Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

Commission's Proposals on Transmission Use of System Revenue Requirement and Tariff Structure 1 October 2003 – 30 September 2007

Summary of Comments Received

23 July 2003

CER/03/144a

Introduction

On 17 June 2003, the Commission for Energy Regulation ("the Commission") published a Consultation Paper entitled "Commission's Proposals on Transmission Use of System revenue Requirement and Tariff Structure 1 October 2003 – 30 September 2007" (CER/03/144). This set out the Commission's proposed Bord Gáis Transmission allowed revenue and tariff structure to apply from 1st October 2003 to 30th September 2007. This comments received have informed the Commission of its final decision and are summarised below.

The comments are generally addressed in the Commission's decision paper (CER/03/172), either by way of clarification, or amendment to the Commission's proposed decision.

List of Respondents

Comments were received from the following parties:

- BG CoGen
- Bord Gáis Éireann
- Bord Gáis Energy Supply
- Dairygold
- IBEC
- McKinnon & Clarke
- Premier Periclase
- Viridian
- One party who did not want to be identified

Summary of Comments Received

Comments received were both general, and related to specific sections of the Commission's paper. The general comments are summarised below, followed by the specific comments for the different sections of the Commission's paper.

A number of respondents expressed strong concerns about another increase in gas transmission tariffs. They said that the increase will have an impact on the competitiveness of Irish firms, some of which are competing in international commodity markets against firms that face different costs.

One respondent pointed out that the proposed decision did not have anything to help the installation and use of CHP.

Section 3.1: Duration of Revenue Control

One party suggested that a rolling 4-year period might be better, while another suggested that the tariff calculation should use a 20-year period so as to not impose an undue burden on the early years.

Section 3.2: Opening Asset Value

One respondent said that the Commission has used an incorrect figure in the deduction of costs associated with the laying of fibre optic cable.

A number of respondents made comments on the method of adjusting the asset base for inflation. One respondent said that it was inconsistent to use

Irish CPI to uprate the assets of BGÉ in the past but to use European rates in the future. The party suggested using European rates for the past also.

Another party did not support indexed historical cost, saying CPI bears little relevance to pipes in the ground. The respondent suggested using market value or replacement value of the assets. If indexed historical cost is to be used a more relevant index should be employed.

Yet another party strongly expressed the view that the EU Harmonised Index of Consumer Prices (HICP) is not the appropriate index - rather the Irish CPI or, as a reasonable compromise, the Irish HICP should be used. This is on the basis of:

a) Construction of the Index: The index should best reflect real cost increases in the transmission business unit and exclude housing costs /excise duties. The majority of costs that reside in BGE's asset base are construction related, subject to contract award and predominantly comprising of labour costs. The bulk of BGE's future capital costs are also very much Irish driven, comprising period contractors, predominantly Irish labour and Irish sourced polyethylene pipe and fittings. Thus the Commission should assume that (other things being equal) all of BGE's costs are likely to increase in line with the Irish CPI, or the Irish HICP;
b) Reflection of Costs: It is reasonable for allowed revenue to increase at CPI-X, where X is expected productivity above the general rate of economy-wide productivity, to cover costs that increase at CPI. If however, allowed revenue increases at HICP-X and HICP is consistently lower than CPI, then without any inefficiency on BGE's part, revenue will not cover costs even if BGE achieves productivity growth of X. In order to match revenues to costs, BGE's costs would have to increase by no more than CPI-X-(CPI-HICP). The party believes this would be unfair and unachievable.

Section 3.3: Depreciation

One party said that it supports the change in depreciation for the Second Interconnector and the Pipeline to the West (IC2 and the PTTW). However, as tariffs are still going up, depreciation should be further changed by depreciating pipes over 60 years and using less than 1% depreciation per year on IC2 and the PTTW.

Another party also supported the use of 60 years for the depreciation of pipes.

A third party said that the Commission should not be prescriptive about having decreased depreciation on IC2 and the PTTW for a full 10 years. The rate could be reviewed at the end of the current control period. Another party noted that 1% depreciation for the PTTW may not be appropriate when the Corrib field comes onstream.

Section 3.4: Cost of Capital

One party pointed out that there is a discrepancy between the WACC used in NERA's report and in the Commission's paper.

Other parties suggested a lower rate of return be used, with one suggesting 4.8% and another 5% (and also saying that the Energy Supply arm of BGÉ should not be taken into account when calculating the rate of return for BGÉ's transmission assets).

Another respondent believes, like NERA, that the appropriate rate of return (ROR) is c. 6.5% real pre-tax, on the basis that:

a) The central estimate of the Commission's expert advisers, NERA, is that BGE's appropriate allowed return is 6.54%. The Commission's view of the appropriate rate of return at 5.74% differs significantly and it has taken its own view of some of the key components of the formula. The Commission has used a beta of 0.40 in its calculation of the allowed WACC, in contrast with NERA's recommended range of between 0.45 and 0.55. NERA's paper makes it quite clear that the lower end of its estimated range i.e. 0.45 is consistent with the 'least regulatory uncertainty' approach. These qualifications therefore cannot be used to justify an estimate of beta that is below the lower end of NERA's range. The reason for such a decision should be clarified;
b) On the issue of tax, normal regulatory practice is to express returns for utilities based on a real pre tax basis. To do otherwise would require detailed analysis of the regulated utility's projected tax position. The respondent noted that if a post tax view was taken, NERA recommended a rate of 5.99% real post tax but that allowance should be made to increase the revenue requirement to include projected tax payments as an additional operating cost. This is considered this to be an unwieldy mechanism – a real pre tax approach is the most appropriate way to express the ROR.

Section 3.5: Operating Costs

One party said that the levels of operating costs in the Commission's proposals are a stretch for the business.

Section 3.6: Capital Expenditure

One party questioned whether delaying interconnector reinforcement (Cluden to Brighouse Bay) from 2006/7 to 2007/8 would impact security of supply. The Transporter agreed, however, with the Commission's proposals that the interconnector reinforcement can be deferred to fall outside the 4-year review period.

One party said that the 10% reduction in forecast capital expenditure is likely to understate likely system capital expenditure. However, the party acknowledges and agrees that a mechanism should be put in place for approving additional expenditure.

Section: 3.7: Treatment of Interconnectors

Two parties welcomed reallocation of the EU grant to the Interconnectors.

One party said that with the construction of the south-north pipe Northern Ireland users should pay appropriately for the use of the Interconnectors.

Section 3.8: Previous Under-Recoveries

One party suggested that the previous under-recoveries should be recovered in the next price control period when there is more growth in the economy.

Another party said that the treatment of the allowable under-recovery of €22.1m in the CER proposal paper did not represent the present value of the under-recovery.

A party questioned the allowance of only 50% of the IFI loss, saying the disallowance of 50% is wrong. The Commission has set a revenue as opposed to a price control, and so if the closure of IFI had happened in the forthcoming period it would have been recovered.

Section 4: Form of Revenue Control

One party said that there should be provision in the formula for a 'k-factor' which would facilitate the inclusion of economically attractive projects not originally envisaged at the outset of the regulatory period.

Another party said that 'X' should be a real value and not zero.

Section 5.1: Structure of Transmission Tariffs

One party expressed support for the Irish Entry/Postalised exit structure and the retention of a 90:10 capacity/commodity split.

Another party said that, to encourage investment in energy efficient technology, there should be a high variable charge and a low fixed charge. If charges are largely fixed and energy efficiency savings can only be made in summer and shoulder months, there is less incentive to invest in more efficient processes because users will be paying largely fixed tariffs for their peak capacity, meaning they will not realise any significant savings by decreasing their use of gas through efficiency savings in non-peak periods. The respondent also says that users should be able to revise downward capacity bookings immediately that processes are made more efficient.

Section 5.2: Pricing of Short-term and Interruptible Services

Two parties agreed that a short-term product should not be developed that will undermine the yearly product.

However, one party said that there should be a monthly capacity service (for CHP users).

One party agreed that it is not necessary to develop an interruptible service.