Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

ESB PES MAXIMUM ALLOWED REVENUE
QUARTERLY REVIEW
JANUARY 2011

Information Note

CER/11/026

10th February 2011

1 – Executive Summary

This information note sets out the Commission for Energy Regulation's (CER) decision on the first quarterly review of ESB Customer Supply's (ESBCS) compliance with the Maximum Allowed Revenue (MAR).

In its decision on the Revenue Regulation Framework[1] the CER stated that it would continue to monitor the ESBCS's regulated tariffs, as the Public Electricity Supplier's (PES). The decision paper set out a requirement for ESBCS to submit quarterly reports to the CER stating accrued over or under recoveries. The CER would then conduct a review on a quarterly basis and publish an information note within one month of quarter end. This review will confirm if ESBCS tariffs are cost reflective, and provide an update on forecast demand for the calculation of the MAR period and on ESBCS's hedged position.

On the 17th January, ESBCS submitted the quarterly MAR report to the CER updating the CER on the cost reflectivity of the regulated ESBCS tariffs. The CER has reviewed the ESBCS submission for domestic customers to ensure that the tariffs reflect the underlying cost inputs. Following this review the CER has found that revenue earned from regulated domestic tariffs does not fall outside of the 3% tolerance band set out in the revenue regulation framework and as such they will remain unchanged. Therefore, the impact for regulated domestic customer will be as follows;

- Standing charges will remain unchanged
- General Unit charges will remain unchanged
- The PSO levy will continue to be applied at € 2.73 per customer per month

The CER will continue to monitor the ESBCS tariffs on a quarterly basis to ensure that tariffs remain costs reflective. If there are significant changes in underlying costs then tariffs may change to reflect those changes.

[1] Decision on ESB PES Revenue Regulation Framework CER/10/067

2 - Background

On the 21st April 2010 the CER published its decision paper on the Roadmap to Deregulation[2] accompanied by the competition review[3] for Q1 2010, which concluded that the Large Energy User, Medium-Sized Business and Small Business markets had met the criteria for deregulation. Following on from this decision all business markets were deregulated on the 1st October 2010, which meant that ESBCS tariffs for business customers would no longer be approved by the CER, but rather set by ESBCS in the same manner as other suppliers. The competition review also concluded that the criteria for deregulation had not been achieved in the domestic market. Therefore the CER continues to regulate ESBCS tariffs for domestic customers, as the PES, and will continue to do so until the criteria for deregulation have been met.

Further to the Roadmap decision paper, the CER published its decision on ESBCS's Revenue Regulation Framework[4], setting out the changes in the revenue setting process to come into effect from 1st October 2010. In previous years the CER conducted a formal *ex ante* review and public consultation on regulated ESBCS revenue and tariffs, however the decision on Revenue Regulation Framework set out a new approach in which the CER would not conduct an *ex ante* review of ESBCS' tariffs. Instead the CER approves cost inputs to be included in the *ex-post* Maximum Allowed Revenue (MAR) coupled with *ex post* monitoring.

The paper on Revenue Regulation Framework removed the *ex ante* consultation process, but ESBCS are still required to demonstrate to the CER that tariffs are set at a cost reflective manner and in line with the revenue formula based on forecast demand, system marginal price (SMP) and contract cover. On the 1st September 2010 the CER published an information note on regulated ESBCS Domestic Tariffs[5] to apply from 1st October 2010 to 30th September 2011. This note set out how the CER reviewed ESBCS tariffs to ensure that they are cost reflective and line with the projected MAR.

Further to this ESBCS is required to submit quarterly reports to the CER within 10 working days of quarter end stating accrued over or under recoveries for the domestic customer category. These reports must include forecast demand, revenue and cost position for the domestic customer category by month through to the end of the MAR control period. ESBCS submitted the first quarterly report to the CER on 17th January. The CER has evaluated the report data to establish if the tariffs remain cost reflective and in line with the updated MAR.

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[2] Roadmap to Deregulation – CER/10/058
[3] Electricity Retail Market Competition Review Q1 2010 – CER/10/059
[4] Decision on ESB PES Revenue Regulation Framework CER/10/067
[5] Regulated ESB PES Domestic Tariffs to apply from 1 October 2010 CER10151

3 - Review of Tariffs Inputs

3.1 Introduction

The decision on revenue regulation framework set out that the MAR is to be calculated using the price control formula shown in the box below. This formula applies for the period commencing 1st October 2010.

MAR** BY CUSTOMER CATEGORY **= Wholesale Generation Costs + Network Charges + Supply Costs + Allowed Margin + PSO Costs

ESBCS, as the PES, is required to include forecast demand, revenue and cost position in its quarterly report. This data shows actual outturn data where possible and forecast data for the remainder of the year.

In their submission, ESBCS reported that tariffs remain cost reflective. The data in the submission indicated that costs and revenues remained within the 3% band set out in the revenue regulation decision paper and as such there should be no change to the regulated domestic tariffs.

The CER has examined the data provided by ESBCS to establish if costs reflect the forecast MAR and are in line with the above formula. The following areas have been checked to ensure the cost reflectivity of the regulated domestic tariffs remains within the 3% band;

3.2 Generation Costs

ESBCS provided the CER with the following data to facilitate the review:

1. Actual outturn demand data where possible and detailed half-hourly demand forecasts for the remainder of the tariff period. An aggregated forecast was provided for each of the regulated domestic tariffs; Urban 24hr and Nightsaver, Rural 24hr and Nightsaver.
2. Detailed data with respect to Directed Contract and Non-Directed Contract purchases made by ESBCS, and nominated for the 2010/11 MAR period, including; transaction prices, quantities, delivery profile and delivery periods covered.
3. Data on actual and forecast ESBCS capacity costs for the tariff period.
4. A half-hourly SMP forecast for the tariff period based on a Plexos run using forward fuel prices from 16th December 2010
5. A model showing how the fixed contract prices had been shaped to half-hourly periods for the purposes of allocating contract costs to each tariff.

ESBCS selected the 16th of December as the date for its PLEXOS run to model forecast SMPs for the remainder of the MAR period. The CER has analysed the data provided, taking independent runs of the PLEXOS model to verify the reasonableness of the ESBCS forecast SMP. While there were some variances in the model results the CER found that the inputs included by PES in the PLEXOS model were reasonable as were the results of their final forecast SMP.

ESBCS is required to inform the CER within five working days of the purchase of a hedge to fulfil part of the portfolio for regulated tariffs. Therefore the CER has been monitoring ESBCS's hedging activity on an ongoing basis to ensure that purchases were line with the stepped approach set out in the decision on Revenue Regulation Framework. This limited the level of hedging that could be included in tariffs and the CER has only allowed those hedges purchased up to the quarterly limits set.

Furthermore, ESBCS forecast capacity payments were checked against forecast payment obligations to the capacity pot. Once the data provided was verified, it was then used to produce the CER's own estimate of the forecast generation costs for each ESBCS domestic tariff. This exercise corroborated the reasonableness of the ESBCS forecast of generation costs for each domestic tariff.

The CER is satisfied that the generation costs submitted by ESBCS are accurate and are fully reflected in the tariffs.

3.3 Customer Numbers and Demand

The CER has reviewed the customer numbers and forecast demand used by ESBCS for the calculation of the 2010/11 tariffs.

Due to a higher level of customer losses than forecast and the fact that the demand loss has been significantly greater because of the higher proportion of higher-consumption customers that have switched, the forecast demand for ESBCS domestic customers during the 2010/11 period has been reduced.

The CER has reviewed the latest switching data to verify whether these changes to forecast demand are in line with market activity. Given the most recent market share data and switching trends the CER is satisfied that the changes to the forecast customer numbers and demand over the 2010/11 period submitted by ESBCS are reasonable.

The CER also checked that the current Distribution Loss Adjustment Factors published on 22nd July 2010[6] were incorporated in to the tariff calculation.

3.4 Updated Demand Forecast & ESBCS Hedged Position

In the fifth update on ESBCS hedging and work plans[7] published on the 24th September, ESBCS had a forecast demand of 5,801GWhs for the 2010/11 tariff period. However, as stated above the forecast demand has changed since then.

[6] Decision on 2011 DSO Distribution Loss Adjustment Factors – CER/10/119
[7] Information Note on Retail Tariffs 2010/11 Fifth Update on ESBCS/NIEES Hedging and Workplans - CER/10/173

Table 3.4 below shows the total ESBCS forecast demand and hedges purchased up to and including the 31st December 2010 for each quarter of the 2010/11 tariff year. The total percentage hedged cover represents the total hedges purchased for the year as a percentage over the total forecast demand.

Total Demand & Hedged Volumes (GWh) 2010/11		
Time Period	**Forecast Demand**	**Hedges Purchased**
Q4 2010	1,548	84%
Q1 2011	1,470	80%
Q2 2011	1,174	62%
Q3 2011	1,107	58%
Total - 2010/11	**5,299**	**72.6%**

Table 3.4- Aggregated Demand & Hedge Volumes Purchased up to 31st December 2010

In the CER's decision on Revenue Regulation Framework the upper hedge limit allowed in any quarter is 80%. Due to the reduced demand forecast for the tariff period ESBCS is now above the 80% limit in Q4 2010.

The CER reviewed the customer numbers and forecast demand, submitted by ESBCS in its proposal for regulated domestic tariffs for the period beginning 1st October 2010, and found their figures reasonable given forecasts in market demand and the changes in the average consumption of ESBCS domestic customers. Therefore the CER has decided not to disallow the hedges taking ESBCS above the revised upper hedge limit.

The stepped approach is to remain in place however and the revised forecast demand will now set the upper limits allowed for the remaining quarters of the tariff period.

3.5 Network Costs

The ESBCS submission includes actual outturn network costs where possible and forecast costs for the remainder of the tariff period.

In order to verify the forecast network costs the CER estimated the costs of providing Transmission Use of System (TUoS) and Distribution Use of System (DUoS) charges for each tariff, given the updated demand forecast data provided by ESBCS and the TUoS[8] and DUoS[9] tariffs published by the CER in July 2010

A key factor in determining DUoS and TUoS charges for each tariff is how much of the usage occurs during the day and how much occurs at night. In this regard, ESBCS has clarified that it continues to rely on the day-night usage split from its historical actual billing data for each tariff in relation to DUoS (TUoS applied per standard profiles). The CER accepts the application of historical settlement data

[8] Approved TUoS Demand Tariffs for the period 1st October 2010 to 30th September 2011 – CER/10/102

[9] Approved DUoS Tariffs for 1st October 2010 to 30th Sept 2011 – CER/10/103

is appropriate as it is a methodology that will lead to a reasonably accurate level of cost recovery for ESBCS. The CER has checked that the methodology and data have been applied to the forecast network costs for the remainder of the tariff period.

3.6 Supply Costs

On the 13th October 2010 the CER published its Decision Paper on ESB PES's Price Control and allowed revenue for 2011 and 2012[10]. This paper set out the final decision on ESB PES's allowed revenue of €87.81m for 2011 and €83.78m for 2012. Further to this the paper set a total of €94.67m as allowed revenue for the 12-month period from 1st October 2010 to 30th September 2011

The ESBCS submission includes the €94.67m figure in regulated tariffs for the 2010/11 MAR period. These supply costs have been apportioned to the different domestic tariffs on a cost to serve basis, in line with the methodology used in previous years[11].

3.7 Standing Charges

As set out in the information note on regulated ESBCS domestic tariffs to apply from 1st October 2010, the CER approved the ESBCS proposal to maintain the standing charges at current levels. This was done bearing in mind the disproportionate impact an increase in standing charges would have on low consumption customers.

3.8 Margin

As in previous years the allowed margin for ESBCS is set at 1.3%. The margin must be calculated based on forecast generation, capacity and network costs for the 2010/11 MAR. Supply costs are excluded when calculating the allowed margin, as set out in the revenue regulation framework paper. The CER have checked to ensure that the allowed margin has been correctly applied.

3.9 PSO Levy

The PSO levy is charged to all electricity customers and is designed to recoup the additional costs incurred by ESBCS and other suppliers in meeting their obligations to purchase electricity from sustainable, renewable, and indigenous sources pursuant to the relevant Government support schemes. The CER has responsibility to administer the scheme, calculating the amount due under the legislation.

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[10] Decision on ESB PES Price Control 2011-12 CER/10/182

[11] ESB Customer Supply Tariff Methodology Statement for Tariff period 1st October 2009 to 30th September - CER/09/168

The CER published the final decision[12] on the PSO Levy on 29th July 2010. This decision set a monthly charge of €2.73 per domestic customer over the period 1st October 2010 – 30th September 2011. The levy is included as a separate line item on all customers' bills and will continue to apply for the remainder of the tariff period.

3.10 Comparison of Projected Revenue and Aggregate All-In Costs

When setting tariffs, ESBCS calculates the cost-reflective tariff change required for each customer class by comparing the aggregate all-in costs to supply that customer class with the forecast revenue at its current rates. The aggregate all-in costs comprise the sum of generation, TUoS, DUoS, supply costs and margin. The CER is satisfied with the reasonableness of each component of ESBCS's costs. In calculating the revenues ESBCS has used actual revenues where possible and historic sales figures (as per the actual settlement) to calculate forecast revenues from the volumes applicable to the various rates in each tariff.

The CER has reviewed the forecast revenues and carried out independent calculations to ensure that the current tariffs are cost reflective

3.11 Conclusions

The ESBCS submission stated that tariffs remain cost reflective and as such there should be no change to the domestic customer tariffs following the quarterly MAR review. Having undertaken a review of the ESBCS submission and an evaluation of the various costs elements, the CER is of the view that the current tariffs continue to be reflective of the underlying costs.

Therefore the CER is of the view that there should be no change to ESBCS's regulated domestic tariffs.

[12] Public Service Obligation Levy 2010/11 – CER/10/131

4 - Next Steps

4.1 Quarterly Reviews

As set out in the paper on Revenue Regulation Framework, the CER will continue to monitor ESBCS tariffs throughout the 2010/11 MAR period to ensure that they remain cost reflective. ESBCS is required to submit the next quarterly report to the CER on Thursday the 14th April 2011. The CER will conduct a second quarterly review once the ESBCS submission has been received and publish an information note by the end of April providing an update on the cost reflectivity of regulated domestic tariffs.

On the 3rd February the CER published its competition review[13] for Q4 2010 in which it made its assessment of competition in the domestic market. The report found that switching trend data indicates that the market share 60% threshold will be met within Q1 2011. Therefore, pending further steps and milestones being completed with regards to the rebranding process ESBCS could be deregulated in the domestic market on 1st April 2011.

The CER will conduct another review at the beginning of March 2011. Providing switching rates continue as expected and ESBCS continues to progress its rebranding, then deregulation of the domestic market should take place. Once this occurs, ESBCS will be no longer be subject to tariff regulation and will be able to set their domestic tariffs as they see fit. Under such circumstance the MAR will no longer apply and the CER will not conduct any further quarterly reviews.

4.2 Ex Post Review

In the event that the deregulation of the domestic market does not proceed, at the conclusion of the 12 month MAR review period, the CER will conduct a detailed *ex post* review of ESBCS' tariff revenues and the MAR formula. The CER will consult on the findings of the review, publishing a final decision on the MAR issued within four months of the end of the review period.

[13] Competition Review Q4 2010 - CER/10/021