



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

## **A Non-Technical Guide and Summary of the Commission's recent Consultation Paper on...**

**Proposals for the Economic Regulation of the Gas Safety Supervisory Body and any Electrical Safety Supervisory Bodies to be designated by the Commission**

### **Who should read this document**

This Non-Technical Guide and Summary is aimed at any person or organisation involved in the installation, repair or maintenance of gas installations or electrical installations in Ireland.

**Commission/08/050A**

**14<sup>th</sup> March, 2008**

## Introduction

This document is a Non-Technical Guide and Summary of the Commission for Energy Regulation's consultation paper on the Economic Regulation of the Gas Safety Supervisory Body and the Electrical Safety Supervisory Bodies to be designated (or appointed) by the Commission in the course of the next year ("**the Consultation Paper**")<sup>1</sup>.

## Why should I read this?

If you are involved in the installation, repair or maintenance of gas or electricity installations in Ireland, then you may have an opinion on the matters considered in the Consultation Paper.

The Commission will designate a number of Safety Supervisory Bodies in the coming year who will be responsible for the supervision of gas installers and electrical contractors with respect to safety. These Bodies will be operated on a not-for-profit basis and will earn their revenue from charges levied on gas and electrical contractors (e.g. plumbers, electricians).

The Consultation Paper sets out the proposals on how the Commission will set (or approve) the revenue which each of these Bodies will be allowed to earn each year of operation. This revenue will then be recovered from gas and electrical contractors.

This document has been presented as a non-technical overview of the Commission's proposals. It does not form part of the consultation on the Commission's proposals for the Economic Regulation of Safety Supervisory Bodies. Anyone who wishes to make a submission on the proposals for the Economic Regulation of these Bodies should review the full detail of the Commission's proposals set out in the Consultation Paper.

## Background to the Consultation Paper

The Commission has been granted the statutory function for the regulation of the activities of electrical contractors and gas installers with respect to safety<sup>2</sup>.

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<sup>1</sup> The full text of the Consultation Paper CER/08/050 can be found on Commission's website [www.cer.ie](http://www.cer.ie)

<sup>2</sup> The Commission's functions were granted further to the enactment of the Energy (Miscellaneous Provisions) Act 2006

As part of this statutory function, the Commission is to designate a Gas Safety Supervisory Body and one or more Electrical Safety Supervisory Bodies to act on its behalf. Any party designated as one of these Bodies would be responsible for operating and managing a registration scheme for electrical contractors or gas installers.

This will entail the audit, inspection and monitoring of registered parties and their works (i.e. gas and electrical installations) including the tracking of Completion Certificates.

The Bodies will be designated at the end of a competitive tendering process which will take place over the coming months. The costs tendered during this competitive process will feed in to the Commission's process for setting the revenue of each of the Bodies.

Any Safety Supervisory Bodies are entitled to recover their costs for providing those services by charging fees; these fees are approved by the Commission.

The Commission now needs to consider how it will determine how the fees/charges are to be approved and what levels of costs that these Bodies can recover through the revenues it receives from the services it provides to the electrical and gas contractors.

The Commission sees it as critical that any of the Bodies which it appoints, which would be acting on the behalf of the Commission, operates in an effective and efficient manner and that any costs imposed on the industry are fair and reasonable.

## **Proposal for Economic Regulation of the Bodies**

The Commission's proposals set out the following key steps/activities:

1. The process for approving, in advance, the costs that the Bodies will seek to recover from their revenues. The total costs approved are called the "**Revenue Requirement**".
2. The process for approving the fees/charges applied by the Bodies for their services to the electrical and gas contractors. This will need to be done in such a way that the Bodies, over the course of the period of regulation, will receive enough revenue from applying charges for the services they provide so as to actually cover the costs of the Bodies in providing those services ("**Approving Charges**").
3. The process for reviewing the economic operations of the Bodies and determining how any changes to the cost of providing their

services, further to (1) above, will need to be dealt with and what adjustments need to be made (“**Review and Adjustment**”).

A brief overview of each of the above three steps/activities is presented below.

### ***Approving the Revenue Requirement***

To do this accurately, the Commission would need to understand the full costs incurred by each of the Bodies in providing their services – the Revenue Requirement.

However, the Commission is required to approve the charges of the Bodies at the start of their period of operation. At that point, these costs can only be a forecast. Hence, the Bodies will have to forecast their Revenue Requirements at the start of the period and this Forecast Revenue Requirement will be used in the setting of the charges that the Bodies can levy.

The actual Revenue Requirement of each of the Bodies will not be established until the end of the period (its Actual Revenue Requirement).

It is important that this Forecast Revenue Requirement is a close estimate of the Actual Revenue Requirement. If there was a substantial difference between the Forecast Revenue Requirement and the Actual Revenue Requirement, the charges will be set at an incorrect level (i.e. either too low or too high) and the Bodies may obtain too great or too low a level of revenue to meet their Actual Revenue Requirement.

In addition, the Commission wants to ensure that only the appropriate level of costs are approved and allowed to be recovered from the charges of the Bodies and, in approving the Revenue Requirement and the charges of the Bodies, the Commission must be in a position to regulate the economic aspects of the Bodies in order to protect the interests of the customers of the Bodies (which will include electrical contractors, gas installers and the general public).

### **Forecasting the Revenue Requirement**

It may be difficult to set accurately the Forecast Revenue Requirement as a “total figure” at the start of the period as there will be uncertainty about the volume of the services each of the Bodies will provide.

This is due to the fact that the new regulatory system will only be starting operations and over the course of the years of the Bodies’ volumes of activity may vary and fluctuate. This will cause the costs of the Bodies to fluctuate and, if the Forecast Revenue Requirement was

approved as a “total figure”, it may be significantly higher or lower than the Actual Revenue Requirement.

To avoid this problem, and to allow the Commission to regulate the economic aspects of the Bodies, the Commission is proposing that the Forecast Revenue Requirement is set as follows:

1. The Bodies must propose the forecast level of their Fixed Costs. These are the costs that do not change as a result of the changing volume of services provided by the Bodies. Examples of a Fixed Cost include the costs of the Bodies’ insurance, premises, IT systems and a high proportion of its costs of employment.
2. The Bodies must also propose the forecast level of its Variable Costs. These are costs that change as a result of variations in the volume of services that the Bodies provide. Examples of Variable Costs include the costs of the Bodies in carrying out inspections, handling applications for registration and handling Completion Certificates.
3. The Bodies will not be in a position to forecast the Total Variable Costs to a high degree of accuracy (due to volume changes in services provided). However, they will be able to forecast the “Average Unit Cost” of their Variable Costs – for example, the average cost of it carrying out an inspection.
4. Hence, in order to determine the Forecast Revenue Requirement, the following is required:
  - The Forecast Fixed Cost;
  - The Forecast Total Variable Cost – this is calculated by multiplying the Average Unit Cost by the expected volume of the activity that that cost relates to (for example, the total number of inspections planned over the period).

The Commission will decide on its approval of the Forecast Revenue Requirement proposed by each of the Bodies by examining the above elements which go into and will determine that Forecast Revenue Requirement.

The Commission will then approve the Forecast Revenue Requirement of each of the Bodies by approving each of those elements (Forecast Fixed Cost, Forecast Total Variable Cost and Forecast Volumes of Activity).

## **Approving Charges of the Bodies**

This Forecast Revenue Requirement will then determine the level of charges to be applied by each of the Bodies.

The Bodies will be required to propose the charges each of them wishes to set in order to obtain its Forecast Revenue Requirement over the period.

The Commission will require that, in order to approve those charges, each of the Bodies demonstrates that they are cost-reflective, stable and reasonably transparent.

**NOTE:** *Once the Commission has approved the Forecast Revenue Requirement and Charges, the Bodies will then operate its services over the period. The Commission is proposing that, in determining what parties to designate as a Safety Supervisory Body, it will run a competitive process, which will require any interested parties to bid in their proposed Forecast Revenue Requirement and proposed Charges. The Commission will consider these costs in determining what parties to designate as a Safety Supervisory Body.*

## **Review and Adjustment**

At the end of the period, each of the Bodies will be required to confirm its Total Revenue and Actual Revenue Requirement. As the volumes will have been uncertain, and not all of the Fixed Costs and Variable Costs may have been forecast accurately, it is expected that there will be a difference between the Total Revenue and the Actual Revenue Requirement.

The Bodies will be required to report to the Commission on their respective operations, Total Revenue and Actual Revenue Requirement.

The Commission will review this information. In light of the process operated by the Commission for approving the Forecast Revenue Requirement, any differences between the Forecast Revenue Requirement and Actual Revenue Requirement will result from the following:

- Differences between the Forecast Fixed Costs and Actual Fixed Costs;
- Differences between the Forecast Total Variable Cost and Total Actual Variable Cost. This would be as a result of a difference in the Forecast Unit Cost or the Forecast Volume.

In reviewing the differences, the Commission will require that the reason for the differences is established. It can then take a view on what

additional costs, if any, are approved and will need to be recovered by the Bodies and what additional costs, if any, are not approved.

**Next Steps**

Parties are invited to submit comments on the Commission's Consultation Document (reference: CER/08/050) which is published with this Guide. Please refer to Section 1.3 for information on responding to the consultation.