Joint Response by
Forfás/IDA Ireland/ Enterprise Ireland on the
Distribution Price Review 3 2011-2015

August 2010

Forfás is Ireland's national policy advisory body for enterprise and science. The development agencies, Forfás, IDA Ireland and Enterprise Ireland, represent the interests of the internationally trading business sector in Ireland. The reported exports of all agency-assisted firms accounted for 79 percent of total Irish exports in 2008. Total employment in agency-assisted companies operating in the manufacturing or internationally traded services sectors amounted to 285,474 in 2009.

Introduction

The enterprise development agencies, Forfás, IDA Ireland and Enterprise Ireland, welcome the opportunity to input to the consultation on the Distribution Price Review for the period 2011-2015.

At an economy-wide level Ireland must seek to sustain and further enhance the recent improvements in Ireland's cost competitiveness. As prices are now falling in many developed countries, improving our relative cost competitiveness will require us to achieve cost reductions faster than the euro area average. This review is timely in the context of achieving structural reductions in the cost of the network tariff components of electricity bills.

A reliable and competitively priced supply of energy is vital for business and its ability to compete successfully in international markets. From a national competitiveness perspective, the challenge facing Ireland is to reduce energy costs while delivering on our security of supply and environmental sustainability objectives.

We welcome the central conclusions of the Distribution Price Review. This review is vital as it is an opportunity to ensure that all necessary steps are taken to bring operating, maintenance and capital costs for the distribution system in Ireland into line with best international practice. It is essential to realise all of the available efficiencies, as the allowed distribution tariffs form around 25-30 per cent of the typical electricity bill.

Process for the Review

The agencies welcome the focus of the proposals which aim to contain tariffs to the maximum extent possible while delivering efficient network investment. It is also welcome that independent consultants have been engaged to review and validate all expenditure requests.

Review of 2006-2010 Period

The development agencies note and welcome the fact that ESB Networks (ESBN) successfully delivered a significant capital programme on maintenance and network renewal programmes in the 2006-2010 period which has improved the quality and security of supply for customers. It is welcome that ESBN delivered the required level of service and capital expenditure while staying within the allowances set by the CER for operating and capital expenditure for the period.

Allowed Operating Expenditure

For the 2011-2015 period, the development agencies welcome the pressure exerted to find efficiencies in operating costs. It is welcome that the proposed operating costs for ESBN will progressively decline, as these cost savings will ultimately be passed through to final customers. The agencies believe that the proposed reductions in operating expenditure are appropriate given the reduced cost of doing business in Ireland generally and the potential for reductions in labour costs as outlined by the CER and the specialist consultants. Many business customers are struggling to find cost efficiencies and maintain market share in competitive global markets. It is important that the CER ensures that regulation delivers cost efficiencies which will ultimately benefit customers.

It is positive that the review process has been informed by international benchmarking of ESBN's costs against comparator companies. This is vital to ensure the robustness and transparency of the review process. The agencies note the general conclusion from this benchmarking process i.e. that while ESBN appears to be closing the legacy efficiency gap with similar companies in the UK, there is insufficient evidence to conclude that ESBN is at the efficiency frontier and much evidence to indicate that significant further efficiency improvements are available. The agencies support the efforts of the CER and ESBN to ensure that ESBN moves towards the efficiency frontier relative to similar companies in the UK, as this will ultimately benefit electricity customers.

Allowed Capital Expenditure

The CER proposes to allow €2.31 billion in capital expenditure for the 2011-2015 period. This is a significant increase compared to the €1.98 billion over the 2006-2010 period. The agencies recognise that there is a significant programme of works required to reinforce the network, ensure that security of supply for electricity is enhanced and that the distribution system is capable of accommodating new renewable energy sources where feasible.

We welcome the fact that the CER is proposing to rationalise investment plans somewhat– we believe this is positive for businesses as reduced demand for electricity due to the recession is likely to allow scope to defer certain investment projects. The stated reasons for this reduction in capital expenditure (namely the potential for reductions in labour costs and deferral and disallowance of certain expenditure) are sound. It is important to exert pressure (in the absence of competitive forces for a natural monopoly provider) to find efficiencies and avoid the risk of 'gold-plating' capital investment.

The agencies support the CER proposal that ESBN's planned investment of €187 million in charging points for electric vehicles should not be borne by electricity customers through distribution tariffs. As a public policy goal, the investment should be financed through the public capital envelope. This principle also holds true for the request for allowed revenue for a micro-generation pilot scheme. As these costs relate to support payments which the ESB provides as an initiative to support micro-generation, we support the proposal by the CER that this be funded through sources other than distribution tariffs.

Pending the results of the smart metering trial and cost-benefit analysis underway, the proposal to allow a provisional amount of €500 million makes sense. Investment in smart meters has the potential to lower electricity prices for customers in the future, reduce peak demand and provide flexibility in the electricity system. This should ensure that if the smart metering programme is rolled out that there is no step change in distribution tariffs at that stage.

Return on Capital

The development agencies support the methodology outlined by the CER and its specialist consultants to determine the allowed pre-tax return on capital for ESBN. The CER proposes that the cost of capital will decline from 5.63 per cent over 2006-2010 to 5 per cent for the 2011-2015 period. As the CER has determined that this lower return on capital is sufficient to remunerate the debt and equity of ESBN and to finance the required level of capital expenditure, this lower rate of return is positive for cost competitiveness. It is welcome that the methodology to determine the cost of capital has been informed by international comparisons (for example in terms of spreads on the bonds of comparator companies, recent bond issues by utility companies etc. for other European energy companies that own transmission and/or distribution networks).

When applied to the regulatory assets base, the return on capital is €1.398 billion over the period. The development agencies welcome the proposed use of mechanisms to incentivise the timely delivery of the required capital programme.

Overall Allowed Revenue and Impact on Customer Tariffs

Overall, the allowed revenue for ESBN over the period is €3.585 billion which is €332.4million or 10.3 per cent higher than the allowed revenue for the 2006-2010 period. This increase is justified by the cumulative impact of depreciation and return on capital on the larger asset base. It is very welcome that operating costs are lower and that the average unit price for customers will fall, as the cost base supports a higher number of customers and quantity of electricity distributed.
The development agencies welcome the 6.5 per cent reduction in the average unit price for distribution tariffs for customers. This average masks the very significant reductions which will be achieved for small and medium enterprises (average reduction in distribution charges of 11-20 per cent) and for large energy users (circa 45 per cent reduction). These adjustments are significant and represent an important counterbalance to other elements of electricity bills which are set to increase. The agencies note that these reductions in the distribution tariff only account for 25-30 per cent of bills and therefore that the final cost of electricity to customers remains highly dependent on the cost of international coal and gas prices which are beyond the control of the CER, ESBN and power generators. Nonetheless, it is vital to achieve efficiencies in the controllable elements of electricity costs.

Conclusion

The agencies welcome the proposed revenue to be allowed for ESB Networks as the licensed Distribution System Operator for the period 2011-2015. As recent reductions in electricity prices have largely been cyclical, it is vital to ensure that structural improvements are achieved. This review is a significant step in delivering long-term improvements in cost competitiveness for electricity customers by providing strong incentives for ESBN to find efficiencies across all areas of its business. While vigilance is required to ensure that the benefits of the proposals are realised by customers in their final bills, the proposals strike an appropriate balance between minimising network tariffs and providing for an efficient level of investment in upgrading the distribution network.