

## Information Note to CER on analysis of 2015 Distribution Revenue.

### Summary

Table 1 below highlights the movement between the Distribution revenue allowed by the CER in its determination of autumn 2010 and ESNB's revised estimate of the 2015 revenue requirement. A more detailed analysis of each item is given in the following notes.

### 2015 Revenue Calculation

|   | €(m) nominal    |
|---|-----------------|
| <b>CER Allowed revenue 2015</b>               | <b>872.5</b>    |
| <b>Total Distribution Revenue Requirement</b> | <b>725.4</b>    |
|   |                 |
| <b>Difference</b>                             | <b>(147.1)</b>  |
| <i>Made up of:</i>                            |                 |
| K <sub>2013</sub>                             | <b>(7.06)</b>   |
| K <sub>2014</sub>                             | <b>48.34</b>    |
| K <sub>2015</sub>                             | <b>(123.86)</b> |
| Mid Term Review                               | <b>(64.52)</b>  |
|   | <b>(147.10)</b> |

**Table 1**

### 2015 Revenue Formula Assumptions

| Key Assumptions           | 2013   | 2014   | 2015   |
|---------------------------|--------|--------|--------|
| HICP                      | 0.5%   | 0.5%   | 1.0%   |
| Euribor                   | 0%     | (0.6%) |        |
| GWh                       |        |        |        |
| <b>2013-2015 allowed</b>  | 24,649 | 25,338 | 26,067 |
| <b>2013-2015 forecast</b> | 22,359 | 22,493 | 22,663 |

**Table 2**

a) K<sub>2013</sub>

| Description                                 | Note | €(m)          |
|---|------|---------------|
| Higher (lower) Customer Numbers             | 1    | 0.11          |
| Incentives                                  | 2    | (10.53)       |
| Actual HICP Higher (Lower) than forecast    | 3    | (8.69)        |
| Actual Revenue (higher) lower than forecast | 3    | 12.91         |
| Rates Pass through                          | 4    | (1.26)        |
| CER Levy Pass through                       | 4    | 0.32          |
| Keypad Meters                               | 5    | (0.77)        |
| Token Meters                                | 5    | (0.50)        |
| Moves from Single to Dual Tariff Meters     | 5    | 0.27          |
| Load Research Rebalancing                   | 5    | (0.10)        |
| Safe Electric Campaign                      | 5    | (0.13)        |
| Capital spend                               | 6    | 1.27          |
| Interest relating to under/over recovery    | 7    | 0.04          |
| <b>Total</b>                                |      | <b>(7.06)</b> |

*Table 3 K<sub>2013</sub>*

**Notes:**

**1. Customer Numbers:**

ESBN's forecast of customer numbers for 2013 in the 2014 Revenue submission was 12,800 customers versus a connected amount of 13,828. This results in a increase in the 2013 P-cust requirement of €0.11m.

**2. Incentives:**

- I. Customer Minutes Lost: The 2013 CER target for CMLs was 132.10. When adjustments for the work volumes completed were made the revised target was reduced to 108.10 CMLs. ESBN's actual out-turn was 128.85 CMLs which translates into a penalty of €5.54m
- II. Customer Interruptions: The 2013 CER target was 135.90 CIs. When adjustments for the work volumes completed were made the revised target was reduced to 127.11 CIs. ESBN's actual out-turn was 130.80 CIs which translates into a penalty of €0.78m.
- III. Customer Satisfaction: DSO is incentivised to improve and maintain the quality of the service provided to customers in the National Customer Contact Centre (NCCC). Performance is assessed in five specific measures, the results of which are then weighted to reach an aggregate performance figure. The five specific measurements

are:

- Speed of Telephone Response
- Call Abandonment Rate
- Mystery Caller
- Customer Call Back Survey
- First Contact Referral

ESBN outperformed the CER targets in each measure for 2013 resulting in an overall weighted performance figure of 89% versus a target of 85% resulting in a payment of €1.80m.

- IV. RedC Survey: A RedC poll is carried out annually to assess customer satisfaction. In this poll 2,500 independently sampled customers who dealt with the DSO in the previous 6 months are interviewed. In 2013, ESBN scored 82.4% against a CER target of 74%, resulting in a payment of €1.63m.
- V. SLA #14 (Meter Reading Incentives): CER published a set of Service Level Agreements (SLAs) for the provision of certain services by the DSO under its licence obligations. The SLAs include incentivised targets relating to metering. These are:
  - Meters should have 1 reading per annum. In 2013, ESBN scored 98.1% against the CER target of 98%, resulting in no incentive payment because a deadband of 0.2% within which no payments are made applies.
  - Meters will not have back to back block estimates. In 2013, ESBN scored 99.20% against the CER target of 98.40%, resulting in a payment of €510k.
- VI. Losses: A basis for an incentive around system losses has been agreed however the data required to calculate the business performance is currently not readily available. In view of this, no amount has currently been included in relation to this incentive.
- VII. Capex Delivery: It was agreed with the CER in the 2014 Revenue Submission that the Capex Incentive/Penalty is no longer relevant based on the original work programme and would be discontinued..

For PR3 the CER has already made provision of €8m p.a. excluding the Capex Incentive within the revenue which the DSO will be allowed to recover. This represents about 25% of the total value of incentives payments that the DSO could potentially collect in any given year.

If the DSO does not earn €8m worth of incentives in any given year then the difference in revenue will be netted off the income in subsequent years through the k-2 adjustment. Similarly if ESBN earns a payment greater than €8m, that will also be dealt with through the k-2 adjustments. In this instance ESBN incurred a total penalty of €2.37m. When compared with the €8m (€8.16 nominal) already factored into the revenue in 2013, this resulted in a reduction of €10.53m in revenue terms.

### **3. Income & Indexation:**

ESBN's forecasted DUOS revenue for 2013 in the 2014 Revenue Submission was €736.40m versus an amount of €723.5m actually collected. This resulted in €12.91m of uncollected allowed revenue in relation to 2013 being recovered in the 2015 Revenue Submission. The allowed 2013 revenue is decreased by €8.69m in relation to inflation. HICP for 2013 was 0.5% which was lower than the forecast of 1.7% as per the 2014 Revenue Submission.

### **4. Pass Through Costs:**

- I. Rates out-turn 2013 was €1.26m less than included in PR3 Opex.
- II. CER levy out-turn 2013 was €0.32m more than included in PR3 Opex.

### **5. Uncertain Costs:**

- I. Actual keypad meter costs in 2013 were €7.99m versus an allowance provided in the 2014 Revenue Determination for 2013 of €8.76m
- II. Actual token meter costs incurred in 2013 were €0.78m versus an allowance provided in the 2014 Revenue Determination for 2013 of €1.28m
- III. When changes from single tariff meters to dual tariff meters are completed, associated costs are recouped via DUOS revenue. The costs associated with this activity in 2013 amounted to €0.27m.
- IV. €0.05m was incurred in 2013 versus an allowance provided in the 2014 Revenue Determination for 2013 of €0.15m in relation to Load Research Rebalancing. These costs relate to installing and maintaining a population of load research meters.
- V. Safe Electric Campaign - €0.22m was incurred in 2013 in relation to advertising firms ESBN appointed on behalf of CER to conduct the Safe Electric advertising campaign. The allowance provided in the 2014 Revenue Determination for 2013 was €0.35m.

### **6. Capitalised Costs:**

A Capex under spend of €318.46m was recorded in 2013 versus the PR3 allowance for 2013 as set out in the current Price Control Determination. €343.61m of this was included as the forecast amount in the 2014 Revenue Submission. This results in an increase in the revenue requirement of €1.27m for 2013 from the reduced revenue already provided for in the 2014 Revenue Submission.

### **7. Interest:**

Interest based on 2013 and 2014 Euribor of 0% and (0.6%) has been added/(subtracted) to the above adjustments.

b) K<sub>2014</sub>

| Description                                 | Note | €(m)         |
|---|------|--------------|
| Higher (lower) Customer Numbers             | 1    | 0.21         |
| Actual HICP Higher (Lower) than forecast    | 2    | (19.97)      |
| Actual Revenue (higher) lower than forecast | 2    | 18.40        |
| Keypad Meters                               | 3    | 6.84         |
| Token Meters                                | 3    | 0.78         |
| Load Research Rebalancing                   | 3    | 0.10         |
| Worst Served Customer                       | 3    | 0.03         |
| Electric Vehicles                           | 4    | 19.00        |
| Storm                                       | 5    | 24.20        |
| Capital Under Expenditure                   | 6    | (0.97)       |
| Interest relating to under/over recovery    | 7    | (0.28)       |
| <b>Total</b>                                |      | <b>48.34</b> |
|   |      |              |

**Table 4 K<sub>2014</sub>**

**Notes:**

**1. Customer Numbers:**

ESBN's forecast of customer numbers for 2014 is 13,755. This is higher than the 12,800 forecast included in the 2014 revenue submission resulting in an adjustment of €0.21m.

**2. Income & Indexation:**

2014 revenue as forecast in 2013 was based on a forecast HICP of 1.7% for 2013 and 2.0% for 2014. The actual HICP in 2013 was 0.5% and the current forecast for 2014 is 0.5%. This results in a decrease of €19.97m for allowed revenue for 2014 due to inflation.

The allowed 2014 DUOS Revenue as calculated in 2013 was €758.40m. Due to lower growth than expected it is now expected that DUOS income totalling €740m will be collected during the period which results in an under-recovery of €18.40m. This uncollected allowed revenue in relation to 2014 has been factored into the 2015 Revenue Submission.

**3. Uncertain Costs:**

- I. Key Pad Meters – it is estimated that the costs associated with the key pad meter project for 2014 will be €6.84m. No amount was included for 2014 in 2013 in the

2014 Revenue Submission.

- II. Token Meters – the cost of procuring, installing and recalibrating token meters for 2014 is forecast at €0.78m. No amount was included for 2014 in 2013 in the 2014 Revenue Submission.
- III. Load Research Rebalancing - €0.1m had been included as an estimate of ensuring that an adequate population of load research meters are installed and maintained. No amount was included for 2014 in 2013 in the 2014 Revenue Submission.
- IV. The CML and CI targets incentivise the DSO to reduce the total levels of interruptions to customers. However, there are a number of customers located on parts of the network serving low numbers of customers. Outages on these network segments have only a small impact on the overall interruption statistics. While the Customer Charter protects these customers from long outages, there is a need to address such customers in a more pro-active way. The forecast cost of the work to be undertaken in 2014 concerning the worst served customers is expected to be €0.03m.

#### **4. Electric Vehicles**

In 2013 ESB Networks (ESBN) made a submission to the Commission for Energy Regulation (the CER) proposing to undertake a pilot on Electric Vehicles (EVs). The pilot entails the roll out of a charging infrastructure by ESBN to allow it to assess the impact of EVs on the Irish distribution system. In the submission ESBN requested the recovery of some of the costs associated with the pilot project from the distribution customer (DUoS customer – Distribution Use of System).

The CER has decided to allow ESBN recover €25m for the pilot which will be composed of €6m of its existing R&D budget approved in PR3 and a further €19m to be allowed by the CER to be recovered from the DUoS customer. The CER is of the view that €25m will be the absolute maximum recoverable to ESBN through the DUoS tariffs over the course of this project. Any overrun cost of the pilot beyond €25m will be carried by ESBN. Any savings accrued if the cost of the pilot runs under will be passed to the customer.

#### **5. Storm**

Severe storms during the Christmas period of 2013 and New Year Period of 2014 followed by Storm Darwin in February severely impacted on the national electricity networks over the last number of months. ESBN incurred and will continue to incur some very significant additional costs as a result of these storms. As a result, ESBN sought recovery of incremental costs of €24.2m incurred by ESB Networks over the storm period

and a submission was made to the CER in April 2014. A detailed technical examination of this incremental costs will be undertaken by CER as part of the PR4 Project but the CER has agreed to allow a provision for this cost to be recovered in the DUOS tariff for the year 2014/2015.

**6. Capitalised Costs.**

As with 2013, it is not expected that ESNB will spend its capital allowance for 2014.

A Capex under spend of €211m was forecast for 2014 in 2013 when setting the 2014 Revenue Submission versus the PR3 allowance for 2014. This has been increased to €340m (€94m new business and load, €65m non load, €61m non network and €120 Smart metering) for 2014 in relation to the 2015 Revenue Submission. This results in a further reduction in the revenue requirement of €0.96m for 2014 on top of to the reduced revenue already provided for in the 2014 Revenue Submission.

**7. Interest:**

Euribor of (0.6%) has been reflected in the above adjustments.

c) **K** 2015

| <b>Description</b>              | <b>Note</b> | <b>€(m)</b>     |
|---------------------------------|-------------|-----------------|
| Higher (lower) Customer Numbers | 1           | (9.06)          |
| Keypad Meters                   | 2           | 6.84            |
| Token Meters                    | 2           | 0.78            |
| Capital Under Expenditure       | 3           | (122.42)        |
| <b>Total</b>                    |             | <b>(123.86)</b> |

**Table 5 K<sub>2015</sub>**

**Notes:**

**1. Customer Numbers:**

ESBN's forecast of customer numbers for 2015 is 14,500 which is lower than the original forecast of 34,622 included in the PR3 determination. On a cumulative basis this is leading to almost 86,000 fewer customers by the end of 2015 when compared with the PR3 Determination. This leads to a forecast reduction of €9.06m in relation to 2015 allowed revenue.

**2. Uncertain Costs:**

- I. Key Pad Meters – it is estimated that the costs associated with the key pad meter project for 2015 will be €6.84m.
- II. Token Meters – the cost of procuring, installing and recalibrating token meters for 2015 is forecast at €0.78m.

**3. Capitalised Costs:**

In light of continuing weak economic activity, the original PR3 forecasts was reviewed. New business activity is lower than forecast when PR3 was agreed. In addition the delivery of SMART metering is progressing in a controlled manner albeit at a slower than anticipated pace than envisaged at the start of PR3 and will run into PR4.

The new ESB Networks headquarters development in Carrickmines was forecast and provided for in the PR3 determination. The spend associated with this was allowed in the 2014 and 2015. A decision has been made to defer this investment and to carry out small scale development on existing premises sites instead.

In light of this €316m has been included as a reduction for the 2015 Capex. This



comprises a reduction of €57 in relation to new business, €207m in relation to SMART metering and €52m in relation to Carrickmines. This 2014 forecast reduction in addition to the cumulative effect of the 2011 – 2014 reduction in capital expenditure results in a reduced allowed revenue for 2015 in the region of €122m.

d) **Mid Term Review**

| <b>Description</b>                      | <b>Note</b> | <b>€(m)</b>    |
|---|-------------|----------------|
| Reduction in Revenue 2014 for 5.2% WACC | 1           | (42.43)        |
| Reduction in Revenue 2015 for 5.2% WACC | 1           | (44.89)        |
| Opex additional efficiencies 2014       | 1           | 11.24          |
| Opex additional efficiencies 2015       | 1           | 11.56          |
| <b>Total</b>                            |             | <b>(64.52)</b> |

**Table 6 Mid Term Review**

**Notes:**

**1. Reduced WACC of 5.2% and Opex Efficiencies:**

The original PR3 determination outlined that a mid-term review of the WACC applicable for PR3 may occur. In view of significant changes in circumstances, particularly in the light of the near normalisation of Irish government bond yields since September 2012, the CER conducted that mid-term review in January 2014.

CER's decision as per CER/14/026 was that a reduced WACC of 5.2% was appropriate for 2014 and 2015. This resulted in a reduction in allowed revenue for ESNB of €42m in relation to 2014 and €45m in relation to 2015.

In setting the WACC at a level of 5.2% the CER considered it appropriate that further Opex efficiencies that would have been sought from ESB Networks for the 2014 to 15 period have been reversed. This reduced the reduction in allowed revenue for 2014 and 2015 by 11.2m and 11.6m respectively.