Gas Tariff Review 2009 - 2010
Bord Gáis Energy's Residential and Smaller Industrial and Commercial Customers

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The Commission for Energy Regulation,
The Exchange,
Belgard Square North,
Tallaght,
Dublin 24.

www.cer.ie

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Abstract:

This paper outlines the Commission for Energy Regulation's decision with respect to the Non Daily Metered (NDM) tariffs for the residential and small Industrial and Commercial (I&C) customers for the period 1st October 2009 to 30th September 2010.

The Commission has reviewed the submission from Bord Gáis Energy (BG Energy), which has been updated to reflect the most up to date market data. The Commission approves an average decrease of 9.8% in the NDM tariff for the residential and small I&C customers for the period 1st October 2009 to 30th September 2010.

Target Audience:

Gas Customers, Suppliers, Shippers and Producers.

Related Documents:

- CER/09/124 – Gas Tariff Review 2009 – 2010
- CER/09/054 – Final Decision on Gas Price Options 2009 – 1st May to 30th September 2009
- CER/09/039 – Consultation – Proposed Reduction in Gas Tariffs 2009
- CER/07/158 – Final Decision on Bord Gáis Energy's Non-Daily Metered 5-Year Regulatory Review 2007/2008 2011/12

For further information on this decision paper, please contact Stuart Coleman (scoleman@cer.ie) at the Commission.

Executive Summary

This paper outlines the Commission for Energy Regulation's decision with respect to Bord Gáis Energy's allowed revenues for the 2009/10 gas year and the associated tariffs to be applied to the residential and small I&C customer segment from the 1st October 2009.

In its formal submission to the Commission, BG Energy requested €387 million in revenues for the 2009/10 gas year. This translates to an average tariff decrease of 9.8% for residential and small and medium sized business customers.

As part of the consultation process, the Commission published on 6th August 2009 the BG Energy submission and the Commission's initial views (CER/09/124). The Commission also facilitated an Open Forum on 10th August 2009, at which BG Energy presented their submission to interested parties.

Having examined the BG Energy submission (including the forecast taken at close of business 6th July) and taken into consideration the oral and written responses offered by interested parties, the Commission has decided to approve €387[1] million in allowable revenue. In their submission, BG Energy also applied for an increase in the standing charge (from €52 to €60 ex VAT) to take effect from 1st October '09. The Commission has approved this increase. However, it should be noted that the increase in the standing charge does not affect the overall average 9.8% decrease in NDM tariffs.

The Commission also confirms that the BG Energy allowable revenues (gas commodity & volumes) will be reviewed in December of each year and a change in tariffs if warranted will take effect the 1st February each year.

[1] See Schedule of BG Energy Tariffs, published separate to the document.

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1.0 Introduction

1.1 Legal Framework

Under section 23 of the Gas (Interim) (Regulation) Act of 2002 ("the 2002 Act"), the Commission for Energy Regulation ('the Commission') is responsible for regulating charges in the natural gas market, including supply tariffs to final customers. As such, the Commission examines the costs underlying these tariffs and approves revenues for Bord Gáis Energy (BG Energy).

This decision paper refers to the regulation of BG Energy revenues and tariffs for residential and small and medium sized business customers.

In making this decision the Commission has been mindful of its legal functions under the 2002 Act including the protection of final customers, promotion of competition within the gas market and continuity, security and quality of supply of natural gas.

1.2 Purpose of this paper

This paper details the Commission for Energy Regulation's decision in relation to the allowable revenues for BG Energy's residential and smaller industrial and commercial NDM customers. The allowed revenues and resulting tariffs relate to the gas year from 1st October 2009 – 30th September 2010.

1.3 Comments Received

The Commission received four responses to the consultation paper (CER/09/124). Two of the parties requested that their submission remain strictly private and confidential. The remaining two submissions were received from the following organisations or individuals:

- Flogas
- Viridian Power & Energy Limited

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 given due consideration in the Commission's decision.

1.4 Background Information

2008/09 Approved tariffs:

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 (CER/08/148). It was anticipated at the time that there would be a further increase in the second phase. However, wholesale gas prices reduced significantly in the intervening period. This, combined with a voluntary €8.5m rebate offered by BG Energy to all residential and small I&C customers - i.e. regardless of their supplier - resulted in the CER decision on 1st December that there would be no further change to existing tariffs (CER/08/247). Following on from this and following a request from Minister for Communications, Energy and Natural Resources, Mr Eamon Ryan T.D., the Commission set out in decision paper CER/09/054 *Final Decision on Gas Price Options 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.

Taking account of these 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 decided that a 12% decrease in tariffs from the 1st May 2009 was appropriate and best served the interest of gas consumers (CER/09/054).

Following on from this and as part of the normal annual review process, the Commission published on the 6th August 2009 CER/09/124 "*Gas Tariff Review 2009 – 2010 ,Bord Gáis Energy's Residential and Smaller Industrial and Commercial Customers"* a consultation paper outlining the BG Energy submission of allowed revenues for gas year 2009 – 2010, along with the Commission's views. As part of this consultation process, the Commission also facilitated an Open Forum on 10th August, at which BG Energy presented to interested parties. The Commission requested feedback from industry on the allowed revenues. Responses received and the Commission's decision is detailed in section 3 of this paper.

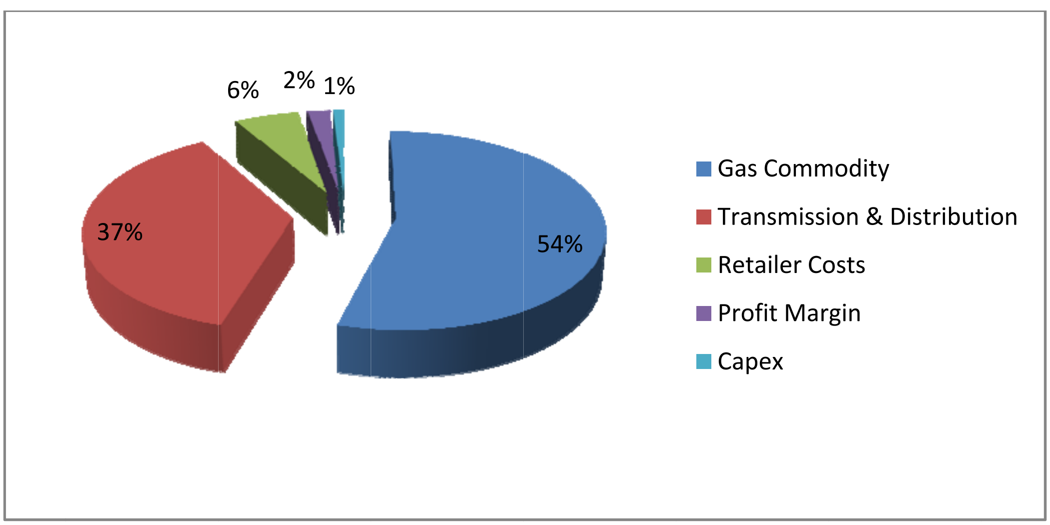
2.0 Gas Market

2.1 Introduction

With the steady decline in indigenous Irish gas supplies through Kinsale and Seven Heads gas fields, Ireland now sources the greater part of its natural gas requirements in the UK gas market. Currently, over 90% of Ireland's gas is imported through our interconnectors with Scotland, with the remainder from indigenous sources, including the Kinsale and Seven Heads gas fields. Corrib will add to Ireland's indigenous supplies but the nature of the Corrib field is such that its production profile is expected to decline quite sharply after the early years of flow. 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 speed with which changes in international energy commodity prices – upwards or downwards – feed through to gas retail tariffs to end customers is affected by, among other things, the hedging policies of suppliers and how BG Energy in particular is regulated in this regard. This is dealt with in more detail in section 3 below.

With respect to the actual price of gas delivered to consumers, the cost of purchasing wholesale gas accounts for approximately between 45 - 60%[2] (see fig 2.) 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.

Figure 1: Components of natural gas bill (taken from 08/09 RCF[3])



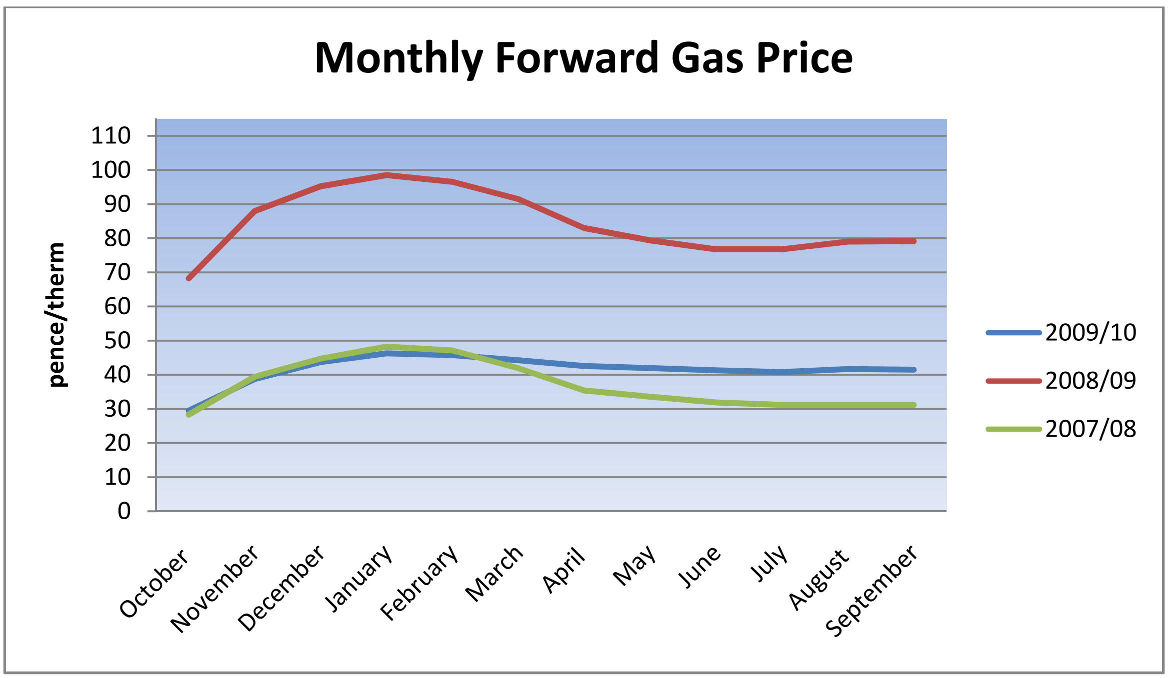
[2] Gas commodity component of bill changes with the price of wholesale gas
[3] Excludes, Vt, K Factor and rebate

2.2 Wholesale Gas Market

Gas prices at NBP have become more stable over the past eight months with gas prices retreating from the highs of over 100p/therm in July 2008.

Prices peaked in July 2008, then began to fall back steadily. Prices have declined since, but are not back to those levels seen in 2007 (Winter '09 price 41.35p/therm versus Winter '07 40.57p/therm)[4]. Figure 2 shows the forward monthly prices for the gas year (taken on the 19th of August, or nearest day each year) 2009/10 in comparison to those in 2008 and 2007.

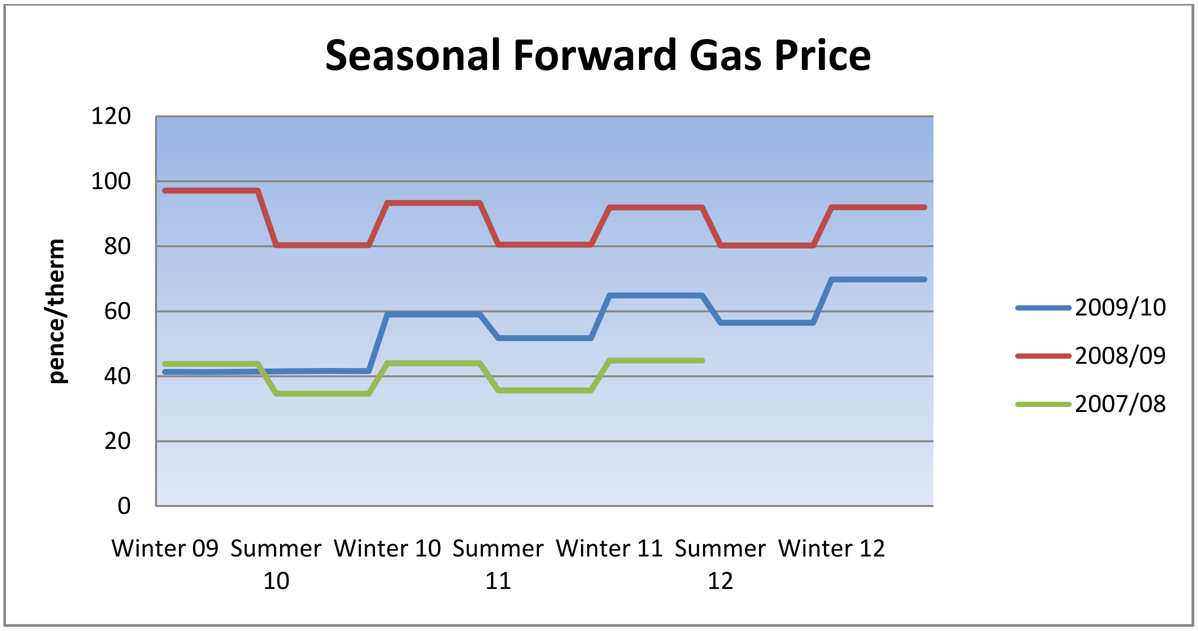
Figure 2: Forward monthly wholesale prices @ NBP (p/therm)[5]



It can be seen in the above graph that prices have not fallen back fully to those in 2007.

[4] Price taken for winter season on 19th August.
[5] Prices taken from ICE index, prices represent the monthly forward prices @ NBP for year ahead taken as a snapshot on the 19th August 2008,09 and on 17th August 2007.

Figure 3: Forward seasonal wholesale prices @ NBP (p/therm)[6]



The volatility seen on the global fuel markets in the second half of 2008 has now largely dissipated and the markets have begun to return to some normality. The outlook for the gas year 2009/10 looks relatively stable for the time being.

The fall in the price at NBP has come about largely due the weakening oil prices globally, economic factors and drop in demand. Continued deliveries of LNG into the UK and forecasts of lower demand appear to have depressed the prices in the short term but there is uncertainty in the maket at how long this will last.

Although, prices appear to be stabilising in the short term, in a global fuel market where prices are influenced by a number of political, geographical and economic factors, it is difficult to predict how, or the scale on which, they will change in the coming year.

[6] Prices taken from ICE index, prices represent the forward seasonal prices @ NBP on the 19th August 2008/09 and on 17th August 2007. Note values for Summer & Winter 12 were not available for '07/08 forward projection.

3.0 Responses to Consultation

The Commission received four responses to the consultation on the tariff submission from BG Energy for its residential and small industrial and commercial customers. The responses received commented on various aspects of the BG Energy submission. This section summarises those comments and outlines the Commission's response. The Commission appreciates comments received from respondents.

The principal points raised by respondents are as follows:

- hope the Commission had fully reviewed and tacitly approved the tariff reductions before this was released to the press by BG Energy.
- believe the Commission should publish the values and basis of each component part of the RCF formula, in addition to detailed derivation for these values.
- no backup data to qualify how costs have been allocated across customer segments.
- encourage both ESB PES and Bord Gáis Energy to be a great deal more forthcoming in terms of the underlying facts and how the tariffs have been arrived at.
- greater transparency is required around the criteria and assumptions made by Bord Gáis Energy in calculating their projected Supply Costs.
- the projected percentage loss of customers should be provided.
- ask the Commission to confirm the standing charge of €60 represents the complete supply cost applied to each customer.
- would like to see K-factors removed from the RCF equation as they distort competition by providing a bias of risk in favour of the incumbent.
- fundamentally believe this tariff structure should be done away with. It is not transparent as it is not based on a price regulated regime.
- does not give alternate shippers a sustained benchmark against which to compete.
- Believe the removal of the k-factor should be done in conjunction with an increase in the supply margin. This should be carried at the same time as a complete overhaul of the retail structure of the NDM market.
- gas benchmark data should provide market participants with a sufficient level of detail that enables them to understand how regulated prices have been derived.
- benchmark data is still too broad, require monthly benchmarked data.

- the current tariff structure requires suppliers to recover fixed transportation costs by means of a unitised commodity rate, believe the current systems need to be changed.
- Network charges: current regime of revenue regulation must change to ensure sustainable competition can develop, no transparency on how network costs are transposed by BG Energy into the tariffs.
- strongly opposed to a midyear review, believe it will introduce regulatory uncertainty to the market.
- do not believe that it is useful or necessary to carry out a bi-annual review of “all” the elements of the RCF.
- do believe an interim review would go some way to creating a more competitive environment.
- are supportive of a tariff adjustment that reduces the effect of the K-factor.
- propose midyear review on gas commodity only.
- would agree that the midyear review should look at the key components i.e. cost of gas and sales volumes.
- believe that it would make more sense for the implementation date of any change in tariffs to be 1st March 2010.
- in CER/09/054(d) the capacity tariff for medium business user was reduced by 12%, this is in contravention with the CER decision to reduce the commodity element of the tariff only. Has this under recovery meant the capacity element for the coming tariff period higher than it ought to be?

Commission’s View

The Commission has taken account of all views and in making its decision it has also aimed to balance its long term goals of ensuring long term secure supply, promoting competition, while also considering and protecting the interests of customers both in the short term and long term. In taking its decision, the Commission has aimed to ensure that the tariffs are cost reflective, while allowing for acceptable margins to operate in the market.

Questions were raised in relation to the timing of the tariff announcements and whether the Commission had tacitly approved the tariff reductions before it was released by BG Energy in their press release. The Commission would like to emphasise that there was nothing approved, tacitly or otherwise in the draft decision paper CER/09/124. The Commission clearly stated its views under each section; Gas Commodity Purchases, Network Charges, Supply Costs, Margin, Correction K Factor, Capital Expenditure, Interim Review. As to the matter of the timing of the BG Energy press release, the Commission was not in any way involved in either the substance or the timing of this BG Energy announcement and had no prior knowledge of the announcement.

In relation to the values and basis of the components of the RCF, all formulas and percentages are published in the Commission's papers regarding the 5 year review[7]. The Commission firmly believes there is more than sufficient information in the public domain relating to costs and allocations in the RCF formula for independent suppliers to examine and understand the BG Energy costs. The Commission also believes the information provided in the benchmark is sufficient and do not propose to publish the full benchmark. However, the Commission will endeavour to give all suppliers access to as much information as possible in relation to NDM consumption and profiles to help them better understand the market. Publishing the full benchmark would expose confidential information with respect to BG Energy's business.

The question of K factor removal is brought up by the majority of respondents. They believe the inclusion of such distorts competition. The Commission has worked with BG Energy to minimise the effect of the K factor, namely by introducing the midyear review. Introducing the midyear review will allow the costs to be more accurately reflected through the tariffs across the year as a whole and in turn aim to reduce effect of a K factor. All factors relating to the current RCF formula and its components will be reviewed at the end of the five year review period, until such time the Commission will keep the RCF under review.

With respect to Network charges, these are levied upon all suppliers including BG Energy. These charges are treated as pass through costs and are distributed in a fair manner. The Commission does not see any significant reason for change at this stage. If a supplier can demonstrate how the current setup is detrimental to their business the Commission will take that argument under review. However, in the meantime the network tariffs are subject to a five year review period and the form of the tariffs will be reviewed at the end of the current period.

There has been a mixed response to the introduction of a midyear review. The Commission believes the addition of such would help cement regulatory certainty rather than create uncertainty in the market. As was seen over the last twelve months, the market was extremely volatile. This meant prices were unstable. By introducing a midyear review the costs incurred can by more accurately reflected

[7] CER/07/158, CER/07/130, CER/07/129, CER 07/101

through the tariffs. The aim is to increase customer awareness of actual costs and let the tariffs more closely track real time commodity movements. The Commission has decided a midyear review will be conducted. The midyear review will not look at the full RCF formula, it will only review the actual and forecast sales volumes and gas prices. The review will not automatically result in any tariff changes. The Commission would only propose changes in regulated tariffs if emerging trends in underlying volumes or commodity prices were of such a significant scale as to warrant mid year “corrective” action. In other words materiality will be a consideration. The Commission will examine the mid year submission from BG Energy in late November, if it appears that a change is warranted, a consultation period will begin in early December 2009 with an early January decision, and any change if warranted will be implemented on the 1st February 2010.

The question was raised in relation to the Commission’s 1st May decision CER/09/054 and whether the 12% decrease on the capacity tariff for medium business users has allowed for an under recovery. The Commission’s decision at that time was for a 12% decrease in the commodity component only, However, BG Energy decided to give those customers a net 12% decrease off both the capacity and commodity elements of their bill rather than an equivalent larger decrease on their commodity component only. Therefore there will be no under recovery. However, as the capacity element of the tariff was reduced when the actual transmission and distribution charges had not decreased there is now a need to rebalance the capacity charge.

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4.0 Revenue Control Formula

4.1 Introduction

In October 2007, the Commission approved a Revenue Control Formula (RCF) to calculate revenue regulated gas tariffs for the gas years 2008/09 – 2011/12[8].

There are six main features of the RCF:

1. Gas Commodity Purchases
2. Network Charges
3. Supply Costs
4. Margin
5. Correction Factors
6. Capital Expenditure

1: <u>Gas Commodity Purchases</u>

As part of the RCF the Commission approved the use of a benchmark mechanism to calculate the allowed gas commodity cost. This benchmark applies a laddered approach to the purchasing of gas for each month throughout the whole year.

Two key elements underpin the benchmark:

1. A certain percentage of the total anticipated gas volume demanded for each delivery month will be procured in a gradual manner as the delivery month approaches (i.e. the “laddered approach”, see Table 1). The percentage of total anticipated monthly gas volume demand procured prior to the delivery month differs by delivery month.
2. The procurement pattern of gas contracted for delivery in any given gas month is fixed for the period the benchmark is applicable.

This acts as a hedge on changes to the gas price and offers transparency in the tariff formulation process and provides a target for other suppliers to compete against.

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[8] CER/07/158: Final Decision on BGES NDM 5 Year Regulatory Review 2007/08 – 2011/12

Table 1: Gas purchasing benchmark

For delivery in:	Q4 2009	Q1 2010	Q2 2010	Q3 2010
Purchases starting in:				
Q4 2008	20.9%	16.1%	0.0%	0.0%
Q1 2009	20.9%	16.1%	0.0%	0.0%
Q2 2009	20.6%	21.4%	7.6%	22.1%
Q3 2009	18.0%	19.3%	12.5%	22.1%
Q4 2009	4.5%	11.1%	16.1%	0.0%
Q1 2010	0.0%	3.0%	19.5%	3.7%
Q2 2010	0.0%	0.0%	4.3%	13.7%
Q3 2010	0.0%	0.0%	0.0%	8.5%
Total	84.9%	87.0%	60.0%	70.1%

Total = average % of total volume purchased prior to delivery months

The price allowed for BG Energy's gas portfolio requirements for the residential and small I&C customer segment is set using the laddered approach. This strategy is in keeping with general industry practice, and in itself is a hedging type strategy, which ensures that gas costs are not heavily impacted by random market spikes. Instead, the cost of gas is smoothed out to reflect changes that occur in the market throughout the year.

2: Network Charges

Network charges (Transmission & Distribution) are the Commission approved costs that suppliers are required to pay the operator of the natural gas network for the transportation of gas to the consumer. Network charges are largely pass through costs and are outside the control of BG Energy.

The network charge element of the RCF also reflects capacity benefits accruing to the residential and small I&C customer sector. These benefits arise firstly, because of the requirement on suppliers to book onshore transmission capacity for a one-in-fifty peak winter day for all NDM customers (interruptible capacity sales), and secondly through the use of the South West Kinsale storage facility.

Interruptible External Capacity Sales and Inter-Book Transfers
A proportion of the transmission capacity booked by suppliers to the NDM market is used only in periods in extreme cold temperatures and can be sold on an interruptible basis to third parties in the gas market. It can also be transferred between customers segments within BG Energy referred to as inter-book

transfers. The minimum prices charged for BG Energy's secondary market interruptible capacity sales are regulated by the Commission and offered to third party Shippers/Suppliers on a first-come first-served non discriminatory basis. The revenues generated through these sales are redistributed back to the customer, acting to offset part of the transmission charges.

Inch Capacity Benefit
The Inch capacity benefit is the transportation cost savings made when BG Energy brings gas ashore from the South West Kinsale storage facility. Any benefits accruing to BG Energy as a result of the storage are also redistributed back to the customer, again acting to offset part of the transmission charges.

3: Supply Cost

The Commission approves a baseline supply cost for BG Energy as part of its five year review[9]. The supply cost element of the RCF comprises allowed operating expenditure and other costs that are deemed to be efficient and recoverable over the period. This figure is adjusted year on year to account for changes in customer numbers and inflation. It also includes an efficiency factor of a certain percentage, which accounts for annual improvements in productivity within BG Energy.

4: Margin

The Commission also approves BG Energy's allowable margin. BG Energy has been allowed a 2% margin on turnover that reflected the opportunity cost of holding working capital, the cost of capital for investments made by BG Energy and various other risks to which BG Energy may be exposed. The Commission approved a margin of 2% for the residential and small I&C customers segment for the 2008/09 gas year.

5: Correction Factors

The correction factor (K factor) is a key feature in a tariff review process which sets tariffs on an ex-ante basis for the period of the year. A gas year's total correction (or, K) factor is defined as: the difference between the gas years' ex-post allowed revenue and the revenue BG Energy has actually collected given the volumes and customer numbers during the gas year.

[9] CER/07/158 – Final Decision on BGES NDM 5-year regulatory review 2007/8 – 2011/12

As the BG Energy revenue requirement and the associated tariffs for any one year are set in advance of the year to which they relate, they are based on a combination of actual and forecast data. These forecasts include assumptions on various elements of the RCF such as customer numbers, gas sales, weather and gas procurement costs.

In addition to the K factor, the Commission introduced a Z factor (incentive-sharing) whereby BG Energy shares with the customer the difference between allowed gas and supply costs and the actual gas and supply costs. The intention of this factor is to incentivise BG Energy to beat the benchmark and to share any resulting gains with the customer.

6: <u>Capital Expenditure</u>

Finally, capital expenditure allowance is also approved by the Commission on an annual basis, with all expenditure being broken down into the costing of each expenditure and how those costings should be apportioned. This included two systems projects - the Customer Information and Billing System (CIBS) approved by the Commission in 2006 and a new Energy Trading System.

All the above elements make up the gas tariffs. With gas commodity costs comprising up to 60% of the tariff, gas commodity prices can cause the biggest increase or decrease to the NDM market.

4.2 Gas Commodity Purchases 2009/10

In accordance with the benchmark, BG Energy began acquiring the NDM gas portfolio for gas year '09/10 in October '08. Gas requirements for the 2009/10 gas year have been procured on a gradual basis (using a laddered approach) since October last. This purchasing strategy is in keeping with general industry practices, and is in itself a hedging type strategy, which ensures that gas purchases costs are not heavily influenced by random market spikes. The cost of gas purchases is spread across the year to better reflect changes that occur throughout the year.

In addition to the benchmark the Commission introduced a 50/50 incentive-sharing mechanism (Z factor) whereby if BG Energy beats the benchmark price they share the savings with the customer. The intention of this factor is to give BG Energy an incentive not just to match but to beat the benchmark and to share any resulting gains with the customer. This is a mechanism to incentivise BG Energy to procure gas at the cheapest price available at that time.

The gas purchase prices are reflective of recent movements in energy markets. There is, outstanding, a proportion of gas left to be procured for gas year '09/10. Prices of these future gas contracts are marked to market using the prevailing forward curve prices as of close of business on 6th July 2009. The Commission has examined and verified these figures.

Commission Decision:

The Commission has reviewed the gas benchmark costs and is satisfied that it reflects the weighted average cost of gas purchases since October 2008 up to 6th July 2009 and, also the forecasted cost of gas requirements, yet to be procured.

4.3 Network Charges

Network charges consist of the transmission and distribution capacity and commodity charges levied on BG Energy by the Transporter. It also reflects discounts redistributed to customers as a result of both the interruptible capacity sales and usage of the South West Kinsale Storage facility.

The transmission and distribution charges for 2009/10 are detailed in CER/09/149 and CER/09/150. These charges form the basis of network charges for all gas suppliers in the market.

BG Energy is permitted to pass through to its customers all efficiently incurred Transmission and Distribution charges.

Interruptible External Capacity Sales, Inter-Book Transfers and Inch Capacity Benefit

In the BG Energy submission, forecasts of both Interruptible Capacity sales and the use of the South West Kinsale Storage facility amounted to €6.562m. This figure was net of a 5.1% margin allowed for BG Energy to cover costs involved in the management of interruptible capacity sales.

Commission Decision:

The transmission and distribution charges in CER documents (CER/09/149 and CER/09/150) are charges for all suppliers to the Irish natural gas market. The Commission has examined the costs in the RCF and is satisfied that these are in accordance with the above decisions. The Commission also approves the BG Energy forecast of €6.562m in ICS sales and Inch benefit.

4.4 Supply Costs

As part of the BG Energy five year regulatory review[10] it was decided that the calculation of the allowable BG Energy Supply Costs should be base-lined to 2006/07 at €28.2m. In addition, this amount will change in line with changes in CPI and the revised weightings provided below.

The weightings are:
• 2% volumes
• 35% customer numbers
• 63% fixed cost

Added to this is 0.5% of turnover for the bad debt provision, and a 3% efficiency factor that will reduce allowed supply costs by this percent each year.

[10] 5 year decision document CER/07/158 – CER/07/129 gives breakdown of Supply Cost

Allowing for the above weightings the Commission has decided to approve the BG Energy forecast supply cost of €25.458m. This figure is lower than the base year as a result of estimates of customer losses over the gas year ‘09/10. As part of the latest RCF, BG Energy is now required to share 50% of the difference between ex-post supply cost and the actual supply cost for the year. 50% of any difference that may arise will be recovered in the following year’s tariff. In accordance with this adjustment BG Energy requested approval to recover a further €3.544m from the 2008/09 gas year. This equates to a total supply cost of €29.002m.

BG Energy also requested an increase in the standing charge (from €52 to €60). BG Energy stated that the standing charge which reflects the overhead costs (opex and capex) of serving the customer has increased to €60 in anticipation of the forecasted decrease in customer numbers during the 2009/10 tariff year. BG Energy proposed to set the standing charge to €5 per month (€60 per annum) rather than the (slightly lower) charge that would result from the exact mathematical calculation. The Commission notes that the effect of this standing charge increase is included in the overall average 9.8% reduction.

Commission Decision:

Allowing for adjustments in inflation, customers numbers, volumes, a 3% efficiency factor and a sharing adjustment mechanism, the Commission approves the BG Energy total supply cost of €29.002m to cover the cost of serving the residential and small industrial and commercial sector. The Commission also approves an increase in the Standing Charge to €60.

4.5 Margin

The latest allowed margin in the RCF is 2%. This margin was determined in CER decision paper CER/08/247.

Given the unprecedented volatility that occurred in 2008 the Commission accepted (CER/08/247) that a 2.9% margin may no longer be a fair return for the 15% price risk placed upon BG Energy. The volatility in the market and its associated risk might have warranted a larger margin if it were to be reflective of the risks faced by suppliers to the market. Rather than increasing the margin at that point, the Commission believed that it was appropriate for BG Energy to remain at the 2% margin approved for the 2007/08 gas year. In remaining at the

2% margin, BG Energy was not required to accept any volume risk for the gas year.

The Commission considers that a 2% margin accurately reflects the diminished risk exposure of all suppliers to the revenue regulated market as a result of the volume risk being removed.
BG Energy has been allowed a 2% margin on turnover that reflected the opportunity cost of holding working capital, the cost of capital for investments made by BG Energy and various other risks to which BG Energy may be exposed.

Commission Decision:

The Commission approves the BG Energy allowable supply margin of 2% for gas year '09/10.

4.6 Outturn Adjustment (Correction K-Factor) 2009/10

The K factor is calculated by adjusting the RCF to account for actual annual outturn data, for instance the actual gas procurement costs, customer numbers and demand for a specific year. This is then compared with the actual revenues recovered over the year through the approved tariffs. Any under/over recovery is then passed though into the tariff for the following year.

Adjusting the actual outturn data for gas year '08/09 and taking into account the interim adjustment of the K factor in May, BG Energy forecasted an under recovery of €2.258m.

BG Energy explained in its submission that in the gas year '08/09, the cold winter resulted in an increased forecast volume. This combined with the lower than forecast gas costs, resulted in a large over recovery. The Commission allowed a 12% decrease on the commodity component of the gas on 1st May. The aim of this reduction was to reduce the '08/09 K factor to close to zero. However, due (in most part) to a dramatic fall off in demand seen since March '09 BG Energy forecasted a small under recovery for the remainder of this gas year.

Commission Decision:

The Commission has fully reviewed BG Energy's calculations of its under-recovery. The Commission has taken into consideration the reasons provided by BG Energy for this under-recovery. In this case the Commission is satisfied with the figures provided and approves a correction factor of €2.258 to be included in the tariffs for 2009/10.

4.7 Capital Expenditure

The costs for each Capex project are recovered from the entire BG Energy customer base. The portion of capital expenditure allocated to the NDM customer sector is calculated based on factors including customer numbers and volume demand. This disaggregated capital expenditure is then depreciated over a seven year period following project completion. Capex projects require approval from CER prior to their inclusion in an annual revenue review.

Two capex projects are included in the RCF for '09/10. The first project is the Customer Information and Billing System (CIBS), where the Commission directed BG Energy to separate its systems from those of Bord Gáis Networks. The CIBS project went live in December '08. The second project is the implementation of a new Energy Trading Risk Management (ETRM) trading system which is required to ensure gas procurement purchasing is carried out as efficiently as possible and that correct allocation takes place.

The BG Energy submission requested approval for a capex cost recovery of €4.390m. This was broken down into €3.689m for the CIBS project and €0.702m for the ETRM system. The proposed capex figure was somewhat larger than the approved revenue in 2008/09. The Commission has decided to allow this figure in the interim, as the examination of the costs on the CIBS project is ongoing. More time is required to ensure that all costs are reflective and the customer only pays for efficient work. The outcome of this review will be reflected in the mid year NDM review where any over recovery will be given back to the customers.

Commission Decision:

The Commission has decided to allow the proposed capital expenditure total of €4.390m for the 2009/10 gas year.

5.0 Conclusions and Next Steps

5.1 Summary

The Commission has reviewed the tariff submission from BG Energy. Considering the latest market data as of 18^{th} August 2009 and the responses received, both written and oral, the Commission approves a total revenue requirement of €387m. This equates to an average decrease of 9.8% in the BG Energy tariffs for its residential and small I&C customer segment. The Commission is writing to BG Energy today to this effect pursuant to the Gas (Interim) (Regulation) Act 2002. In taking this decision, the Commission has aimed to ensure tariffs remain cost reflective.

5.2 Next Steps

This decision allows for a 1^{st} October 2009 implementation of the revised BG Energy tariffs. The next review will begin in late November 2009. As part of the midyear tariff review the Commission requests BG Energy to submit an updated gas commodity cost & sales volumes (including actual and forecast data) at the end of November 2009. The Commission will examine the mid year submission from BG Energy; if it appears that a change is warranted, a consultation period will begin in early December 2009 with an early January decision, and any change if warranted will be implemented on the 1^{st} February 2010.