Commission for Energy Regulation
An Coimisiún um Rialáil Fuinnimh

Gas Tariff Review 2011 - 2012
Bord Gáis Energy's Residential Customers

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CER – Information Page

Abstract:

This paper outlines the Commission for Energy Regulation's (CER) decision with respect to the Bord Gáis Energy (BG Energy) Non Daily Metered (NDM) tariffs for its Residential customers for the period 1st October 2011 to 30th September 2012. The CER made an initial proposal of a 22% increase in late July.

The CER has reviewed the submission from BG Energy and comments from respondents. Following this examination the CER has decided to essentially confirm its earlier proposal and approve a 21.72% increase in the BG Energy tariffs for its NDM residential customers from 1st October 2011.

Target Audience:

Gas Customers, Suppliers, Shippers and Producers.

Related Documents:

- CER/11/133 – Consultation – Gas Tariff Review 2011-12
- CER/11/071 – Proposals on a Roadmap for Deregulation in the Non Daily Metered Gas Market
- CER/07/158 – Final Decision on Bord Gáis Energy's Non-Daily Metered 5-Year Regulatory Review 2007/2008 2011/12

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Executive Summary

This paper outlines the Commission for Energy Regulation's decision with respect to the BG Energy NDM tariffs for Residential customers for the period 1st October 2011 to 30th September 2012.

As part of the 2011/12 tariff review BG Energy submitted figures with a forecast taken on the close of business on 17th June 2010. BG Energy's submission requested €287m in allowed revenues for the 2011/12 gas year. This would equate to a 28.13% increase in the current tariffs for residential customers.

As part of the Roadmap to Deregulation in the Non Daily Metered Gas Market (CER/11/071) the CER looked at the form of the Revenue Control Formula (RCF) and examined options to replace/update it with the advent of upcoming deregulation. It was in this regard that BG Energy applied for supply costs which were different from the allowed formula. Ultimately, post consultation the CER decided that the RCF would continue in its current form.

The potential increase is on a par with neighbouring markets. Phoenix Gas in Northern Ireland for example announced an increase of 39% in domestic and small business tariffs for 1st May 2011. Of the "Big Six"[1] gas suppliers in GB, Scottish Power is increasing its domestic tariffs by 19%, and this comes on top of a 2% increase last November. British Gas, the largest gas supplier in GB is increasing its domestic tariffs by 18%, which follows a 7% increase last December and Scottish & Southern Energy, British Gas and Eon have increased their residential gas tariffs by 18%, which also follows a 9.4% increase in domestic tariffs last December.

There has been no change to the BG Energy residential tariffs since February 2010. The last rise in the BG Energy tariffs was in August 2008. A recent publication from the SEAI[2] also shows that the Irish domestic gas prices without taxes are below the EU average.

Following examination of the submission and while satisfied that the main upward cost driver was gas commodity, the CER was not satisfied with aspects of the submission, some of which deviated from the approved Revenue Control

[1] http://www.bbc.co.uk/news/business-14077651

[2] http://www.seai.ie/Publications/Statistics_Publications/EPSSU_Publications/Electricity_and_Gas_Prices/2nd_semester_2010_annex_household_gas.pdf

Formula. The CER therefore proposed (CER/11/133) an increase in the order of approximately 22% to the current BG Energy tariffs for the NDM residential sector. The CER requested feedback on this proposal.

The CER has reviewed the BG Energy submission and taken into consideration the comments from interested parties. Following this the CER has decided to approve a 21.72%[3] increase in the BG Energy tariffs for its residential customers from the 1St October 2011. It notes that there has been no significant change in gas prices since the consultation, and thus the end decision is essentially confirming the figure in the consultation.

The CER understands that an increase of this magnitude will cause hardship for many consumers given the difficult economic circumstances. It very much regrets this, but notes that wholesale gas costs are something over which Ireland has no control. The CER has endeavoured to allow only those costs which are deemed efficient and fair into this increase. The CER would like to stress that there are alternative suppliers and encourages customers to “shop-around” for the best value. The CER also suggests that customers facing difficulties paying their bills to contact their supplier at an early stage to discuss the issue, and also note the scope for savings via investments in energy efficiency measures, which are administered by the Sustainable Energy Authority of Ireland (SEAI).

The next review of the BG Energy tariff for its residential customers will take place in late November/early December 2011 with any change taking effect from the 1st January 2012. As per the decision in CER/11/071 “Roadmap for Deregulation in the Non-Daily Metered Retail Gas Market” BG Energy will submit revised updates each quarter. The CER will not consult on these reviews as it has done in the past given timelines required.

However, the CER will require BG Energy to justify any change to the proposed tariffs – upwards or downwards based on reasonable estimates of demand and forecast costs. A change to the tariff will only result if the total tariff change – upwards or downwards is of sufficient magnitude to warrant change. Tariffs will continue to be priced in an efficient, fair and cost reflective way and BG Energy will be required to provide the CER with evidence to justify any change within the tariff year.

[3] Allowed Revenue for 2011/12 €273.258m

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1.0 Introduction

1.1 Legal Framework

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

In making this decision the CER has been mindful of its legal functions under the Interim Gas Regulation 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 CER’s decision in relation to allowable revenues for BG Energy’s Residential non-daily metered customers. The allowed revenues and resulting tariffs relate to the period from 1st October 2011 – 30th September 2012.

1.3 Comments Received

The CER received four responses to the consultation paper (CER/11/133). One of the parties requested that their submission remain strictly private and confidential. The other submissions were received from the following organisations/individuals:

- Flogas
- National Consumer Agency
- Ray O’Connor

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

1.4 Background Information

2010/11 Approved tariffs:

On 1st September 2010 the CER approved (CER/10/158) a total allowed revenue of €307.290 million which equated to no change in the BG Energy tariffs for their residential and smaller I&C customers. As part of this decision and to ensure a level and competitive market, the K factor (€9.992m) rebate for customers was to be redistributed by the transporter to all customers who resided on BG Energy's book in 2009/10 regardless of who their supplier is during the 2010/11 gas year.

Following on from this decision the CER published a consultation paper CER/10/205 "Splitting Gas Tariff Regulation by Customer Group" which detailed a proposal to split out the then current BG Energy tariffs into two separate customer sectors and the criteria for allocating costs between them. The CER considered splitting the residential customers from the smaller I&C customers to be more cost reflective and allow for savings/overruns to be assigned more accurately to each NDM sector.

In December 2010 CER carried out an interim review, this paper examined the potential for a decrease (3.26% in residential and 1.94% in I&C) in the tariffs. However, given the then current forecasts of rising forward gas costs the CER decided (CER/11/003) to make no change to the BG Energy tariffs. The CER considered this to be a prudent measure at that time. In CER/11/003 the CER also decided to split the Revenue Control Formula (RCF) into two parts, residential and I&C. This was done in order to better reflect actual cost inputs to each sector. This move also facilitated the NDM I&C customer sector to be deregulated without affecting the overall residential revenue requirements.

As part of the Roadmap to Deregulation in the Non Daily Metered Gas Market (CER/11/071) the CER looked at the form of the RCF and examined options to replace/update it with the advent of upcoming deregulation. It was in this regard that BG Energy applied for supply costs which were different from the allowed formula. Ultimately, post consultation the CER decided that the RCF would continue in its current form.

The paper also noted that the RCF would be set initially at the start of the 2011/12 gas year. Following this BG Energy will submit revised updates every three months thereafter (December, March and June). These submissions will not be consulted upon given the timelines required. The CER will examine the submissions and either approve or disallow any tariff changes. Tariffs may change on 1st October, 1st January, 1st April and 1st July. If deregulation of the NDM residential sector has not occurred by July 2012, a full review of the RCF (with consultation) will take place.

In CER/11/072 the CER decided that the NDM I&C market sector had met the criteria[4] required for deregulation and would be deregulated from 1st October 2011. This leaves the NDM Residential market sector as the only regulated sector in the gas market. No decision has been made for the required threshold for deregulation of the NDM residential sector; a decision may be expected in late 2011.

As part of the 2011/12 tariff review BG Energy submitted figures with a forecast taken on the close of business on 17th June 2010. BG Energy's submission requested €287m in allowed revenues for the 2011/12 gas year. This equated to a 28.13% increase in the current tariffs for residential customers.

Following examination of the submission and while satisfied that the main upward cost driver was gas commodity the CER was not satisfied with aspects of the submission which deviated from the approved Revenue Control Formula. The CER therefore proposed (CER/11/133) an increase in the order of approximately 22% to the current BG Energy tariffs for the NDM residential sector. The CER requested feedback on this proposal. Responses received and the CER's decision is detailed in section 2 of this paper.

[4] See CER/11/071 for criteria.

2.0 Responses to Consultation

Three main areas of interest were raised by respondents. These, and a summary of the main comments received on each, are set out below:

Gas Commodity Costs:

- Seeks information with regard to the success or otherwise of BGE's past record in gas hedging to ascertain the impact, if any, that prior hedging strategies have in the current request for a 28% tariff increase
- The cost of providing financial security has increased significantly in the last 18 months. These costs should be included in the gas commodity calculations.
- The paper is lacking some crucial details with respect to the performance of BGE's energy trading unit in meeting the obligations to customers and against the metrics for evaluation purposes. If the CER wants to persist with the use of the Z factor until such time as the sector is deregulated, it should disclose the real benefit/cost to end users of allowing BG Energy trade their gas volumes.

Supply Costs:

- Full allowance should be made for actual bad debt costs in the Revenue Control Formula
- The proposal to increase the bad debt allowance from 0.5 % to 1% is inadequate. Based on the current economic climate and in the absence of an effective debt blocking system the allowance for bad debts should be set at 2% of sales value. Do not believe that the proposed system of debt flagging will have a material impact on bad debt levels in 2011\12.
- The CER previously decided that Suppliers should bear 50% of the cost of credit locks/unlocks. This arbitrary decision was extremely unfair on suppliers in that no mechanism was afforded to suppliers to recover these costs in the market place. The relevant costs should be included in the Supply Cost calculations.
- a relevant share of the Bord Gais sales and marketing costs should be included within the regulated Supply Cost figure.
- the reason for introducing debt flagging was to reduce the incidence of bad debt going forward, yet the CER is proposing to allow BG an increase in bad debt provisions, therefore despite introducing measures to alleviate bad debt issues going forward, it is deliberately allowing recovery of previous losses through this increase

- welcomes CER's decision that losses on historic bad debt should not be paid for by current BGE customers
- Requests the publication by CER of non-commercially sensitive outcomes resulting from a detailed examination of BGE's operational costs to ensure that the organisation is performing at a maximum efficiency

Margin:

- Suppliers now face a myriad of significant business risks including price, currency, volume, bad debt and financing. Financing costs have increased significantly. In light of the real market circumstances the allowable supply margin needs to be increased to 3%.

Other Comments:

- calling on the CER to sanction the absolute minimum tariff increase necessary, less that the 22% proposed.
- There is insufficient detailed analysis to make any clear conclusion as to the adequacy or appropriateness of the proposed changes. The message to the market is prices should be increasing by 28%, but due to the intervention of the CER following their review, the increase is being limited to 22%
- Support the general principle that retail gas tariffs should move in line with international gas (and most often oil) price trends and while we understand the need to avoid lengthy time consuming consultations it is not acceptable that the Bord Gais regulated tariffs may change in an un-transparent and unexplained manner. This creates significant uncertainty for other suppliers. It should be possible to have an efficient and timely consultation with suppliers
- The consultation paper is vague regarding the information in a number of areas, e.g. transportation charges for 2011/12 are included in residential tariffs, but the paper does not make clear if the CER's proposed reduction in the transport cost is reflected in the residential tariff.
- BG Energy submission did not mention the implementation of the 3rd Package. Does this mean that the CER has withheld information from market participants which would allow a more in-depth assessment of supply costs that should be allowed?
- With regard to capital expenditure why does the commission allow the cost of Capex to be passed on to the consumer?
- seek assurances regarding provisions in the current regulatory framework that account for the potential of cross-subsidisation between the

residential and non-residential gas markets as well as between BGE's interests in the residential gas and electricity markets.

CER View

The CER has taken account of all views and in making its decision it has also aimed to balance its long term goals of promoting competition, while also considering and protecting the interests of customers both in the short term and long term.

CER's response to the comments regarding gas commodity costs, supply costs margin, and other comments are outlined below.

Gas commodity costs:

The CER has considered the issue of the costs of providing financial security and in an effort to recognise this as a legitimate cost being incurred by all suppliers in the market currently is adding a provision[5] onto the gas commodity cost for BG Energy to reflect the increased cost.
Regarding the comments on hedging and the BG Energy trading unit, the CER would like to point out that BG Energy is obliged (as per Condition 22 Supply licence) to purchase natural gas at the best effective price reasonably obtainable.
The fact that only 50% of any gas cost over-run relative to the benchmark would be returned to BG energy is designed to promote a sufficient level of prudence in BG Energy's effort to beat the benchmark. BG Energy has beaten the benchmark over the past few years with 50% of any resulting profit being passed back to their customers. Details of which have been disclosed in previous decision papers.

Supply costs:

The RCF has a stated allowance for bad debt. BG Energy like any prudent business should make every effort to reduce the occurrence of bad debt.
The CER has made no provisions in the 11/12 allowed revenues for historic bad debt. BG Energy is allowed an annual bad debt provision equal 0.5% of its NDM attributed turnover. No specific allowance is made for historic bad debt. The BG Energy allowed margin (2%) should reflect the risk a business faces. Margin

[5] Increasing the cost of holding letters of credit by 0.7% p.a. from purchase of gas to delivery.

reflects working capital and capital at risk, therefore BG Energy's margin reflects the risk of incurring bad debt over the provision made in the formula.

In recognition of bad debt going forward, the CER has examined the provision for an increase in the allowance going into the 2011/12 gas year. The CER recognises bad debt has become a significant issue for all suppliers and in doing so has decided to increase the bad debt provision from 0.5% of turnover to 1% of turnover for the 2011/12 gas year. This along with the introduction of debt flagging and the rollout of a further 20,000 prepayment meters should aid the control of bad debt going in the gas year 2011/12.

Regarding the decision on credit locks, the CER has stated it would review these costs after 1 year, a full review is expected to take place later in the year. There is no specific line item in the RCF for the CER decision on credit lock/unlock.

Margin:

The CER recognises that business risks have increased for all suppliers in the market. To this end the CER has increased the allowance being provided for bad debt going forward and the allowance for financial security costs. Along with these and the decision on debt flagging and the increased installation of 20,000 pre-payment meters by year end and taking into account the best interests of already hard pressed final customers the CER considers it inappropriate to increase the margin above 2% at this time.

Other Comments:

The CER will allow an increase in costs only when those costs are fully justified. In the case of the 21.72% increase the CER has endeavoured to allow only those costs which are deemed efficient and equitable.

The CER considers figures relating to the proposed increase in the consultation paper to be sufficiently transparent. The consultation paper should be read in conjunction with previous decision papers to understand the allowed revenues.

With regard to the interim consultation the CER have stated in CER/11/071 "the RCF will be set initially at the start of 2011/12 gas year. Following this BG Energy will submit revised updates every three months (September, December, March and June). These submissions will not be consulted upon given the timeline *required. The CER will examine the submission and either approve or disallow any tariff changes. Tariffs may change on 1st October, 1st January, 1st April or 1st July". If deregulation of the NDM residential sector has not occurred by July 2012, a full review of the RCF (with consultation) will take place.*

Tariffs will continue to be priced in an efficient, fair and cost reflective way and BG Energy will be required to provide the CER with evidence to justify any change within the tariff year. Any changes will be well notified in advance of implementation. The CER does not consider that this creates uncertainty for other suppliers.

Regarding transportation charges - these charges are treated as pass through and reflect the charges in decision paper CER/11/170 and CER/11/171. The BG Energy submission included these charges, 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 forecast split in BG Energy's submission for 2011/12 is Moffat 74% and Inch 26%.

Third Package costs are not included in the supply cost formula as approved in CER/07/158. No allowance has been made for Third Package costs. The treatment of such costs is dealt with in the decisions on the Transmission and Distribution (CER/11/170 & CER/11/171) tariffs for 2011/12

With regard to capital expenditure the CER directed BG Energy in June 2003 to separate its supply business systems from all other systems in Bord Gáis Eireann. It was agreed at that time that a system would be designed to handle its customer information and billing for all segments of the BG Energy customer base. The CIBS system costs are apportioned by customer sector and numbers and each customer segment pays for it allocation of the CIBS system.

The CER has previously examined the issue of cross subsidization between BG Energy's gas and electricity and its residential and non-residential customers. The allowance for its residential customers is as per the approved split in CER/11/003 Section 3.

3.0 Revenue Control Formula

3.1 Introduction

In October 2007, the CER approved a Revenue Control Formula (RCF) to calculate revenue regulated gas tariffs for the gas years 2008/09 – 2011/12[6].

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

These various features are described in detail in CER 11/133 Section 3.1

3.2 Gas Commodity Purchases 2010/11

In accordance with the laddered benchmark approach the allowed gas costs for the BG Energy NDM gas portfolio for the gas year '11/12 have been priced into the RCF model since October '10. Gas requirements for the 2011/12 gas year have been priced on a gradual basis (using a laddered approach) since October 2010. This strategy is in keeping with general industry practices and is in itself a hedging type strategy, which ensures that gas purchase 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 there is the 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. In 2010/11 the average Z factor saving was approximately €2.50 per customer.

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

BG Energy submitted to the CER the latest market data as of close of business **17th June 2011**. 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 '11/12. Prices of these future gas contracts are marked to market using the prevailing forward curve prices as of close of business on 17th June 2011. The CER has examined and verified these figures. The CER has monitored the wholesale prices during the consultation period and taking a snapshot on 17th August the flat year ahead price was 68.74pence/therm. Comparing this to the price of 68.95pence/therm taken on close of business 17th June, the CER will continue to allow gas being priced into the benchmark using the close of business on 17th June snapshot price.

In recognition of the increased cost of holding letters of credit for purchasing gas on the forward curve the CER has allowed a provision of €470,000[7] into the total cost of gas. Given the current economic climate the CER acknowledges that the cost of providing financial security has risen considerably over the past 18 months and in doing so has allowed a sum into the 2011/12 gas costs. The CER will examine this provision in future reviews.

CER View:

The CER has reviewed the gas benchmark costs and is satisfied that it reflects the weighted average cost of gas purchases since October 2010 up to close of the 17th June 2011 and, also the forecasted cost of gas requirements, yet to be procured.

3.3 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 forecast % split is Moffat 74% and Inch 26% which is the overall capacity costs for the NDM residential split between Moffat and Inch including ICS sales.

[7] Using the benchmark gas cost and increasing the cost of holding letters of credit by 0.7% p.a. from purchase of gas to delivery.

The transmission and distribution charges for 2011/12 are detailed in CER/11/170 and CER/11/171. 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, there were forecasts of both Interruptible Capacity sales (ICS) and the use of the South West Kinsale Storage facility amounting to €2.358m. This figure is down from the figure of €7.111m attributed to residential customers in 2010/11 gas year. BG Energy suggested that this was largely due to a loss of ICS contracts as customers may have chosen to book firm or short term capacity due to interruptions that occurred in 2010/11 gas year; also with less customers than 2010/11 there is less secondary capacity available to sell on. The figure of €2.358m is net of a 5.1% margin allowed for BG Energy to cover costs involved in the management of Interruptible Capacity Sales.

If there is any saving brought about by an increase in revenue from sales in ICS it will be passed back to BG residential customers through its tariffs in future reviews.

CER View:

The approved transmission and distribution charges in CER documents (CER/11/170 and CER/11/171) are charges for all suppliers to the Irish natural gas market. The CER has examined the costs in the RCF and is satisfied that these are in accordance with the above proposals. The CER has also allowed the BG Energy estimates of €2.358m to the residential sector in respect of ICS sales and Inch benefit.

3.4 Supply Costs

As part of the BG Energy five year regulatory review[8] 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 was 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.

As per the approved supply cost formula BG Energy's forecast cost to serve for 2011/12 should be €21.332m[9]. Given the current economic climate and increases in bad debt the CER has decided to increase the bad debt provision of 0.5% of turnover to 1% of turnover for 2011/12. This increases the allowable supply cost for 2011/12 to €22.360m.

BG Energy's submission requested an overall supply cost figure which was significantly higher than that allowed for residential customers in 2010/11 and equated to a rise of approximately 23% on their previous allowed supply costs.
As part of their supply cost submission, BG Energy also requested recovery of increased costs of bad debt which, they argue, have increased by a factor of three relative to the bad debt related costs allowed for in 2010/11. BG Energy further requested recovery of their supply cost opex over run of for 201/11 of €0.514m.

The CER has allowed the opex over run as this is part of the approved Z factor on supply costs.

After reviewing the decision setting up the supply cost for the 5 year RCF, it is the CER view that BG Energy is allowed an annual bad debt provision equal 0.5% of its NDM attributed turnover. Ex ante this is 0.5% of forecast turnover and ex post

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[8] Using estimated turnover of €273m. 5 year decision document CER/07/158 – CER/07/129 gives breakdown of Supply Cost
[9] Supply cost minus allowance for bad debt is €20.284m

this is 0.5% of actual turnover. No specific allowance is made for historic bad debt. The BG Energy allowed margin (2%) should reflect the risk a business faces: margin reflects working capital and capital at risk. Therefore BG Energy's margin reflects the risk of incurring bad debt over the provision made in the formula. BG Energy takes the view that while an ex ante provision for bad debt of 0.5% is made, that the difference between this and the actual bad debt is subject to a 50/50 Z factor. To be fair, both interpretations are defensible.

In any case it is difficult to argue that the amount of historic bad debt BG Energy has incurred is an efficient cost. The CER is not aware of any extra ordinary measures BG Energy employed to keep this level of bad debt to a minimum or keep it within their allowed levels. A prudent commercial company would be expected not to have allowed such levels of debt to arise. In this respect this decision makes no provision for any historic bad debt to be recovered.

Looking forward, the CER does recognise that the deterioration in the credit and overall economic climate should, arguably, be given some recognition and has agreed certain measures with the industry to address this issue. The CER has agreed to increase the regulatory provision for bad debts in BG Energy's tariff formula from 0.5% to 1% of turnover for the 2011/12 year.

Given the increase in bad debt provision going forward, along with the provision of a programme to install a further 20,000 prepayment meters by year end and the recent decision on debt flagging the CER expect this should help supply companies to better manage their debt.

CER View:

The CER has allowed BG Energy a total supply cost provision of €22.874m for the gas year 2011/12.

3.5 Margin

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

The CER considers that a 2% margin accurately reflects the risk exposure of all suppliers to the revenue regulated market as a result of the volume risk being removed.

The CER has examined suggestions from respondents to increase the margin. The CER recognises that business risks have increased for all suppliers in the market. However, considering the increased allowance being provided for bad debt going forward and the provision for financial security costs, along with these and the decision on debt flagging and the increased installation of 20,000 pre-payment meters by year end and taking into account the best interests of already hard pressed final customers the CER consider inappropriate to increase the margin above 2% at this time.

CER View:
The BG Energy allowable supply margin will remain at 2% for the gas year 2011/12.

3.6 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. BG Energy submitted a projected final K factor for the gas year 2010/11 of €2.527m[10] for their residential customers. This figure has since been revised upwards to €3.139m

BG Energy suggested this over recovery (although not as large as the then forecasted figure of €9.678m in December 2010) is due mainly to a very cold December and BG Energy not losing as many customers as expected. BG Energy have also suggested the reason for such a drop off in their previous forecast of an over recovery is due to a warmer end to winter ‘10/11, a mild April and customers turning off their heating earlier in the year than they would have

[10] This figure is subject to change once the 10/11 gas year has out turned.

done in previous years. The CER notes that the K factor of €9.992m of last year was returned via Gaslink to all customers who resided on BG Energy's books in 2009/10 regardless of who their supplier was. Clearly the K factor this year is smaller than €9.992m at €3.139m. The CER notes that the suppliers active in the residential market have been in the market for some time now. Therefore the K factor of €3.139m will be returned via the BG Energy tariff to its customers only.

CER View:

The CER has fully reviewed BG Energy's calculations of its suggested over-recovery. The CER has taken into consideration the reasons provided by BG Energy for this over recovery The CER has allowed a correction factor of €3.139m into the tariffs for 2011/12.

3.7 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.

One Capex project is included in the RCF for 2011/12. This project is the Customers Information and Billing System (CIBS). BG Energy have requested recovery of a capex spend of €1.927m from their residential gas customers for the gas year 2011/12.

CER View:

As per the approved split out in CER/11/003, the CER will allow a total capital expenditure figure of €1.927m into the allowed revenue for the 2011/12 gas year.

4.0 Conclusions and Next Steps

4.1 CER's Decision

The CER has reviewed the BG Energy submission and taken into consideration the comments from interested parties. Following this the CER has decided to approve a 21.72%[11] increase in the BG Energy tariffs for its residential customers from the 1St October 2011.

In taking this decision the CER has aimed to ensure tariffs remain cost reflective and ensure that it has not caused market distortion or negatively affect competition or potential new entrants into the residential market.

The next review of the BG Energy residential tariffs will take place in late November 2011 with any changes being effective from 1st January 2012.
The CER will require BG Energy to justify any change to the proposed tariffs – upwards or downwards based on reasonable estimates of demand and forecast costs. A change to the tariff will only result if the total tariff change –upwards or downwards is of sufficient magnitude to warrant change. Tariffs will continue to be priced in an efficient, fair and cost reflective way and BG Energy will be required to provide the CER with evidence to justify any change within the tariff year.

The next competition review due for publication in late October 2011 will give an updated forecast on the possible deregulation timeline for the BG Energy NDM residential customers.

11 Allowed Revenue for 2011/12 €273.258m