going forward the SEM Committee in proposing and implementing required design changes to SEM will seek to minimise costs in the interests of customers while efficiently implementing the Target Model.²⁴

Whilst recognising that redesigning the SEM market will result in additional cost it should be noted that such a redesign will facilitate participation in the internal market for electricity. There are benefits associated with deeper market integration, these include: consumer protection; enhanced security of supply; and greater renewable penetration.²⁵

5 Network charges

Network charges consist of four separate elements – use of system charges, public service obligation charges, system support services, and the Collection Agency Income Requirement – as illustrated in Figure 3. These four elements combined account for £116.6m in charges for the 2013/14 period, equivalent to 28% of Power NI's total allowed revenue.

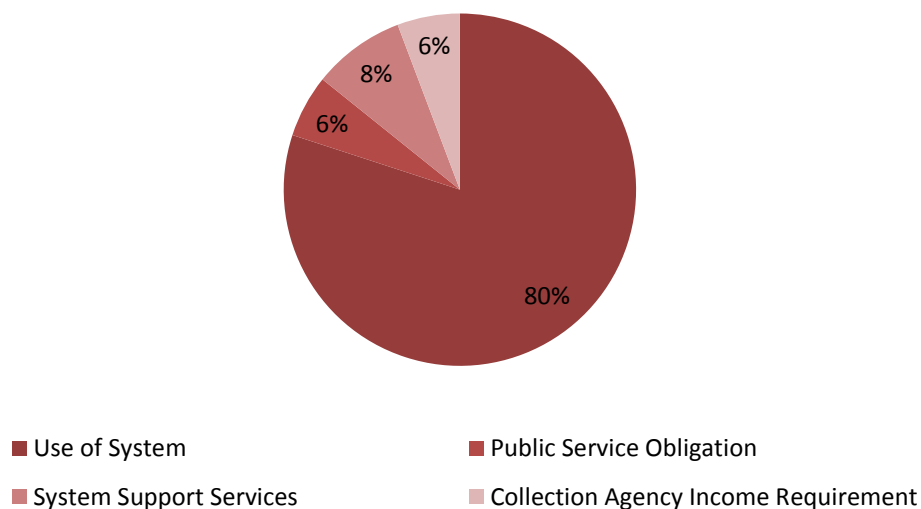
Of the four elements the largest contribution to Power NI's costs is made by use of system charges. These represent 80% of total network charges for 2013/13 and 22% of total allowed revenue. They are the second largest component of total allowed revenue after generation costs.

Overall charges due to Use of System, System Support Services and Public Services Obligation have decreased from 2012/13 to 2013/14, meaning that they have not contributed to the 17.8% increase in the Power NI's tariff. The Collection Agency Income Requirement is a new element to Power NI's total allowed revenue in 2013/14, and has also contributed of the under-recovery noted in Section 3. As such this factor has contributed to the tariff increase.²⁶

²⁴ *Ibid*

²⁵ Eolas Magazine Alex McLean on regional electricity market reform (28 May 2012) <http://www.eolasmagazine.ie/alex-mclean-on-regional-electricity-market-reform/>

²⁶ The Utility Regulator 'Power NI's 1 July 2013 Tariff Review – A Regulatory Briefing' (1 July 2013) http://www.uregni.gov.uk/uploads/publications/Retail_Tariff_Background_Briefing_May_2013.pdf

Figure 3: Network Charges 2013/14²⁷

5.1 Use of System Charges

Use of System (UoS) charges consist of two elements: distribution use of system charges (DUoS) – which relate to the cost of investing, operating and maintaining the distribution system in NI (voltages below 10kV); and transmission use of system charges (TUoS) – which relate to the cost of operating, investing and maintaining the transmission network in NI (voltages above 10kV).

The total cost of UoS charges for 2013/14 is £93.3m. TUoS charges total £13.076 and DUoS total £80.228m. In other words, TUoS contributes to 14% to total UoS, with DUoS contributing 86%.

Over 2013/14 UoS system rose by 1% from £92.3m in 2012/13. DUoS remained flat in this period, whilst TUoS rose by 5%. This increase has been attributed to *‘the development of the network to support renewable generation’*.

DUoS charges are reviewed and approved by the regulator via NIE Transmission and Distribution price control. TUoS are reviewed and approved by the regulator via SONI’s Price Control.²⁸

5.2 System Support Service

System Support Services (SSS) charges cover the cost of SONI and ancillary services to ensure the safe and reliable operation of the transmission system.

²⁷ *Ibid*

²⁸ *Ibid*

For 2013/14 these charges totalled £9.9m, which represents a fall of 12% on the previous year (from £11.2m).²⁹

5.3 Public Service Obligation

The PSO is a flat rate levy charged on each unit of electricity. The charge covers costs associated with the land bank, the Northern Ireland Sustainable Energy Programme (NISEP) and market opening costs.

The level of this cost was at a similar level in 2013/14 compared to 2012/13.³⁰

5.4 Collection Agency Income Requirement

The Collection Agency Income Requirement, known as Cair_t, is a charge associated with the operation of the Moyle Interconnector. This charge is not always applicable. Until 2012 sales of capacity on the interconnector sufficiently covered costs, however, since 2012 a number of factors have resulted in the need for a Cair_t charge to be levied. The Regulator summarises these factors as follows:

...in 2012 it [the Moyle Interconnector] had a forecast shortfall in its income due to [a] loss of sales due to outages, [the] introduction of a new interconnector in the SEM [the East/West interconnector] and increased bond payments due to indexation.³¹

The amount to be collected to meet the Cair_t for 2013/14 is £20m for the whole NI market, with Power NI contributing £6.7m.³²

In addition, Cair_t for the period 2012/13 makes up £5.4m of the under-recovery explained in Section 3.

5.5 Issue to note – Forthcoming study of network costs

The Utility Regulator published a study into electricity pricing across Europe in March 2013. Further work is likely to result from this study. The document suggests that this will include an investigation into how network charges are allocated throughout Europe, with a particular focus on the allocation of network charges amongst consumer groups (i.e. domestic/industrial and commercial customers).³³

Further details of this study are not available at the time of writing. A next steps paper by the Regulator is imminent, however.

²⁹ *Ibid*

³⁰ *Ibid*

³¹ *Ibid*

³² *Ibid*

³³ The Utility Regulator *NI Electricity Prices: Data and Comparisons* (26 March 2013)

http://www.uregni.gov.uk/uploads/publications/Electricity_Pricing_Paper_website_-_March_2013.pdf

6 Supply costs

Supply costs include the cost to supply electricity to customers. This element of the tariff is set via the application of the Power NI Supply Price Control (which determines the amount required for Power NI to meet its operating costs and sets the company's allowable margin).³⁴

Figure 1 shows that supplier costs contribute 9% to the retail tariff.

As noted in Table 1 supply costs have increased by 12% from £32.5m in 2012/13 to £36.5m in 2013/14. The Regulator notes that in terms of actual revenue amount to be collected supply costs have remained flat. They add, however:

*...this amount is to be collected across less units due to a lower Power NI forecast demand for this tariff year (due mostly to expected customer loss) Hence, when last year's overall supply cost is restated to be comparable with this year i.e. reduced to bring the total overall down to current Power NI demand forecast, the supply cost per unit is 12% higher. Many cost of running the supply business e.g. IT, billing, and accommodation are fixed cost that do not reduce immediately as customers numbers reduced hence the cost is smeared over a lesser number of units.*³⁵

The supplier's profit margin is included in the supply costs component. This is currently set at 1.7% of total allowable revenue. Power NI's profit margin is set by the Regulator. The Regulator's current consultation on Power NI's price control (published July 2013 and closing October of the same year) proposes an increased profit margin of 2.2% for 2014. This, the Regulator has estimated, will increase the average customer bill by 25p/month, or £3.00/annum.³⁶

7 Correction factors

Should the amount of revenue collected by Power NI in any one year exceed or fall short of the allowed amount a correction factor operates in the following year to recover any deficit and pay back any surplus.

Table 1 shows a recovery requirement of £12m over the period 2013/14, this is attributed to energy charges that were 'higher than anticipated'. This is the known under recovery at the time the tariff was set, it covers the period October 2012 to April 2013.³⁷

³⁴ The Utility Regulator *Power NI (Formerly NIE Energy Supply) Price Control 2011-2013 Decision Paper* (October 2011) http://www.uregni.gov.uk/uploads/publications/Decision_Paper_for_Power_NI_Price_Control_V1_0.pdf

³⁵ The Utility Regulator *'Power NI's 1 July 2013 Tariff Review – A Regulatory Briefing'* (1 July 2013)

http://www.uregni.gov.uk/uploads/publications/Retail_Tariff_Background_Briefing_May_2013.pdf

³⁶ The Utility Regulator *The Utility Regulator's proposals for the 2014 Power NI supply price control* (23 July 2013)

http://www.uregni.gov.uk/uploads/publications/Power_NI_Price_Control_Consultation.pdf

³⁷ The Utility Regulator *'Power NI's 1 July 2013 Tariff Review – A Regulatory Briefing'* (1 July 2013)

http://www.uregni.gov.uk/uploads/publications/Retail_Tariff_Background_Briefing_May_2013.pdf

The total £23.1m under-recovery noted in Section 3 is the cumulative under-recover for the period October 2012 to September 2013. This figure includes the £12m under recovery from October 2012 to April 2013, the £5.4 Cair_t not included in 2012/13 (as noted in Section 5.4) and an additional figure for under-recovery for the period April 2013 to September 2013 – i.e. £5.7m.³⁸

8 Conclusions

The above breakdown of Power NI retail tariffs has shown the wholesale costs, and in particular generation costs, are the largest element of electricity prices. The link between generation costs and wholesale fuel prices, specifically gas, introduces significant volatility into the system. Northern Ireland's geographical position and reliance on imports for generation needs ensure that it is particularly exposed to international gas market volatility.

Northern Ireland operates in the SEM wholesale market for electricity. Changes to the SEM's market design have been necessitated by EU legislation. These changes may result in increased costs, although the SEM Committee is seeking to minimise the impact upon consumers.

The next largest element of electricity costs are network charges. These are charges the suppliers pay to use the system, and which are then passed on to consumers. Overall charges due to Use of System, System Support Services and Public Services Obligation have decreased from 2012/13 to 2013/14 and have not contributed to increased tariffs. Cair_t charges have, however, increased in this period and have contributed to the tariff increase.

The Regulator appears poised to investigate network charges, with specific reference as to how these are allocated between different consumer groups and how this allocation varies across the EU. Further details of this investigation will become known when the Regulator publishes its next steps paper in the coming weeks.

Supplier charges account for 9% of the retail tariff. These have risen due to Power NI's contracting customer base. Power NI's profit margin forms part of its allowed supplier charges. The Regulator is currently consulting on the company's price control for 2014. This consultation includes proposals to increase Power NI's margin from 1.7% to 2.25%. This, it is estimated, is likely to cost the average customer an additional £3.00 per year.

Finally, it is evident that Power NI is currently required to pay for an under-recovery totalling £23.1m. This is attributed to *'higher than anticipated'* energy cost.

³⁸ Email correspondence with the Utility Regulator 20/08/13