An Coimisiún um Rialáil Fóntais
Commission for Regulation of Utilities
21 Years 1999–2020

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20th August, 2020

Ms. Cathy Mannion
Commissioner
Commission for Aviation Regulation
3rd Floor, Alexandra House
Earlsfort Terrace
Dublin 2
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CRU Ref: D/20/16068

Re: Submission on COVID-19 Price Regulation Response Airport Charges - Dublin Airport CP3/2020

Dear Cathy,

Further to your correspondence inviting observations to the Commission for Aviation Regulation's (CAR) consultation paper, *COVID-19 Price Regulation Response Airport Charges - Dublin Airport CP3/2020*, the CRU has set out its observations in the annex to this letter.

We have considered this paper in the context of the CRU's experience in the regulation of network utilities in the electricity, gas and water sectors. It is noted that the nature of the aviation industry generally, and the regulation of an airport in particular, represents a different set of regulatory challenges and considerations than apply in relation to utilities. However, we hope that our observations are of some assistance and we would be happy to discuss these with you in further detail.

Yours Sincerely,

Aoife Mac Evilly

Chairperson, Commission for Regulation of Utilities

cc John Melvin, CRU
Robert O'Rourke, CRU

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Annex

For energy networks, revenue regulation, as opposed to price regulation is a common approach among energy regulators internationally. The CRU sets allowed revenues for the electricity, gas, and water network companies ex-ante on a five-year cycle. The efficiency of these costs are then assessed ex-post as part of the subsequent five-year determination. These processes determine the total revenues the network companies can recover from customers in each year of the five-year period. Each year network tariffs are set at levels that enable the network companies to recover the allowed revenue. Any over or under recovery in the year, for example due to actual demand being higher or lower than forecast, is added or subtracted from subsequent years' allowed revenue.

- It is standard practice for the CRU to include provision for a reopener in the final revenue determination if any of the underlying assumptions change over the period. However, as stability in the regulatory framework is one of the objectives of the five-year revenue framework, the CRU sets the determination with the expectation that it will remain in place for the full five-year period.

- The CRU has taken a targeted approach to reopening aspects of revenue determinations when circumstances have required. Although typically the CRU endeavours to address any unexpected items of expenditure through the framework itself; for example serious storms that cause severe damage to the electricity network.

- During "PR3" the electricity determination for the distribution and transmission networks over the period 2011-2015, the CRU made adjustments to the capex allowances and to the cost of capital allowances.

- The PR3 determination provided for a large Capex programme to facilitate the development of the infrastructure required to meet the 2020 national renewable energy targets. However, there were significant changes to both demand levels and the funding environment which led to a reprioritisation from distribution capex to transmission capex in addition to a reduction in the overall capex programme.

- In the PR3 determination the CRU made explicit provision for a mid-term review of the Weighted Average Cost of Capital (WACC). This was due to uncertainty owing to the impact of the financial crisis on the cost of and access to debt but which the CRU did not consider would necessarily persist for the full PR3 period. Ultimately the CRU did carry out a mid-term review of the WACC which resulted in a lower WACC in line with market conditions.

- Similarly owing to the uncertainty around the impact of the financial crisis, in "PC3", the gas determination for the distribution and transmission networks over the period 2012-2017, the CRU used variable inputs to account for the economic uncertainty in setting the WACC. This allowed the WACC to adjust in response to changing market conditions within the parameters of the PC3 determination.

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- Shortly after the publication of PC3, GNI experienced a significant reduction in demand. To address this the CRU did not reopen PC3 but did carry out a mid-year review of the annual network tariffs to address the expected under-recovery of allowed revenues. It is noted that the elasticity of demand in the electricity and gas sectors is different to that in the aviation sector.

- RC3 covers the Irish Water revenue determination for the period 2020 to 2024. A portion of Irish Water's network capital expenditure, amounting to €788 million, was not approved at the time of the CRU's RC3 decision in December 2019. This arose due to significant revisions to Irish Water's capital investment programme and associated outputs and outcomes coming to light during the process. However, the RC3 decision provided Irish Water an opportunity to make a further submission in 2020 if it wished to seek further capital funding for this potential expenditure.

- Irish Water submitted a further capital funding request in April 2020 which was reviewed in its entirety by the CRU. A decision, termed RC3.5, for the five-year period was approved by the Commission in July 2020. The decision took into account evidence related to commitment dates for projects that Irish Water plans to deliver in the period and information provided by a review of Irish Water's capital planning processes by Scottish Water International.

- In the RC3 decision, the CRU acknowledges that Irish Water's business plan is highly dependent on a transformation to a single public utility model, and that achieving the efficiency challenge set by the CRU will be difficult if there is no progress during RC3. The CRU accepts that if the WIOF programme does not progress over the period there will need to be a reassessment of Irish Water's operating costs (RC3 reopener).

- The CRU is currently consulting on PR5, the electricity determination for 2021-2025, and is proposing an "agile investment framework" to manage the high level of uncertainty in the sector over the period. This approach also proposes to allow more flexibility to the network companies to move allowed revenues between opex and capex.

- With regard to depreciation of assets, while depreciation profiles of regulated assets are not usually altered, the CRU has varied the depreciation lifetimes of assets in the light of expected throughput. In 2003 the second gas interconnector and the pipeline to the west were both moved from the then standard 40 year depreciation to 100 year depreciation in recognition of the under-utilisation of both. The depreciation rate of the pipeline to the west was changed to the then standard 50 years in 2007 and the depreciation rate of the second interconnector was changed to 50 years in 2012.

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Conclusion

The CRU therefore has a number of precedents to re-opening or amending a revenue determination when some of the core assumptions, inputs or underlying circumstances have changed dramatically. While the five-year determination period is intended to provide regulatory certainty and consistency, our experience has been that responding and adapting appropriately at times of rapid change has tended to provide greater certainty and consistency than holding to a revenue determination that no longer reflects reality.

These processes have not been full reviews or re-runs of the revenue determination, but rather have tended to focus on an element of the revenue determination which has been subject to the greatest change (e.g. the WACC or the Capex programme). The benefit of targeting has also been that the process can be completed more quickly than a full revenue determination, which has generally been important in the context of the drivers for the review. We have also found that a clear set of objectives for the review (which can include both protection of the regulated entity and its customers) has helped to target the review.

In the context of the high level of uncertainty associated with the scale, geographic spread and pace of decarbonisation in the electricity sector, the CRU is proposing to adopt an agile investment framework, including new regulatory approaches and methodologies such as uncertainty mechanisms.

Should you wish to discuss any aspect of this letter please do not hesitate to contact us.