Commission for Energy Regulation
An Coimisiún um Rialáil Fuinnimh

Proposed Gas Distribution Connection Policy (CER/03/143)

SUMMARY OF COMMENTS RECEIVED

7th August 2003

CER/03/191

Introduction

On 16th June 2003, the Commission for Energy Regulation ("the Commission") published a Consultation Paper entitled "Proposed Gas Distribution Connection Policy" (CER/03/141). This showed the Commission's proposals on the policy for connection to any natural gas Distribution system, to apply from 1st October 2003. The 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/03/168), either by way of clarification, or a change in the Commission's position.

List of Respondents

Bord Gáis Energy Supply;
Bord Gáis Cogen;
Bord Gáis Éireann;
Viridian.

Summary of Comments Received

General Comments/Section 1: Introduction

One party suggested that the Distribution connected end users are much more price sensitive than the Transmission connected customers - being generally smaller and having to pay a contribution to both the Distribution and Transmission systems. Hence the party is concerned that imposing "upfront" connection charges is likely to discourage new connections, to the detriment of the gas community as a whole. In particular the party believes that the imposition of the 25% charge may be too high to attract smaller Industrial and Commercial ("I&C") and domestic customers.

Another respondent believes that given that the Bord Gáis Distribution network is a developing one, the connection policy must be founded on the principle that encouragement of new connections will reduce the costs of the network to all customers in the long run. The party believes that the correct balance has not been struck between asking customers to pay a contribution upfront (which may present an unattractive barrier to connection) and the owner of the assets recovering the cost of the connection over a longer period of time.

One party agreed with the 5 stated objectives in the Introduction. However, in relation to these principles, another party states that the Commission should be aware that recovery of connection charges for domestic and small existing I&C customers (i.e. Small and Medium Enterprise "SME") must be weighted against the possibility that this new strategy will reduce benefits to the final customer in the medium to long term. Significant connection charges would mean that the ability to maintain customer growth in gas would be significantly disadvantaged; it will progressively erode the economic growth efficiencies built up over the last 15 years. Imposing progressive extra costs on an ever diminishing level of existing gas customers base can result in a self reinforcing circle of decline as weakening customer numbers will have to carry the same or increasing overall cost burden. The Commission's connection policy principles should put emphasis on one that encourages a continued growth pattern of customers. This provides the best opportunity to meet the Commission's market-opening objectives and also make more efficient use of under utilised gas assets.

Another party made the general point that connection policy needs to be transparent and consistent, while capital recovery periods should be extended from 7 to 10 years to reduce capital contributions from the final customer.

A party refers to the Gas Market Opening Working Group (GMOWG), where Bord Gáis has outlined proposals relating to the provision of siteworks services (including connections) for domestic and small I&C offtakes. Bord Gáis has proposed that the Shipper/Supplier would manage the customer interface for the provision of new connection to all domestic customers and to I&C customers with an annual consumption below 735,000 kWh, as it does not have the facilities to provide the interface service with customers. The GMOWG has yet to publish agreed principles on market opening. The party notes that costs associated with such an interface have not been addressed in the Commission's proposal on the Distribution Use of System Revenue Requirement. The Commission should consider the additional costs and the allocation of such costs, relating to new market arrangements for I&C customers in 2004 and arrangements for the full market in 2005.

Section 2.1: Existing Housing (including small developments of 1,2 or 3 houses)

One party argued that 10 years does not reflect an appropriate medium term payback period for all customers. Bord Gáis Distribution ("BGD") currently depreciates its pipelines over 60 years, while the Commission has instructed Bord Gáis Transmission ("BGT") to depreciate its pipelines over 50 years and its above ground installations ("AGIs") over 40 years. Thus to effectively have a payback for pipes of 10 years seems inappropriate, somewhat arbitrary and based on little public evidence that such a period is needed or justified. While accepting that a period shorter than any depreciation period should apply, as one will have to take account of the risk of a business "going bust", it believes that as an average a period of 20 years seems more appropriate for Distribution customers (as is the case for new housing developments). This should be implemented unless there is some objective verifiable evidence in Ireland to support having a shorter period.

Another party states the Commission's proposal would result in a standard connection charge of approximately €330 for a normal domestic customer. Given that natural gas is an optional fuel, the likely impact of this will be to materially reduce the number of connections, as consumers opt for the fuels that require a lower initial investment.

Another respondent proposed that:

- There should be no connection charge for reasons highlighted in the Introduction regarding the negative affect on the market;

- A revenue life in the Net Present Value ("NPV") economic test to be extended to 20 years similar to the proposals in the new housing market;
- The proposed standard connection allowance to be increased to meet any additional negative NPV within 20 years;
- Any incremented costs for services longer that 15m to the premises should be paid for by the customer.

Section 2.2: New Housing Developments

Two respondents suggested that the policy outlined appears reasonable. However one stated that charges to similar builders in similar circumstances should be standardised.

In addition a respondent states that the Commission should be aware of the long lead times associated with new housing type projects. Some infrastructure contacts can be signed between a year and two years prior to the commencement of construction. This means that any change in policy cannot be uniformly implemented from the 1st October 2003 as Bord Gáis will be required to honour existing contracts under the existing criteria.

Section 2.3: Existing Industrial and Commercial Customers

A party supports the idea that small I&C customers should pay "standard contribution charges based on average costings". However as with existing housing, it believes that 7 years is too short a period, particularly if the customer is paying 25% of the connection charge plus any required contribution up front. The party believes that unless there is some objective verifiable evidence in Ireland to support having a shorter period, then a 15-year period should be imposed.

Another party believes that the 25% minimum charge will also have the effect of discouraging potential natural gas customers.

Another party supported the Commission's proposals. However it suggested that the Commission, for reasons similar to the existing domestic housing market, considers either reducing or removing the proposed standard charge on small I&C existing customers. It proposes for the small I&C market (i.e. up to 735k kWh):

- There should be no connection charge for reasons highlighted in the Introduction regarding the affect on the market;
- Revenue life to be extended to at least 10 years project life;
- Standard connection allowance based on up to 15m in length from the premises be applied equal to the negative NPV based on 10 years;
- Any incremental costs for a service longer than 15m from the premises should be paid by the customer.

Section 2.4: New I&C Customers with a choice of location

One respondent supports these proposals.

One party pointed out that Ireland does not have too many "large" I&C customers by international standards. Thus such a blanket approach to the allocation of 100% of the costs of CAPEX and tariffs may strongly discourage many potential investors. Hence it recommended that a tiered approach depending on capacity and volume usage may be more appropriate.

One party argued that, unlike the Transmission system, the logic of charging 100% is not applicable to the Distribution system, where the location of the connection is not normally an issue for an integrated network, nor for the locating of the I&C business. New I&Cs wishing to connect to the Distribution network should not be treated in any way differently from existing I&Cs.

Section 3: Investment Appraisal Methodologies

One party recommends a change to the Commission's general principles of investment appraisal methodologies so that all revenue from the Distribution tariffs should be applied to the NPV economic test in all cases.

It was also pointed out that the current proposals for investment appraisal methodologies are silent on incentives to OPEX and CAPEX costs containment. The party has four general queries:

- Can the Commission clarify what incentive cost and revenue control mechanism will be put in place?
- Can the Commission clarify if reinforcement to the network was considered and provided for in determining capital contribution by final customers?
- Can the Commission clarify how the capital contribution will be collected for final customers and who will carry the commercial risk?
- Can the Commission clarify how the final customers will be billed for capital Contribution charges?

Section 3.1: Investment Appraisals for New Towns Connected to the Transmission Network

One party expressed concern with the use of the terminology "…*that are reasonably expected to connect…*". It believes this to be a very subjective approach to investment where the ultimate bearer of the costs of which are borne by the end users - whether the decision proves correct or not. It is concerned that there may be no predefined level of guaranteed usage of an asset before an investment is undertaken. As such it requests comfort in this regard. As with existing housing and I&C, the party again argued that the 7 years for I&C customers is too short and should be 15 years.

Another respondent referred to the proposal for new housing developers to pay any resulting negative NPV, which appears to be at odds with the proposal relating to the connection of new housing projects to existing Distribution spine mains. The party believes that a consistent approach to all new housing projects should be applied. The respondent believes that the Commission should consider the circumstances where a combined appraisal including both the Transmission and Distribution tariff revenue streams, which would result from the connection of the new town, would be appropriate. The Commission should also consider how changes to the connection policy would impact on the expected number of connections, which formed part of new town appraisals in the past.

Another party supports the Commission proposals, subject to removal of connection charge as outlined for existing housing and I&C customers as discussed earlier.

Section 3.2: Investment Appraisals for Network Extensions connected to an Existing Distribution Spine Main

One party states that the proposal where a customer who pays 60% of tariff to repay direct connection charges to a new connection and 40% of tariff to pay towards installed pipes does not directly attribute to the new connection appears to have some logic. However it is concerned that, not having performed any detailed analysis, perhaps the contribution to the existing infrastructure may not be high enough to accurately reflect the usage the newly connected end user gets from the asset. The party requested comfort from the Commission in this regard.

Another party however does not support revenue from the tariff being retained and extracted to support cost recovery on existing Distribution assets (i.e. not included in an economic cost) for payment of the spine main. If the existing Distribution network is in place with over capacity (as is the situation in the majority of cases) there are consequences to extracting a significant portion of Distribution tariff revenue as a levy for cost recovery on the upstream network assets. To do so would be an unsustainable extra charge on future gas final customers and make gas less competitive with other alternative fuels. This leads inevitable to constrained growth and can result in a self-reinforcing circle of decline as lower sales will have to carry the same overall cost burden of the project.

Another respondent also believes that the impact of this policy change will be to reduce the number of new housing developers/builders that opt for natural gas over other fuels. A requirement for a contribution would in addition have a marked effect on the apartment and small housing unit market segment, where natural gas would quickly lose out to electricity as the fuel of choice. The respondent believes that the portion of the "all the way" Distribution tariff to be attributable to a new housing project should not be at a fixed percentage which is applied to all cases. This would be compatible with the Commission's proposals on the appraisals for new towns and allow all economically efficient projects to be connected. The remaining portion of the revenue would then be allocated to the upstream network.