



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

**Calculation of ESB Power Generation
Allowable Revenue for 2004 under the
Annual Bulk Power Agreement**

**Proposed Decision by the Commission
for Energy Regulation**

**CER/03/220
5 September 2003**

DECISION

Under Regulation 31 of Statutory Instrument No 445 of 2000, the Commission is required to examine the charges and underlying costs of the sale of electricity supplied by ESB Power Generation (ESBPG) to ESB Public Electricity Supply (ESBPES) under an agreement known as the Bulk Power Agreement (BPA). For 2004, the Commission hereby approves an allowable revenue to ESBPG under the BPA of €718m.

INTRODUCTION

In December 2002 the Commission published a decision¹ paper that set out details of the transfer pricing mechanism for the sale of output by ESBPG to ESBPES for the period from 1st January 2002 to 18th February 2005 inclusive, known as the Bulk Power Agreement. The paper explained the methodology for calculating ESBPG's allowable revenue in each year and included details of the estimated allowable revenues for 2003 and 2004.

This paper sets out the Commission's decision on ESBPG's actual revenue for 2002, its revised forecast revenue for 2003, and estimated allowable revenue for 2004.

OVERVIEW OF BPA

The BPA revenue that ESBPG can derive from sales to ESBPES is based on ESBPG's estimated allowed costs, regulated market revenues (i.e. revenues not related to the sale of electricity from ESBPG to ESBPES) and VIPP and Top Up sales discounts. The estimated allowed costs are made up of Controllable Costs, Market-driven Costs and Fuel Costs. The regulated market revenues consist of payments for constraints, Top Up and Secondary Top Up, VIPP, system support, ancillary services and capacity margin.

ESBPG's allowable revenue has been set out on a €/MWh basis and comprises both a controllable and a market driven component. This price is profiled by time of day and season.

The fuel component makes up the largest part of the market driven costs. The initial fuel component is compared to indexed outturn figures for each month. Each month a revised fuel component is calculated.

This indexation process takes account of changes in a basket of specific fuel indices. For the purposes of the BPA, the weighting for each fuel type included in the basket is calculated as: expected output by fuel type expressed as a percentage of ESBPG's total output. ESBPES and ESBPG review and agree these weightings annually prior to submitting them to the Commission for approval.

Changes in the fuel prices for a particular month are forwarded by ESBPG to both ESBPES and CER. An annual reconciliation process is used by ESBPG and ESBPES to determine and agree the overall financial under/over recovery to be factored into the following years' ESBPG charges to ESBPES for use in tariff determinations.

Due to the interaction between the gas and electricity markets ESBPG may, on occasion, incur additional gas costs as a result of following dispatch

¹ CER/02/240

instructions. The Commission reviews these costs ex-post and makes corrections as appropriate. Other reasonably incurred market driven costs including additional peak capacity and rates are passed through to ESBPES. Costs such as transmission use of system charges are passed through in full to ESBPES. Where the market driven costs and revenues are greater or less than the forecast values the difference passed through to the BPA is the net value.

Controllable costs are indexed to CPI and or the Programme for Prosperity and Fairness - with in built efficiency factors. The BPA price is adjusted, if appropriate, for the volume of all ESBPG sales, e.g. if sales to ESBPES, VIPP and top up, differ substantially from the forecast levels.

ESBPG REVENUE SUBMISSION FOR 2004

In May 2003, ESBPG presented its revenue submission (covering 2004 estimates and allowable adjustments for the outturn costs and revenues for 2002 and the revised forecast for 2003) to the Commission for approval. As a result of the Commission's review of this submission, a proportion ESB's submitted revenue was disallowed. The reduction arose from a downward revision of interest allowed on fuel stocks, a reduction in the rate of stock losses, a reduction in the gas swing premium, and pass-through to customers of benefits arising from the operation of some of ESB's fuel contracts.

Given the current shortages in generating capacity, as publicised in ESB Nation Grid's Generation Adequacy Report for 2003 to 2009, the Commission has asked ESB to contract for additional peaking capacity for Winter 2003 and beyond. The Commission considers it prudent to allow ESBPG to recover a proportion of the costs associated with these contracts in 2004.

The remainder of this paper sets out ESBPG's actual outturn costs and revenues for 2002, its revised forecasted figures for 2003, and its estimated revenues and costs for 2004.

CONTROLLABLE COSTS

Controllable costs are those costs over which ESBPG can influence the outturn value. In its December 2002 paper, the Commission determined ESBPG's controllable costs on the basis of estimates and information available at that time. In any year the allowed amount will only be adjusted for actual inflation verses the inflation assumed in the original estimates (made in 2002). In relation to ESBPG's controllable costs, Table 1 below sets out the Commission's decision on the actual outturn for 2002, the revised forecast for 2003, and estimated controllable costs for 2004.

The allowed values for controllable costs have been capped to incentivise ESBPG to operate efficiently and make cost savings. Any additional expenses incurred will not be passed through to the final customer. Conversely, ESBPG may retain any savings against these values throughout the duration of the price control.

Nominal Prices	2002	2003	2004
Payroll	*	*	*
Operations and maintenance	*	*	*
Non-recurring (minor)	*	*	*
Business services	11,934	12,138	13,446
Corporate centre	8,497	8,643	8,315
Depreciation	90,871	78,940	81,702
Employee and public liability	912	951	984
Environmental	3,247	6,152	11,395
Return on investment	80,329	77,148	74,130
Industry restructuring	0	4,359	4,511
ESBPG Overheads	0	-5,392	3,336
Closure	0	0	0
Total € million	*	*	*

Table 1. Controllable costs

Notes to table 1:

1. * these values are not provided individually as ESBPG considers this information to be commercially sensitive.
2. All values are inflated by CPI with the exception of Payroll, Business Services and Corporate Centre Costs. Payroll is inflated by PPF (Programme for Prosperity and Fairness).
3. Business Services and Corporate Centre Costs are inflated by 50% PPF and 50% CPI. The CER has approved an annual fixed sum for minor non-recurring projects (< €2.5 M). The cost recovery for larger projects is approved on an individual case basis by CER.
4. ESBPG's share of Business Services and Corporate Centre costs allocated to peat-fired plant have been included in 2002 and excluded thereafter.

MARKET DRIVEN COSTS AND REVENUES

Market driven costs and revenues are those that are subject to market forces and are, to varying degrees, outside ESBPG's control. The 2002 actual outturn, the 2003 revised forecast, and the 2004 estimates are detailed in Table 2.

Except for non-recurring costs, any variance between the estimate, revised forecast and actual out turn for the costs and revenues in Table 2 will be recovered via the annual correction (k) factor. The treatment of non-recurring costs was outlined in Appendix 5 of the December 2002 paper (CER/02/240).

Market Driven Revenue²	2002	2003	2004
Top up and secondary top up	17,745	21,970	21,364
VIPP	152,667	50,030	76,502
System support	0	0	0
Ancillary services	25,204	32,457	33,593
Constraint payments	18,675	18,992	19,656
Emergency generation	0	0	0
Capacity margin	30,100	29,919	13,967
Total € m – nominal prices	244,391	153,368	165,082
Market Driven Costs	2002	2003	2004
Rates	24,346	26,813	30,931
Insurance	7,972	11,779	12,862
Emergency generation	23,400	12,971	39,005
System support	0	0	0
Powersave scheme	1,216	700	0
Purchased electricity (Spill)	30,866	30,426	6,869
Transmission use of system charges	32,445	33,664	34,843
Non-recurring	*	*	*
Constraint costs	18,675	18,992	19,656
Environmental	0	0	1,760
Total € m – nominal prices	*	*	*

Table 2. Market Driven Costs and Revenues

Notes to Table 2:

* these values are not provided individually as ESBPG considers this information to be commercially sensitive.

In the area of environmental expenditure, during the period of this Agreement ESBPG may face additional legal obligations. Subject to the Commission's approval, ESBPG will be allowed to pass through all reasonable costs for compliance with all

² Revised per ESBPG's Allowed Revenue Submission 2002 Actual Outturn, 2003 Revised Forecast, and 2004 Estimate.

future environmental requirements, including work that has to be carried out as a result of station IPC licence requirements, compliance with emission bubble limits, landfill levy and associated compliance/ mitigation costs, etc.

3. The Commission requires ESBPG to demonstrate to the Commission's satisfaction that, whilst acting as a Reasonable and Prudent Operator, it maximises the level of revenue or minimises the level of costs included in Table 2.

4. The emergency generation costs for the period November 2000 to February 2001 will be recovered in the years 2003 and 2004.

5. ESBPG will absorb the difference between the revenue received from VIPP and Top Up as compared with the revenue that would have been received if these products had been sold at the ESBPES price (as determined in the BPA). The income differential amount, known as the "VIPP and Top Up discount", will be calculated using actually half hour data.