

23 July 2003

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Mr. Gerry Walsh
Chief Executive
Bord Gáis Éireann
Gasworks Road
Cork.

Gas Transmission Tariffs 2003/04

Dear Mr Walsh

I am writing to you pursuant to the Commission's powers under Section 14(3) of the Gas (Interim) (Regulation) Act, 2002.

As you know, the Commission has been conducting a full review of the charging regime for gas transmission and distribution services in time for the gas year commencing 1st October 2003. The enclosed document sets out the Commission's Decision on the determination of revenues for Bord Gáis Transmission ("BGT") during the four-year period from 1 October 2003 to 30 September 2007. Also enclosed is the Commission's 'Gas Transmission Connection Policy' document, which will form the basis of a connection policy to be published by Bord Gáis before the commencement of the next gas year.

In preparing its tariff direction the Commission has considered the various submissions and information provided by Bord Gáis Éireann over the course of the tariff review. The Commission has also taken into consideration the responses to both of its public consultation documents 'Transmission and Distribution Tariffs Objectives and Principles' published on 19th March last and 'Proposal on Transmission Use of System Revenue Requirement and Tariff Structure' published on 17th June last.

Arising from these considerations the Commission is now issuing its direction on Gas Transmission Tariffs to apply for the gas year commencing 1st October 2003. I enclose a copy of this direction.

The Commission would also like to draw your attention to a number of matters arising from the review.

- The existing transmission tariff structure - locational entry charges and a 'postalised' exit charge - will be retained for the current four-year review. The Commission has decided to base transmission tariffs on average costs and the tariffs will continue to be made up of a capacity charge and a commodity charge that reflect a 90:10 capacity/commodity split.
- The EU grant awarded for the construction of IC1 will be reallocated back to IC1 (it had previously been allocated to the Onshore system). This has the effect of increasing the asset base of the onshore system and reducing the asset base of IC1 by the net book value of the grant, €105.4m (in 2002 prices) at the start of the 2003/4 Gas Year.
- In recognition of the under-utilisation of both the pipeline to the west and the interconnectors (following the completion of IC2) the Commission has decided to defer depreciation of these two particular assets compared with what a straight line profile would produce. In the case of both the pipeline to the west and IC2 the Commission will allow depreciation at a straight line rate of 1% a year for the current regulatory control period. This level of depreciation can be thought of as a proxy for a depreciation profile based on expected usage.
- The Commission has estimated Bord Gáis' cost of capital using a weighted average cost of capital (WACC) of 5.74%. The Commission has based its estimate of BGÉ's WACC on an asset beta of 0.4. This is in line with estimated betas for British Gas (before Lattice was demerged from British Gas) and Gas Natural (Spain).
- Regarding expenditure, growth capital expenditure and non-growth capital expenditure have been reduced by 10% on the advice of our engineering consultants, based on scope for continuing efficiency improvements. Capital expenditure for new connections has been reduced by a further 25%, from 2004/5. This reflects the new connections policy, which is the subject of a separate paper (CER/03/173), which will allow a varying proportion of the costs of connection to be recovered directly from the customer depending on whether or not they have choice of location.
- BGÉ under-recovered revenues in 2002/3 to the extent of €27.16m, in 2002/3 prices. The Commission will allow BGÉ to recover all the under-recovery, less 50% arising from the loss of IFI. The closure of IFI is certainly an exceptional event, the and latter stand-alone decision has been taken on the basis that the Commission does not consider it reasonable that customers alone should bear the consequences of the particular event of IFI's closure. In total, therefore, just under €22.1m will be recovered in tariffs over the period of the control period (i.e., up to the end of gas year 2006/7).

These tariffs and new connection policy will apply to all customers from 1st October next.

I would also like to take this opportunity to thank you, your staff and consultants for their assistance and considerable effort over the course of this review.

Kind regards.

Yours sincerely,

Paul McGowan
Head of Gas