



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

**Response to comments received to CER/12/057 & CER/12/058 (Consultations on BGN Distribution and Transmission Revenue for PC3)**

DOCUMENT TYPE:	<b>Response Paper</b>
REFERENCE:	<b>CER/12/198</b>
DATE PUBLISHED:	23 <sup>rd</sup> November 2012

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**Abstract:**

This response paper provides a summary of the views provided by industry in response to the CER's recent consultations on BGN Distribution and Transmission Revenue for PC3 (CER/12/057 & CER/12/058). This paper also documents the CER's response to those comments.

This response paper should be read in conjunction with the CER's two decision papers on this matter. These papers set out the CER's decision on Distribution and Transmission revenues for Bord Gáis Networks for the period and have been published alongside this paper.

**Target Audience:**

This response paper is for the attention of all members of the public and the energy industry. It will be of particular interest to parties that directly pay gas distribution and transmission network charges to Bord Gáis Networks and end-user customers to whom these charges are passed on.

**Related Documents:**

<a href="#">CER/11/070</a>	Information Paper on scope of this review
<a href="#">CER/12/058</a>	CER Consultation on BGN Transmission Revenue for PC3
<a href="#">CER/12/058a</a>	CEPA Report on BGN Transmission opex and capex for PC3
<a href="#">CER/12/058b</a>	CER Model on BGN PC3 Transmission Network Revenue
<a href="#">CER/12/058c</a>	Oxera Report on cost of capital
<a href="#">CER/12/057</a>	Consultation on BGN Distribution Revenue for PC3
<a href="#">CER/12/057a</a>	CEPA Report on BGN Distribution on Opex and Capex for PC3
<a href="#">CER/12/057b</a>	CER Model on BGN PC3 Distribution Revenue
<a href="#">CER/12/057d</a>	CEPA report on outputs and incentives

## **Executive Summary**

On the 22<sup>nd</sup> May 2012 the CER published two consultation papers covering Bord Gáis Networks distribution and transmission revenue for the period 1<sup>st</sup> October 2012 to 30<sup>th</sup> September 2017. This paper provides a summary of the views provided by industry in their responses to those consultation documents as well as the CER's response to the main points and comments raised.

This response paper should be read in conjunction with the CER's two decision documents on this matter, which have been published alongside this paper.

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## **1.0 Introduction**

### **1.1 The Commission for Energy Regulation**

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

### **1.2 Purpose of this paper**

The purpose of this response paper is to provide:

- a summary of the views provided by industry in response to the CER's recent consultations on Bord Gáis Networks (BGN) distribution and transmission revenues for PC3; and,
- a summary of the CER's response to those comments.

### **1.3 Background information**

Section 2.0 in each of the two decision papers on BGN's distribution and transmission revenues for PC3, published alongside this document, provide background information on the consultation process which led to the publication of this paper.

### **1.4 Structure of this paper**

The structure of this consultation paper is outlined in this section:

- Section 1.0 – Provides a brief introduction and background
- Section 2.0 – Outlines the comments received and the CER response to each
- Section 3.0 - Conclusion

## **2.0 Comments Received**

### **2.1 Introduction**

On the 22<sup>nd</sup> May 2012 the CER published two consultation papers covering Bord Gáis Networks distribution and transmission revenue for the period 1<sup>st</sup> October 2012 to 30<sup>th</sup> September 2017. This section provides a list of the consultation responses received and a summary of the main issues raised by respondents. In addition the CER's response to those comments is provided.

Several respondents submitted a single response to the Transmission and Distribution consultation papers and many of the comments contained in the responses refer to areas common to both. Therefore this section covers all of the responses received and the issues raised relevant to both consultations.

### **2.2 List of Respondents**

In total there were eleven responses to the consultation documents, these are listed below:

- Bord Gáis Networks
- Endesa Ireland
- Energia
- ESB
- Glanbia
- Irish Offshore Operators' Association
- Kinsale Energy
- Kore Energy
- Manx Electricity Authority
- Shannon LNG
- Vayu

Please note that the full version of all eleven responses have been published alongside this paper.

### **2.3 Comments Received**

This section provides a compilation of the comments received and for ease of reference the comments are grouped by topic.

### **2.3.1 Process**

#### **Comment**

In their consultation response BGN expressed concerns over the way the CER has conducted the PC3 review. BGN state that they have provided detailed information on their proposals, facilitated workshops, conference calls and closed out all additional queries from the CER's consultants. In their view there were conflicting messages given by CER as to the form and nature of the consultation and they have provided a number of examples of where they viewed this to be the case.

#### **CER Response**

Over the last 18 months the CER and our consultants have been engaged fully with BGN in this process. The CER appreciates that BGN have also engaged fully and endeavoured to provide the CER with the information and data requested. However, we do not accept BGN's criticism of the approach adopted by the CER and our consultants. While there may have been disagreements between the parties on the approaches adopted, the CER and its consultants have maintained a consistent approach in line with best regulatory practice.

### **2.3.2 Bottom up assessment**

In their consultation response BGN expressed concerns around the way in which the bottom up analysis was developed. Their concerns were focused on the following areas:

#### **BGN Comment - Impact of key cost drivers**

BGN believe that CEPA misunderstood the impact that growth and changing regulatory requirements have on operating costs. They state that there has been a substantial growth in terms of customer numbers, network length & demand. They state that CEPA have not set out any analysis on what the impact of these core cost drivers might be on BGN opex or demonstrated that they took the core cost drivers into account when setting the normalised 2009/10 costs.

#### **CER Response**

CER (and CEPA) reject the assertion that there was any misunderstanding as to the impact of growth and changing regulatory requirements on operating costs. While there has been substantial growth in terms of customer numbers, network length & demand, it is the view of CER that the levels of costs in the CER decision are sufficient to allow the system to be operated reliably and safely with an appropriate level of quality of service. To be clear, the normalised 2009/10 costs have been adjusted, inter alia, for changes in customer numbers, network

length & demand.

### **BGN Comment - 2<sup>nd</sup> & 3<sup>rd</sup> Directive projects**

It was stated that European regulations require that BGN implement the ITO project under severe timelines as failure to meet timelines would result in the State and BGN being subject to fines. This move meant that BGN would no longer receive the benefits associated with shared support and IT functions. BGN's view is that the benchmarks used by CEPA were inappropriate and that the project is incomparable to a de-merger or an outsourcing project.

### **CER Response**

In assessing the level of ITO operating costs proposed by BGN the Consortium drew on its direct experience of transactions, including demergers and outsourcing. The consortium examined several UK public sector service project examples and set out several success factors in those projects and enablers for reducing costs. In light of this the consortium were of the view that BGN could have achieved greater efficiencies during the project. They set out several examples of how BGN could have been more efficient. The CER considers that the work undertaken by the consortium in this area was appropriate and comprehensive and agrees with their recommendations.

### **BGN Comment - Analysis**

BGN felt there was a lack of evidence that the consortium carried out detailed bottom up analysis and that the benchmarks were subjective and opinion based. BGN stated that the approach to bottom up assessment was inconsistent with Ofgem's approach which used verifiable benchmarks. In their view there was no evidence that normalised costs have been informed by independent benchmarks or any benchmarking of BGN activities against other operators, but instead it was largely the consortiums view.

### **CER Response**

The CER reject the assertion that there was no detailed bottom-up analysis carried out or that the benchmarks were subjective and opinion based. In conducting their analysis CEPA conducted a full bottom up review and their Opex allowances for BGN were broadly traceable from the actual levels of costs incurred by BGN in the PC2 period. In summary their review included:

- Development, with the CER, of a business plan questionnaire (BPQ) requesting detailed analysis of BGN's PC2 actual costs and proposed PC3 costs.



- Review of variances between PC2 actual costs and PC2 allowances. Using this analysis CEPA derived a “normalised” (the year on year base level of cost at which each business operates) view of annual distribution and transmission Opex (eg after adjusting for any “one off” costs) focusing on the most recent actual years of 2009/10 and 2010/11 as well as the forecast year 2011/12. In view of the lumpy and cyclical nature of transmission particular care was taken to allow for this, such as reflecting the timing of compressor overhauls and subsea pipeline inspections.
- A review was conducted of BGN’s forecast Opex for PC3 for each business in detail and all supporting documents provided by BGN to their BPQ responses including, for example, the asset plans for pipelines and compressors. The approach was to understand the reasons for differences between BGN’s forecasts and the “normalised costs” in PC2 including assessing changes in cost drivers (where appropriate) and costs between PC2 and PC3.
- All engineering related Opex (separately for Transmission and Distribution) was reviewed by experts in the consortium and a “best practice” view was developed of the various engineering Opex elements of cost across PC3.
  - This was undertaken for distribution on the basis of an analysis of workload volumes and unit costs where it was appropriate to do so, for example in Network Maintenance and some Business Support activities.
  - The transmission opex review was largely based on a review of the trend in overall expenditures between PC2 and PC3, due to the variable nature of transmission opex spend, largely as a result of increases in Interconnector opex driven by compressor overhauls and subsea pipeline inspections.
- During the review a significant number of supplementary detailed questions were raised with BGN in order to understand the reason for cost increases or decreases for each cost element in both PC2 and PC3.
- The consortium met on several occasions to reconcile and challenge their respective views of what should be an allowable level of Opex for each element of cost going forward. The relative efficiency of Opex was then informed by benchmarking and efficiency factors were derived across PC3.

- In addition to reviewing each cost element CEPA reviewed three other key areas of cost input: HR and pay rates, and the cost of setting up the ISO and ITO.
- The benchmarking involved comparison with the GB GDNs and found BGN to be relatively inefficient compared to the GB GDNs. The extent of inefficiency depended on the specification of the panel regression and whether an upper quartile or median performance line was adopted in analysis.

### **BGN Comment – Scope of works included**

There was concern expressed by BGN that CEPA had accepted the scope of works in many instances as being required, but the necessary allowances to undertake the works had not been allowed. They provided a number of examples of cases where they viewed this as being the case.

### **CER Response**

The CER has continued to engage with CEPA and BGN on a number of areas where BGN felt the necessary allowance had not been allowed. As a result of clarifications and further discussions the final allowances for a number of items in the final decision documents have been amended to capture the appropriate figures and these changes have been noted in the decision documents.

## **2.3.3 Benchmarking**

### **Comment**

BGN highlighted a number of issues with how benchmarking was undertaken by the CER's consultants, CEPA. It was stated that that the analysis was not statistically valid and failed statistical tests. It was further stated that the bottom up benchmarking was not based on any objectively justifiable external benchmarks or evidence – rather it is merely the view of consultants.

BGN also expressed disappointment of the use of panel data analysis as they believe the analysis to be flawed. BGN stated that their consultants, Frontier Economics, reviewed the analysis and identified a number of serious issues. Frontier took the view that CEPA should have revised the specification of their panel regression so that it included variables that estimate how the impact of network scale opex changes over time – thereby helping to remove the bias in the basic four-year panel data regression. When Frontier re-ran the model with variables introduced to remove this bias the results showed BGN to be efficient operators.

BGN stated that Frontier's analysis demonstrated that the panel analysis carried out by CEPA was flawed. Therefore the results could not be relied on and they should be rejected in their entirety.

### **CER Response**

The CER recognise that there are differences of opinions between economic consultants employed by BGN and the CER's consultants. However, following further discussions between the parties, it is clear to the CER that, while BGN's consultants have a preference for other benchmarking methodologies, the panel data analysis conducted is valid and fit for purpose. Further to this, it is an approach adopted by regulators in other jurisdictions. Therefore the CER is confident that the benchmarking approach employed is robust and appropriate.

### **2.3.4 WACC**

#### **Comment**

Several respondents stated that they recognise the merit for the introduction of a trigger mechanism and viewed the range proposed as being reasonable. However the floor and ceiling were questioned by some respondents with one stating that the upper range may need to be altered should there be a significant increase in the cost of Irish Government bonds. Another respondent stated that the price floor could result in the best value not being extracted by BGN in the event that borrowing costs decrease significantly.

#### **CER Response**

The CER welcomes the fact that most respondents see the introduction of a trigger mechanism and a range for BGN's cost of capital as a sensible reaction to market conditions. With regards to concerns about the floor and ceiling, the CER considers that these are reasonable given the conditions that currently exist in the market. In relation to concerns that the price floor may result in best value being extracted by BGN, the CER is confident that the floor of 5.2% is the appropriate level. This is primarily due to the fact that the 5.2% was based on the WACC in PC2, which was a time of benign market conditions. Therefore, should the economic situation improve to such a level the WACC will be able to reduce to what it was before the economic crisis.

As pointed out in the consultation documents, in the event of extreme changes in market conditions, such as the collapse of the euro, it may be appropriate to consider alternative approaches. Therefore should events unfold that result in the floor and ceiling set out in the decision document no longer being appropriate the CER will review the situation at that time.

## **Comment**

A couple of respondents questioned the application of the WACC to the entire RAB. It was suggested that the WACC applying at the time of investment should be applied.

In addition some respondents suggested that the WACC should be calculated separately for the different components of the RAB. There were proposals for a breakdown for the BGN and non BGN components of BGÉ, isolation of refinancing requirements for the transmission network and the separate treatment of long term loan repayments and refinancing from the WACC.

## **CER Response**

As set out in the Oxera report published alongside the consultation documents, BGN have locked in some debt during times when there were more benign market conditions. The cost of this existing debt along with the cost of new debt, to be raised over the course of PC3, have both been incorporated into the WACC. With regard to the application of the WACC to the entire RAB, this is consistent with the approach taken in previous price controls and has been adopted in a number of recent price reviews by UK regulators. In addition the trigger mechanism will allow flexibility in adjusting the WACC to ensure that any reduction in the cost of capital feeds through to allowed revenues.

The issue regarding cost of BGÉ debt versus cost of BGN debt, is a complex issue which was covered in considerable detail in the Oxera report (CER 12/058(c) section 1.1 and section 6 published alongside the consultation paper. In summary, the CER takes the view that appropriate consideration was given to this issue in calculating the cost of debt to be used in establishing the WACC for PC3.

## **Comment**

In their response BGN broadly welcomed the proposals, regarding WACC, set out in the consultation document. However BGN did not agree with the treatment of embedded debt. They saw this as a complete departure from established regulatory precedent by the CER and at odds with the approach taken in other regulatory sectors in Ireland and the UK. They urged the CER to reconsider the approach to the treatment of embedded debt.

However it was also stated that should the CER proceed with this approach then this change cannot be a temporary change in regulatory approach due to the financial crisis. If the CER intend to retain this principle then a clear signal must

be sent to the market that the same approach will be adopted in PC4. It was stated that in instances where this approach has been adopted similar signals were provided that the change would be permanent.

### **CER Response**

Under normal economic circumstances the pre-existing debt would not have been taken into consideration when calculating the WACC for the following period. In previous price controls only the prevailing cost of debt would have been considered. However, given the extremely turbulent period recently experienced in international financial markets the CER took the view that it was appropriate to depart from standard practice. The CER took the view that the embedded debt on BGÉ's books had been efficiently incurred. The CER therefore considered it appropriate to include this efficiently incurred embedded debt into the calculation of the WACC for the PC3 period.

If the Eurozone crisis prevails over the course PC3 the question arises as to how embedded debt might be treated in PC4. If by the start of PC4 the crisis has passed, would the cost of (presumably expensive) historic debt be taken into account in calculating the WACC for PC4?

The CER intends to return to the standard practice as soon as possible. While the CER cannot bind future decision makers, the CER expects that when it is setting the cost of debt for PC4, the cost of efficiently incurred embedded debt will similarly be included in the level of the WACC for the PC4 period. There are many uncertainties over the next period, for example the Eurozone crisis might pass into history quickly, in which case it may be appropriate to revert to standard practice for PC4. On the other hand the crisis might prevail for an extended period during PC3. In any event the CER will take its financeability duties into account in setting the appropriate WACC for PC4.

### **2.3.5 OPEX**

#### **Comment**

A number of respondents raised concerns regarding the proposed levels of opex. With regard to transmission opex, one respondent questioned how the cost per customer compared to other European TSO's of a similar size in Europe. Another respondent made comparisons of transmission system tariffs with both the UK and Denmark, using these international examples to show that there is a gross disparity between opex costs for the Irish system with other similar sized systems in Europe. It was suggested that there is a need to radically reduce these costs.

#### **CER Response**

As part of the benchmarking process the CER's consultants compared the

efficiency of BGN with other similar gas networks in the UK and proposed appropriate adjustments to bring BGN's opex in line with industry norms. The CER, in the final decision on the level of allowed opex for Transmission and Distribution in PC3, have imposed significant reductions compared to the level of opex sought by BGN.

However, the CER also recognise that BGN require some time to introduce efficiencies and reduce their opex. Therefore, while significant reductions have been made to BGN's opex submission, the CER has included some monies in the first years of the price control in order to create a glide path to efficiency and allow BGN sufficient time to reduce opex, while still maintaining a safe and reliable gas network.

### **Comment**

One respondent questioned Section 5.4 of the CEPA report which stated that Opex for Inch was 35% above that budgeted for the five year period. The respondent sought further explanation of this, questioning whether BGN are entitled to be reimbursed for this overrun and stating that large overruns should be investigated.

### **CER Response**

The 35% increase set out in Section 5.4 of the CEPA report refers to an increase in opex costs for PC3 in comparison to PC2. The report goes on to set out some of the drivers that are causing this increased opex. These included the decommissioning costs associated with the wind down of Kinsale Offshore Storage Facility and the retirement of Inch Compressor Stations in 2015/16.

CEPA went on to conclude that the forecast costs for PC3 overall do not appear unreasonable. The CER is satisfied that the consultants have fully examined the issue and provided sufficient details on the increase in costs between PC2 and PC3.

### **Comment**

A number of respondents also stated that they support the proposal for the inclusion a 1% efficiency target applied to opex as an incentive for BGN to introduce efficiencies.

### **CER Response**

In the final decision documents published along with this paper the CER details its decision to retain the 1% year on year efficiency on allowed opex for the PC3

period, as was proposed in the consultation document.

### **2.3.6 CAPEX**

#### **Comment**

One respondent stated that the replacement cost approach provided an incentive for BGN to over-invest. Therefore, in the interest of consumers, the CER should adopt an “Acquisition Cost” approach which would allow BGN to recover capital over the lifetime of the investment, but would remove the current incentive to over-invest.

#### **CER Response**

As set out in the consultation document the CER recognises that there are advantages and disadvantages associated with each methodology used to value of the distribution and transmission business’s RABs. However, the replacement cost approach was taken as it is more likely to result in the correct level of network investment. In addition, replacement cost has been used in each of the previous two control periods, so the continued use of this approach will provide continued regulatory certainty.

With regards to any incentive to over invest created by the use of the replacement cost approach, it should be noted that the CER only allows for Capex that is deemed to be efficient and necessary.

#### **Comment**

One respondent stated that as part of the CER’s approval process a cost benefit analysis should be published, justifying the expenditure on IT. The respondent’s view was that the proposed investment in IT should result in significant reductions in operational costs.

#### **CER Response**

The consultants examined, in detail, the necessity of the proposed IT investments and the operational cost benefits they were expected to deliver over their lifetimes.

BGN had proposed IT costs of €39.9m during the PC3 period. However, as a result of the examination into each of the three areas covered by IT costs, the final allowed revenue has been set at €30m for the five year period; 25% lower than the level sought by BGN.

### **Comment**

One respondent questioned whether there was a mistake in the spreadsheet. They highlighted Section 7.4 of the Transmission document, where the deferral of €1.5m upgrade works was deemed to be driven by the customer and not an efficient deferral. However it was treated in the CEPA report and the spreadsheet as efficient deferral. Therefore the respondent requested that the CER review the calculations and remove these monies from efficient deferrals.

### **CER Response**

The CER would like to clarify that there was a mistake in the consultation document and the treatment of the €1.5m, as per the spreadsheet was correct. All of the variance was accepted as being efficiently deferred and as a result the transmission business was entitled to a reward for efficiently deferring this Capex. This has been amended in the final decision document.

### **Comment**

One respondent, questioned the proposal for €2.89m for the refurbishment of Midleton Compressor station and whether the inclusion of all Midleton Capex costs as part of the Inch RAB is the correct approach.

### **CER Response**

The CER agrees with the consultants view that the €2.89m needed for the refurbishment of the Midleton compressor station should be allowed in order to cater for reduced flows through the Inch Entry Point, resulting from the expected lessening of flows from the PSE Kinsale Gas Storage Facility post 2013/14. Furthermore the allocation of these costs to the Inch entry point is consistent with the prevailing approach taken in setting entry tariffs.

The CER also agrees with the consultant's proposal for the introduction of a negative investment trigger. Therefore, in the event that the Kinsale Gas Storage Facility is not decommissioned then the revenues would be reduced to reflect this.

## **2.3.7 Additional efficiencies**

### **Comment**

BGN raised objections to the proposal that they be subject to an additional



efficiency incentive of 1% on controllable distribution opex, based on other regulators recent price control decisions.

BGN stated that they have already included ongoing efficiency incentives in their proposals with efficiency factors of 0.5%, 0.75%, 1.0%, 1.25% and 1.5% in each of the five years. In addition it was stated that there is an additional efficiency incentive created through the use of HICP rather than CPI.

BGN also questioned the proposal for a further €1million adjustment over the period due to the fact that the choice of ITO over an alternative ISO structure had been expected to result in ongoing operating costs being lower.

### **CER Response**

Having conducted the benchmarking exercise, CEPA still considered that there was scope for ongoing efficiency gains and proposed that an efficiency target of 1% per annum be applied to controllable costs. The CER find that the CEPA proposal is appropriate have decided to apply the 1% efficiency to controllable costs.

However, as pointed out previously, the CER also recognise that BGN require some time to introduce efficiencies and reduce their opex. Therefore, the CER has included some monies in the first years of the price control in order to create a glide path to efficiency and allow BGN sufficient time to reduce opex, while still maintaining a safe and reliable gas network.

The introduction of the ITO has increased opex costs in BGN over PC3. At the time of selection of the ITO model, BGN's advice was that the ITO model was expected to deliver lower operating costs than under the alternative ISO structure. Given the magnitude of the out turn cost increase, the CER introduced a further adjustment of €2m over the period (€1m each in distribution and transmission) to more closely reflect the lower costs that had been expected.

## **2.3.8 Impacts of cost reductions**

### **Comment**

BGN stated that the only way they could operate under the proposed allowances would be to substantially reduce the scope of the activities undertaken under PC3. They set out a range of areas in which they would have to reduce activities that would have impacts for customer services, maintenance, safety, response times, etc.

### **CER Response**

The CER has engaged extensively with BGN during the course of the consultation process and afforded BGN the opportunity to demonstrate the

impact that the proposed allowances would have on their business and the areas where they felt they would have to reduce the scope of the activities.

In the interim the CER has increased the opex allowances under a number of headings. In addition the CER has included additional monies in the first years of the price control in order to enable BGN implement a glide path to efficiency. As a result the difference in allowances between the two parties has been reduced since the publication of the consultation paper. The CER is satisfied that, while it will pose a challenge to BGN, the allowances for the PC3 period included in the final decision documents provide sufficient revenue in order to allow them to deliver a safe and reliable gas network, without impacting negatively on areas such as customer services, maintenance, safety, response times, etc.

### **2.3.9 Procedure for Additional Funding / Revenue Allowance**

#### **Comment**

In both consultation papers the CER requested that BGN draft a procedure through which it will apply for additional funding/revenue allowances for specific items. One respondent welcomed the proposal for such a procedure.

#### **CER Response**

As set out in the decision papers the CER has requested BGN to draft a procedure through which it will apply for additional funding/revenue allowances for specific items. A non exhaustive list of such items includes smart metering, new towns, unanticipated new large connections, and a substantial increase in standard new connection numbers.

### **2.3.10 Demand Profile PC3 Spreadsheet**

#### **Comment**

One respondent questioned the profile used for Inch. In their view this represented a worst case scenario and should there be continued production and storage to the end of PC3 then this would result in over recoveries at Inch. They requested, given that the CER is proposing to change the tariff regime in 2014, that confirmation be given on how an over or under recovery at the Inch entry point will be carried over into the new tariff regime of LRMC.

#### **CER Response**

If there is an over recovery due to changes in capacity bookings and/or commodity flows, then this will be dealt with at Inch in the same way as at other

entry points. Ex ante any refinements to expected bookings are taken into account before the tariff is set and ex post any over/under recoveries will be returned/recovered as appropriate. Where significant changes in demand arise, re-profiling of revenues can be carried out as was done in the course of PC2

With regards to the issue of tariff regime change in 2014, it is not appropriate for the CER to make any response at this time due to the fact that the issue is currently sub judice.

### **2.3.11 Incentives**

#### **Comment**

One respondent stated that none of the incentives proposed in the consultation document appear to have been designed to address levels of competitiveness, in particular in terms of staff, IT and other Operating costs. The respondent suggested that such costs are benchmarked against other European TSOs of similar size and scope and measures taken to bring them in line with industry norms.

#### **CER Response**

As highlighted in the CEPA report (CER/12/058a) published alongside the consultation document the CER's consultants examined the benchmarking undertaken by Juran on behalf of BGN. Juran benchmarked BGN's transmission operations against seven European comparators. CEPA recognised the difficulty in top-down benchmarking of transmission performance and considered the bottom-up analysis to provide the best estimates for BGNs relative performance. CEPA's bottom-up analysis was cross-checked with the top-down assessment conducted by Juran. As part of their own analysis, a review of Real Unit Operating Expenditure was conducted by CEPA, comparing trends achieved by BGN and other sectors such as gas transmission and distribution in GB.

Through the benchmarking process and efficiency requirements set out by the CER, there have been significant adjustments to operating costs in a number of areas, including IT. However, in general the purpose of the price control is not to micro-manage BGNs expenditure, but to ensure that they operate in an efficient and cost-effective manner.

### **2.3.12 Twinning of SWOS**

#### **Comment**

Several respondents commented on the decision to not proceed with the

reinforcement of the onshore Scotland network and the majority of these respondents supported the CER's decision.

One respondent questioned the proposal to reduce the spending on Future Planning of the SWOS network from €5million to €1million. They stated that, given the ongoing consultation on congestion or short-run bottlenecks on the SWOS network there was no justification for the inclusion of the proposed €1 million for Future Planning. In their view the consultation should either be suspended and recommenced after the study is completed or that the study is redundant and should be eliminated in its entirety.

Another respondent expressed the view that a cost-benefit analysis should be undertaken in order to support the CER's position that the costs of this work are not justified at this time. They also questioned whether there are less costly options, such as installation of an additional compressor that may reduce the potential risk of a constraint materialising.

BGN disagreed with CER's finding that there is not a need to construct the SWOS pipeline in order to overcome a potential 2013/14 winter constraint. BGN consider twinning the pipeline as the only practical solution that can be implemented in a timely manner in order to reduce the risk associated with potential capacity constraint at Moffat.

### **CER Response**

The CER have made the decision not to proceed with the twinning of SWOS. This decision was based on the potential that there could be a short-term capacity constraint in the winter of 2013/14. However, the CER do recognize that there is a potentially strong case for the twinning of the onshore Scotland network in the longer term in particular where Corrib supplies begin to decline (absent any other sources coming onstream). Therefore it is important to provide BGN with the necessary resources to conduct the studies that will allow them to assess the future needs for the reinforcement of the onshore Scotland network

The CER does not see that there is a need to conduct a cost benefit analysis as the issues were covered comprehensively in the consultation on the issue and respondents were in agreement on the measures taken by the CER. As stated in the consultation paper, the CER is of the view that sufficient remedial measures exist to overcome a potential short-term constraint in the winter of 2013/14.

### **2.3.13 Interconnector – Depreciation period**

#### **Comment**

Two respondents raised concerns around the CER's intention to change the depreciation period of IC2 from 100 to 50 years. They highlighted the significant

upward pressure this change would create on capacity and commodity charges, resulting in a year on year jump which is unwelcome and counter to the purpose of multi-year control periods. As a result the proposed gas transportation tariffs may not be affordable.

It was stated that the CER should retain 100 year depreciation as the rationale for this approach set out in the PC2 paper (i.e. likely non-utilisation of IC2 due to future Corrib flows) still applies for the forthcoming control period.

### **CER Response**

The change in the asset life of IC2 from 100 to 50 years was made to reflect the useful life of the asset and to bring it in line with similar assets. The CER recognise that this change will result in an increase in tariffs, however it is the appropriate time period over which to depreciate the asset. Therefore, as set out in the decision paper the CER has decided to apply a 50 year asset life to IC2.

## **2.3.14 Innovation Funding**

### **Comment**

One respondent stated that funding should only be sanctioned for projects of common interest to the Irish gas industry. It was suggested that an industry body should be formed, consisting of the CER, BGN, IOOA and gas shippers. The terms of reference for the governance of such a fund should be developed and funding should be made available to stakeholders other than BGN.

### **CER Response**

The CER has decided that further consideration should be given to this matter and that there should be appropriate engagement with the gas industry on the matter. Therefore, while provision has been made in the accompanying decision documents to allow a total of €8m to be collected for innovation, the CER will consider further the governance arrangements for this fund and will engage with stakeholders as appropriate.

## **2.3.15 Auditing and Transparency Rights for Inch.**

### **Comment**

One respondent expressed their view that there was a lack of transparency in the Capex and Opex cost proposals for Inch entry point. They requested that the CER provide a full breakdown of the Capex & Opex costs to ensure the tariffs paid at Inch are spent in an efficient and timely manner.

## **CER Response**

The CER has published the price control model, the consultants' report and the CER consultation document. The CER takes the view that significant and sufficient transparency has been achieved in this process.

### **2.3.16 Impact on Generators**

#### **Comment**

One respondent highlighted the impact increased capacity & commodity costs would have on generators. They stated that generators cannot recover these costs from the market and that this will have implications for long term investment signals. It was suggested that the SEM Committee should revisit whether generators should be able to recover these costs from the market.

#### **CER Response**

The purpose of the price review is to ensure that BGN are allowed only efficient costs. However, BGN must be allowed sufficient revenues to operate and maintain a safe and reliable gas network. Should an increase in revenues be required to allow BGN to operate their business efficiently then, all other things being equal, it will be necessary to increase tariffs. While the CER recognise that changes to capacity and commodity charges have significant impact on generators, only efficient costs have been included in allowed revenues. With regards to the suggestion that the SEM Committee should revisit whether generators should be able to recover these costs from the market, the CER do not view this consultation as the appropriate forum to raise this suggestion. Should the respondent wish to pursue the matter it is suggested that it be taken up directly with the SEM Committee.

### **2.3.17 Moth-Balling IC1**

#### **Comment**

One respondent suggested that, as a means to reduce Opex, the CER should consider moth-balling IC1 given that it is likely to be redundant once Corrib gas is flowing. They suggested that in order to avoid the asset being "stranded", the IC could be maintained for stand-by use only if the Opex savings were significant.

#### **CER Response**

Any pipeline that is "gassed up" must be maintained appropriately. Therefore there may not be any significant savings in "mothballing" such a pipeline.

Additionally, if a “moth balled” pipeline is not properly maintained then it may not be permissible to bring that pipeline into use at a later date.

There are clear security of supply benefits in having two subsea pipelines. Considering the costs already invested in these two pipelines and considering the potential risks in reverting to a situation of possibly having just one such pipeline in the future the CER does not consider the above option to be appropriate.

The CER would also draw attention to the fact that some of the considerations at issue here are currently the subject of high court litigation arising from the CER Decision Paper on The Regulatory Treatment of the BGE Interconnectors and Future Gas Transmission Tariff Regime<sup>1</sup>.

### **2.3.18 Omissions**

#### **Comment**

One respondent highlighted what they saw as omissions of important information. It was stated that, unlike in the previous price control, analysis of demand assumptions had been omitted from the consultation paper and that this analysis should be retained as it forms an important part of the overall explanation underlying the proposed tariff changes.

The respondent also stated that the consultation paper should have discussed the implications of the recent decision on Interconnectors (CER/12/087) and in particular in relation to tariffs over the course of PC3.

In addition, they requested that the CER outline and explain the basis for both the allowance of specific costs as well as the basis for the proposed tariffs. The respondent’s view is that it is not sufficient to publish the price control model alongside the consultation paper and for the paper itself to remain silent on its implications. It was requested that the decision paper address any information shortcoming in order to allow stakeholders to reconcile the changes in allowed expenditure from PC2 to PC3, with the proposed changes in transmission tariffs.

#### **CER Response**

With regards to demand, the model published alongside the decision documents show the demand forecasts for the PC3 period. Distribution demand is forecast to have moderate growth over the period, which the CER and our consultants consider to be appropriate. With regards to Transmission demand, the model

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<sup>1</sup> The Regulatory Treatment of the BGE Interconnectors and Future Gas Transmission Tariff Regime – [CER/12/087](#)

shows Inch operating until 2015/16 then blowing down. The demand figures for the interconnectors reduce significantly from 2015/16 onwards as a result of Corrib coming online.

There have been a number of recent revisions of expected transmission demand (specifically capacity bookings) over the PC3 period. These downward revisions in expected capacity bookings, if borne out, will result in significant upward pressure on tariffs. The CER expects to consult further on these matters in the very near future.

With regards to the issue of the recent decision on Interconnectors, it is not appropriate for the CER to make any response at this time due to the fact that the issue is currently sub judice.

The CER has published the price control model, the consultants' report and the CER consultation document. The CER takes the view that significant and sufficient transparency has been achieved in this process.

### **2.3.19 Information Request**

#### **Comment**

One respondent highlighted what they saw as a significant disadvantage for stakeholders in that they do not have access to the correspondence between the consortium, CER and BGN. Given that BGN is a monopoly, the respondent called on the CER to publish all correspondence between the CER, BGN and the consortium and to remove all redactions, except where the material is sensitive personnel information.

#### **CER Response**

The purpose of the consultation documents are to provide stakeholders with all the necessary information in order to allow them to assess the proposals put forward. The CER is of the view that the consultation documents and accompanying consultation reports, as well as the models provide stakeholders with the appropriate level of detail.

#### **Comment**

One respondent, Shannon LNG, questioned the statements in Section 10.1 of the paper (CER/12/057d) around BGN's request for the CER to include an investment trigger in the price control in the event that the Shannon LNG terminal is developed and modifications to the network are required. Shannon LNG stated that they would incur any costs associated with connection and if anything the



network should benefit from the introduction of new high-pressure gas supplies. Therefore they request that the CER release information regarding the representations by BGN which suggest operation of the Shannon LNG terminal will lead to new investment on the part of BGN

### **CER Response**

Shannon LNG state in their response that as they are planning to “construct, own and operate the already licensed pipeline between the Shannon LNG terminal and the BGN ring main at Foynes, it is highly unlikely that BGN will incur any costs associated with this connection”.

Section 10.1 of CER 12/057d quotes BGN as saying that in the event Shannon is developed and modifications are required to the network in PC3, it would like the CER to include an investment trigger in the price control to allow BGN to “engage with the CER to determine the approach to the treatment of recovery of resultant investments.” As noted above, Shannon LNG state that they would incur any costs associated with connection. Further to Shannon LNG’s clarification, the CER does not propose to include any such explicit trigger in the PC3 decision, meaning that no new investment on the part of BGN is anticipated.

## **3.0 Conclusion**

The CER received a total of eleven responses to the PC3 consultation. Having reviewed all responses received, and having considered the issues raised, the CER has today published its final decision on BGN’s allowed revenue for both Transmission and Distribution over the course of PC3. The decision documents will provide clarity on many of the issues raised in the consultation process and in addition to the decision documents this paper has attempted to address directly the main issues raised in the consultation responses received.