Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

Determination of Distribution Allowed Revenues and Use of System Tariffs for ESB Networks

Decision Paper

19th October 2007

CER/07/*186*

1. Introduction

In accordance with the Regulatory Authorities' decision (AIP/SEM/07/93) to align the PES Retail tariff period in both jurisdictions of Northern Ireland ('NI') and Ireland ('IRL') it is necessary that DUoS tariffs are set on the basis of an interim 11 month period (1st Nov 07 – 30th Sept 08) and 12-month tariff period running 1st Oct to 30th Sept thereafter.

This Paper sets out, following consultation, the determination by the Commission for Energy Regulation on the allowed Distribution System Operator (DSO) revenue, for the interim period, 1st November 2007 to 30th September 2008. No responses were received through the consultation process.

The allowed distribution revenue for the 11 month period has been determined by demand weighting 2007 and 2008 allowed revenues. This revenue was used to calculate the DUoS tariffs for the interim period. Following this method, with 2007 allowed revenues previously set last October at €634.9m and revenues for 2008 set at €698.8m, ESB Networks, the DSO, will be allowed to collect €627.2m in revenue for the 11 month period, 1st November 2007 to 30th September 2008. This level of revenue leads to DUoS tariffs that are 3.2% higher in nominal terms when compared to current DUOS tariffs (Schedule of DUoS charges 2007**,** CER/06/159).

All prices in this paper are quoted are in nominal prices unless otherwise indicated.

The next section of this paper sets out the background to the DSO allowed revenue and DUoS tariffs. Section 3 explains the derivation of the 2008 allowed revenue. Section 4 sets out the DUoS tariffs for the period 1st November 2007 to 30th September 2008.

2. Background

In September 2005 the Commission published its decision on the allowable revenues that the DSO could earn over the period 2006 to 2010 (see CER/05/138). The decision set out the allowed revenue for each calendar year of the period, as shown in the table below.

DSO Allowed Revenues 2006-2010

(2004 monies, €m)	**2006**	**2007**	**2008**	**2009**	**2010**
DSO Allowed Revenues	535.0	567.4	588.7	601.8	615.4

The upward trend in allowed revenues from 2006 to 2010 is largely driven by the significant programmes of capital investment to be undertaken by the DSO. These include the completion of the Medium Voltage Renewal Programme (completed in 2006) and the ramping up of the Low Voltage Renewal Programme. The aim of these programmes is to bring the distribution network up to modern standards after decades of under-investment. Also in order to support the high level of economic growth a significant amount of reinforcement of the network is required.

The distribution revenue decision for 2006-2010 also set out the method by which the allowed revenues would be updated annually in order to keep the DSO's revenues in line with the allowed costs. Distribution system (DUoS) tariffs are then calculated from the allowed revenues. Following this method the DSO revenues for 2006 and 2007 were updated and set by the Commission at €561.5m and €634.9m respectively.

3. Application of Revenue Control

The Commission has determined the DSO revenue for the year 2008 at €698.8m. This level of revenue represents a 10% nominal increase on the revenue allowed in 2007. The reasons for this increase are explained below.

3.1. Revenue Control Formula

The revenue control formula, which is used to keep the DSO's revenues in line with allowed costs, is set out in detail in Section 9 of CER/05/138. Very simply, the revenue control formula takes the 'base' allowed revenue (in 2004 monies) as set out in Section 2 above, inflates that revenue into nominal figures, and adjusts it for specific revenue parameters, so called K factors. The K factors adjust for, among other things, changes in inflation and customer numbers, and revenue allowances/penalties under the incentive mechanism (the DSO is incentivised to improve various aspects of system performance and the performance of its customer call centre).

The following section summarises the implementation of the revenue formula.

3.2. Adjustments to Revenue

The table over leaf summarises the operation of the revenue control formula and compares the nominal increases in revenue between 2007 and 2008.

Allowed Revenues 2007 and 2008

	Revenues (Nominal, €m)	**% Increase in revenue 2008 v 2007**
Allowed Revenue 2007	634.9	
Base Allowed Revenue 2008	673.5	6.1 %
Allowed Revenue 2008 (incl. K factors)	698.8	10.1 %

The 'Allowed Revenue 2007' is the allowed revenue upon which the 2007 DUoS tariffs are based. The 'Base Allowed Revenue 2008' reflects the base revenue for 2008 (€588.7m in 2004 prices) inflated to 2008 prices. The 'Allowed Revenue 2008' shows the final allowed revenue for 2008 (the base revenue adjusted for K factors). The K factor adjustment is explained below.

K Factor Adjustment

	Total K Factors (€m, 2008 monies)	**Associated % increase in revenue 2008 v 2007**
Higher Customer Connection Costs	8.36	1.3%
Higher Line Diversions Costs	3.52	0.6%
Pensions Allowance	7.29	1.1%
Other	6.08	1.0%
Total	**25.25**	**4.0%**

It is currently forecasted that in 2008 22,291 more new connections will be made than incorporated in the base 2008 allowed revenue of €673.5m. This greater level of new connections causes an upward adjustment to revenues through increased:

- connection costs; and
- line-diversion costs.

Connection costs are increased as customers are charged directly, through connection charges, for only 50% of the cost of their connections. The remaining 50% is added to the regulated asset base and paid for by all customers through DUoS tariffs. The upward adjustment to the DSO's allowed revenue covers the associated incremental operating expenditure and the depreciation and return on the incremental capital expenditure. This adjustment represents a 1.3% increase in allowed revenues.

The level of line diversions is closely correlated to the number of new connections for a given year. As the DSO does not compensate landowners for erecting single pole lines on their lands, line diversions are carried out in order to facilitate development. That is, where land is being developed, for reasons other than for the cultivation of the soil, the DSO will alter the line free of charge to the developer. In many cases this will involve under-grounding the line or diverting it clear of the development. This cost is treated as operating expenditure and is recovered through the allowed revenues. This adjustment represents a 0.6% increase in allowed revenues.

An upward adjustment was made in relation to ESB's pension fund. To this end, the Commission has allowed the DSO an additional €7.29m in payroll costs for 2008. This represents a 1.1% increase in allowed revenues.

Minor factors that had an effect of increasing or decreasing the allowed revenue include:

- Interest adjustments relating to under- or over-recoveries
- Rewards and penalties under the incentive mechanism
- Higher pass through costs

4. DUoS Tariffs

Every year the new allowed revenues are used to calculate the DUoS tariffs for the coming period. A 'scaling factor' is applied to the old DUoS tariffs to ensure that the new tariffs will collect the allowed amount of revenue.

In order to determine the revenue that the DSO are allowed to collect from 1st November to 30th September 2007, the Commission has scaled down the allowed revenues for the calendar years 2007 (€634.9m, approved) and 2008 (€698.8m,) in line with the GWhs sold during the period.

This results in DUoS tariffs that are 3.2% higher than current tariffs. The DSO's Schedule of DUoS Tariffs, published alongside this paper, sets out the resulting DUoS tariffs.