Final Decision on Gas Price Options 2009
1st May – 30th September 2009

DOCUMENT TYPE:	**Decision Paper**
REFERENCE:	**CER/09/054**
DATE PUBLISHED:	9th April 2009
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Abstract:

This paper outlines the Commission for Energy Regulation's decision with respect to the gas tariffs for the residential and small I&C customer for the period 1st May 2009 30th September 2009.

In view of the exceptional difficulties currently facing the economy, the Commission has decided to approve a 12% decrease in the commodity component of the Bord Gáis Energy tariffs for the residential and small I&C sector from 1st May 2009.

Related Documents:

- CER/09/039 – CER consultation on Proposed Reduction in Gas Tariffs 2009
  http://www.cer.ie/en/gas-retail-market-current-consultations_.aspx?article=844762ce-0e80-497a-b9d4-7c43e1b2b5ae

- CER/08/247 - Bord Gáis Tariff Decision Paper 2009
  Final Decision on the Associated Tariffs for Bord Gáis Energy Supply Residential and Smaller Commercial and Industrial Customers January 2009 – 30 September 2009
  http://www.cer.ie/en/documents-by-year.aspx?year=2008

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Executive Summary

Following a request from Minister for Communications, Energy and Natural Resources, Mr Eamonn Ryan T.D., the Commission set out in consultation paper CER/09/039 *Proposed Reduction in Gas Tariffs 2009*, a review of current gas tariffs and options for bringing forward expected tariff reductions in light of the exceptional difficulties facing the Irish economy. This paper outlines the Commission for Energy Regulation's decision with respect to the options proposed.

Taking account of the exceptional economic difficulties, as well as the most recent data on international gas prices and on gas consumption levels in Ireland over the winter months, but also the need for regulatory certainty and market stability, the Commission has decided that a 12% decrease in tariffs from the 1st May 2009 is appropriate and best serves the interest of consumers.

Commission Decision:

The Commission approves a 12% decrease in the commodity component of the current approved residential and small I&C tariffs, to commence 1st May 2009.

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1.0 Introduction

1.1 The Commission for Energy Regulation

The Commission for Energy Regulation ('the Commission') is the independent body responsible for overseeing the regulation of Ireland's electricity and gas sectors. The Commission was initially established and granted regulatory powers over the electricity market under the Electricity Act, 1999. The enactment of the Gas (Interim) (Regulation) Act, 2002 expanded the Commission's jurisdiction to include regulation of the natural gas market, while the Energy (Miscellaneous Provisions) Act 2006 granted the Commission additional powers in relation to gas and electrical safety.

1.2 Purpose of this paper

This paper details the Commission for Energy Regulation's decision in relation to allowable revenues and resulting tariffs for Bord Gáis Energy residential and smaller industrial and commercial non-daily metered customers. The allowable revenues relate to the remainder of the current gas year and the applicable tariffs will be available from 1st May 2009 – 30th September 2009.

1.3 Comments Received

The Commission received 5 responses to the consultation paper (CER/09/039). Two of the parties requested that their submission remain strictly private and confidential. The remaining 3 submissions were received from the following organisations or individuals:

- Airtricity
- Irish Development Agencies (Forfás, Enterprise Ireland, IDA)
- VP&E

These responses are available to view on the Commission's website. The Commission would like to thank those parties for contributing to its consultation process and ensure them that all comments were considered and given due consideration in the Commission's final decision.

1.4 Background Information

Following a request from Minister for Communications, Energy and Natural Resources, Mr Eamonn Ryan T.D., the Commission set out in consultation paper CER/09/039 *Proposed Reduction in Gas Tariffs 2009*, a review of current gas tariffs and options for bringing forward expected tariff reductions in light of the exceptional difficulties facing the Irish economy.

On 8th August 2008 the Commission approved a two-phase approach to tariffs and an interim 20% increase in tariffs for residential and small Industrial and Commercial customer segment. It was anticipated at the time that there would be a further increase in the second phase. However, gas prices had reduced significantly in the intervening period with the result that on 1st December the CER announced that there would be no change to the existing tariffs.

Taking account of the exceptional economic difficulties, as well as the most recent data on international gas prices and on gas consumption levels in Ireland over the winter months, but also the need for regulatory certainty and market stability, the Commission has considered the following three regulatory options for residential and small I&C customers::

- A 12% decrease in tariffs from 1st May 2009
- A 17 month fixed tariff regime
- A redistribution of Networks revenue to provide 10% decrease 1st May 2009 with payback from 1st October 2009

The Commission requested feedback from industry on the proposed options. Responses received and the Commission's decision is detailed in section 3 of this paper.

2.0 Wholesale Market Developments

2.1 Introduction

Currently, over 90% of Ireland's gas is sourced from GB with the remainder from indigenous sources, including the Kinsale and Seven Heads gas fields. Corrib will add to Irelands indigenous supplies but the nature of the Corrib field is such that its production profile is expected to decline quite sharply. Clearly, then, the Irish price for gas is set by the GB price for gas i.e. Ireland is effectively a price taker for gas commodity purposes.

The cost of gas in Ireland depends on the wholesale price of gas at the National Balancing Point (NBP) in the UK, and will do for as long as it remains the marginal source of gas. With respect to the actual price of gas delivered to consumers, the cost of purchasing wholesale gas accounts for approximately 60% of the total delivered cost to NDM customers. Accordingly, a large increase in the wholesale unit cost will have a significant impact on gas tariffs. In noting the high prices faced by customers it must be further noted that large users of gas i.e. FVT, RTF and above 264 GWh, are not locked in to regulated tariffs and have thus been benefitting from the falling fuel prices.

2.2 Wholesale Gas Market

As shown in Table 1 below the monthly forward price of gas for delivery in 2008/09 has dropped since the tariff decision made 1st December 2008. The previous decision took account of forward prices at that time which were still relatively high considering their peak in July 2008.

Table 1: Forward monthly gas price snapshots taken on 1 December and 23 March

	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
1st December				56.26	57.15	56.00	51.60	48.00	46.62	46.37	48.17	48.65
23rd March							32.48	33.00	33.45	33.00	33.25	32.80

Source: ICE Index

Table 2: Forward seasonal price snapshot taken on 1 December and 23 March

	Summer 09	Winter 09	Summer 10	Winter 10	Summer 11	Winter 11	Summer 12	Winter 12
1st December	48.24	62.14	52.28	66.07	54.64	68.23	56.48	69.48
23rd March	33.00	51.87	47.26	62.35	52.28	66.00	55.97	68.43

Figure 1: Forward monthly gas price snapshots taken on 1 December and 23 March

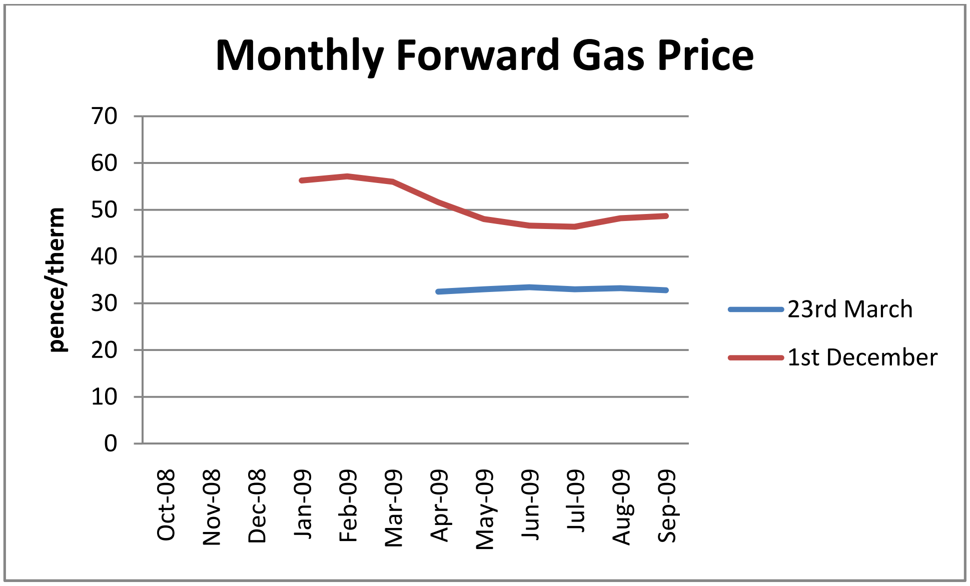
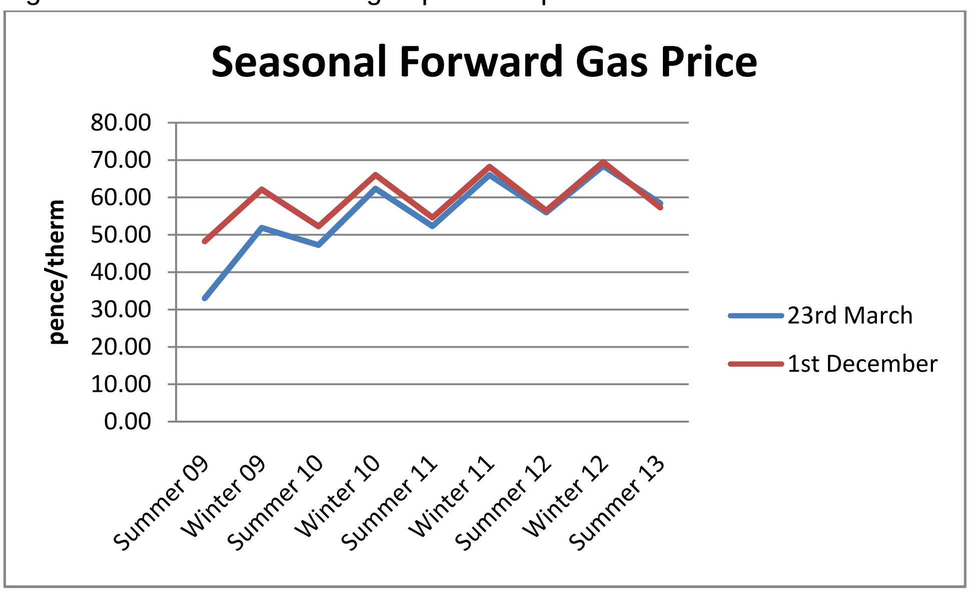


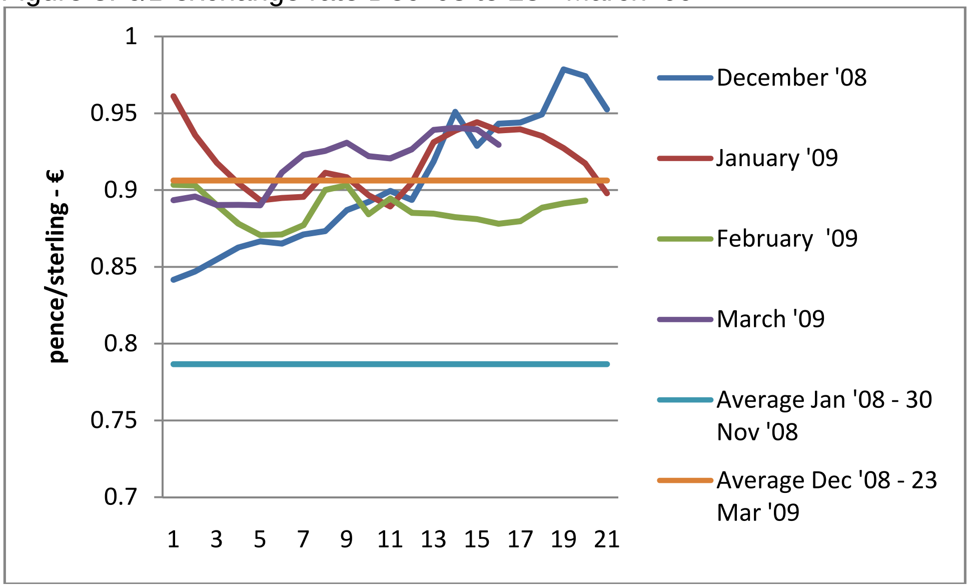
Figure 2: Forward seasonal gas price snapshot taken on 1 December and 23 March



The recent fall in the price at NBP has come about largely due the weakening oil prices globally, economic factors and drop in demand. Forward monthly prices are now falling back to mirror those seen in 2005 with the month ahead price for April averaging around 36 pence/therm compared to the April forward price in December of around 51 pence/therm. Continued devlieries of LNG appears to have depressed the prices in the short term but there is uncertainty in the maket at how how long this will last.

Although prices appear to be moderating at this stage, many analysts are still unconvinced as to how long this will last before we see the re-emergence of the volatily seen in fuel prices last year. With this is mind it is difficult to predict out past the current gas year.

Figure 3: €/£ exchange rate Dec '08 to 23rd March '09



Data Source: ECB & Central Bank

Figure 3 above shows the relative changes between the Euro and Sterling since the tariff decision on 1st December (also included is average for 1st Jan '08 to 30 Nov '08, and from 1st Dec '08 to 23rd March '09). Although the graph does not represent the actual currency hedging strategy it does indicate the recent change in Euro/Sterling conversions, which in theory could account for financial gains if currency was bought at the lower prices. Although the Euro/Sterling conversion has settled around the 90 pence mark there is no guarantee it will stay this high so any financial gains in currency now cannot be assumed to be repeated in the future.

3.0 Comments received

The Commission received 5 responses to the Gas Price Options 2009 consultation paper. Responses were received from a broad range of stakeholders providing comments on the options proposed by the Commission. While there was a general appreciation of the rationale of the Commissions' proposals, beyond that there was a wide range of views.

The principal points raised by respondents are as follows:

- Appreciate rationale behind the Ministers request to the CER to carry out a special review of energy prices given the current economic climate.
- Important that the tariff review process has displayed some flexibility in light of the changed circumstances since the last review.
- Proposed 12% reduction from May '09 is reasonable given the circumstances.
- Call on CER to carry out and publish a regulatory impact assessment from making policy changes in the middle of tariff period.
- Request the CER to clarify the 12% reduction.
- Wholesale markets remain volatile and implementing an interim reduction from May '09 is not without some risk.
- Regulatory intervention on this scale and frequency potentially undermines market confidence and increases risks for independent suppliers, and at this time works to the commercial benefit of BGES. As a result, confidence may be lost and independent suppliers may withdraw from the market at a loss to the consumer.
- Existence of option by the Commission to intervene acts as a barrier to competition and a disincentive for independent suppliers to adopt hedging strategies. Stable regulatory framework is essential.
- Competition for SME customers has only just started to take a serious step forward; any interim measures should take account of this.
- Restoring market confidence is essential going forward.
- Mechanism for changing tariffs in the residential and small business sectors is fundamentally flawed.
- Happy to consider future proposals to amend Market Rules.
- Laddered approach to gas procurement by BGES would suggest that they are taking undue risk with their customer obligations.
- Believe 'K' factor should be removed. It creates barrier to competition and favours the incumbent. Should also not be used to effect mid-term price reductions. 12% reduction could be construed as an abuse of the 'K' factor.

- Is this ad hoc tariff decrease to be repeated or simply a one off exercise?
- CER makes no mention of benefits accruing to Irish consumers as a result of appreciation of the euro relative to sterling or weather influences.
- Disappointed with level of background explanation in regard to proposed tariff options.
- More appropriate to link BGES allowable margin to amount of risk that BGE is willing to accept.
- Commission should provide information on BGE's currency hedging policy.
- Supply Margin should be set at 3% and BGES to take on full price and volume risk, as faced by other suppliers.
- Transport charges should be adjusted to deliver the targeted 12% in delivered prices.
- Gas procurement strategies were put in place predicated on the next tariff review occurring in line with original timetable.
- Recommend a reduction in network component of tariffs, from which all customers might benefit. Benefit would be to leave 'K' factor unadulterated, reducing impact on competition.
- Customers invariably need the lowest possible energy prices; they also require some price stability.
- Important that future reviews ensure that the anticipated input price reductions are passed through to consumers.
- Appreciate the Commission's commitment towards the development of effective markets.

While the overall reason for carrying out an interim review of tariffs was questioned by many respondents, one respondent welcomed the decision by the CER to decrease the cost of energy as the first attempt to restore energy cost competitiveness while maintaining market certainty and regulatory independence to the maximum extent possible.

Commission's View

The Commission has taken account of all views presented, and in making its decision has done so in the aim of keeping account of its long term goals to create a fully competitive market while maintaining the best interests of the consumers.

In approving a 12% decrease on the commodity component of the current BGES tariffs from 1st May 2009, the Commission is anxious to reassure independent suppliers that this option was not taken lightly and is not considered part of the normal review process. However the Commission did in its decision paper CER/08/247 state that it would closely monitor the wholesale market for significant changes and conduct another review if it was deemed appropriate. The Commission also noted in decision document CER/07/158[1] that an update in the RCF's gas commodity element will occur after the first three months of the gas year. If this update, combined with BGES's accrued revenues, realised network charges, residual correction factor, gas cost portion of their incentive share and portion of BGES's acceptance of the volume deviations which arise from attempting to match the benchmark ex ante and being unable to ex post, results in a greater than 7.5% total tariff change, then the Commission, in consultation with BGES, have the discretion to adjust tariffs accordingly.

As can be seen in figures 1&2 above (Section 2) there has been a significant shift downward in wholesale prices for month ahead since the December decision. This combined with some movement in currencies and an increased consumption level due to the cold winter has allowed for the reduction in tariffs to be brought forward to May. A decrease of 12% will ensure that BGES tariffs remain cost reflective for the reminder of the gas year '08/09, consumers get the best price available at that time and independent suppliers are not unduly burdened by a large 'K' factor come October.

On the question of the reasoning for the Commission's ruling out of alternative options for tariff reductions- i.e. reprofiling the Transmission and Distribution (T&D) revenue or introducing a 17 month fixed tariff - the Commission notes the following:

Allowing the T&D businesses to under recover (therefore allowing for a short term reduction in tariffs) for the remainder of the gas year is not a consistent long term solution to reducing tariffs. Any under recovery from this year would automatically be added to networks revenue requirements for gas year 09/10. This is highly risky because of the inherent uncertainty in gas price forecasts for next year. Issues with redistributing the T&D from this year to next could potentially in an overall rise in NDM tariffs come the 1 Oct '09 as any under recovery from this year must be moved to networks '09/10 'K' factor. It may be possible to remove the inherent risk by fixing the gas price in advance; however,

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[1] CER/07/128 - FINAL DECISION ON BORD GÁIS ENERGY SUPPLY NON-DAILY METERED 5-YEAR REGULATORY REVIEW 2007/08 - 2011/12

to do so would mean a departure from the benchmark laddered approach to gas purchasing. Moving from a step by step laddered approach to a one shot 'all in' approach to purchasing gas for the NDM market would in itself be a major risk and a retrograde step in the view of the Commission.

The introduction of a 17 month fixed tariff would allow for customers to budget sufficiently for their energy costs for the remainder of the '08/09 and '09/10 gas years. Allowing a fixed term price reduction would mean a move away from current regulatory practice, which the Commission feels is vital to ensuring that prices remain cost reflective and transparent. A fixed term tariff would for this duration also impact on regulatory risk for independent suppliers. Given that BGES has a large customer base and benefits from a 'K' factor which compensates in the case of an under/over recovery, it is better placed to cope financially with changes to tariffs. A move away from the current review process could place financial burden on independent suppliers which could ultimately result in a degradation of market competitiveness. Current regulatory practices are well documented and allow for a stable and transparent environment, which is a key requirement of any new entrant into the market.

In making its December decision the Commission allowed BGES to revert to a 2% margin with no volume risk for the reminder of the gas year. The Commission made the decision at the time given the inherent volatility in wholesale gas prices. This margin will be fully reviewed in the next tariff review due for 1st October 2009 implementation. In an attempt to reassure the market and give confidence to suppliers the Commission will in its '09/10 gas year consultation paper consider the concept of bi- annual tariff reviews.

4.0 Conclusions and Next Steps

4.1 Summary

The Commission has decided to approve a 12% decrease in the gas commodity component of the current BGES tariffs for its residential and small I&C customer segment. The Commission is writing to BGE today to this effect pursuant to Gas (Interim) (Regulation) Act 2002. An early reduction of the commodity component of the current tariffs can be objectively justified by the clearly evident trends in gas wholesale prices, exchange rate changes and in winter consumption trends.

In taking this decision, the Commission has aimed to ensure tariffs remain cost reflective for the reminder of the ‘08/09 gas year, and that this decision has not unduly affected competitors or potential competitors to the residential and I&C customer segment.

4.2 Next steps

This decision allows for a 1st May 2009 implementation of the revised BGES tariffs. The next review of the NDM tariffs for the ‘09/10 gas year will commence during the late summer months with implementation to commence 1st October 2009.