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

July 2012.

via e-mail only

Dear Jerry,

Re: Bord Gáis Networks Revenues October 2012 – September 2017

Vayu welcomes the opportunity to comment on the Commission for Energy Regulation's ("CER") consultation papers that examines Bord Gáis Networks' ("BGN") transmission and distribution revenues for the period October 2012 to September 2017 – CER/12/057 and CER/12/058. We are responding to both these papers through one submission paper.

Summary

We are conscious that the CER has refused BGN's request for expenditure in a number of areas, which will impact both the transmission and distribution revenues. Given that the significant increase in transmission tariffs will be ultimately borne by consumers, the CER should be making every effort to curtail these increases and only allow BGN recover those revenues to which they are fully entitled.

We note from these papers that the same principles and methodologies are used in the process to calculate revenues as were used in previous price control reviews. There are inherent flaws in a number of the methodologies, which we had expected to be amended in the current review. For example and the most obvious of these is the continued use of replacement cost using acquisition cost, indexed for inflation as the basis for valuing the Regulated Asset Base ("RAB").

At a minimum a reference should have been made to the decision paper on the treatment of the BGE interconnectors ("I/C") in CER/12/087, which introduced the Long

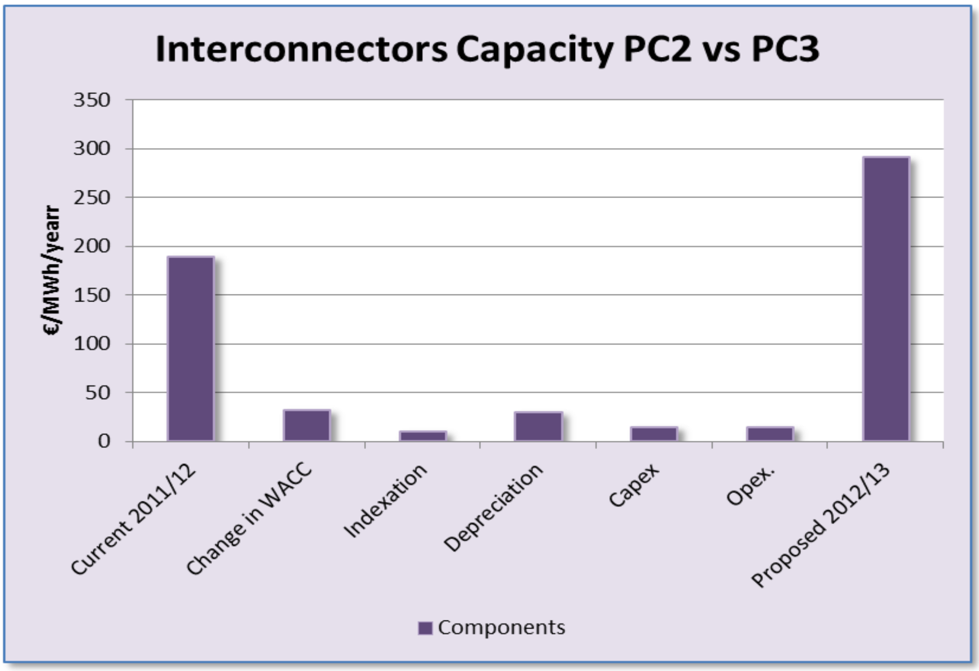
Run Marginal Cost ("LRMC") methodology as a basis for setting tariffs. Tariff policy and regulating revenues for owners of transmission and distribution networks are inseparable. If LRMC is the preferred methodology to be used for the I/C's from October 2014, the CER should be conscious of the need to establish a clear roadmap for the transition and the final decision paper should detail this.

In this roadmap clarity is required with respect to asset lives. The PC3 papers reduce the asset lives of I/C2 to 50 years (I/C1 is already at this level). However, the decision paper for the treatment of the I/C's for tariffing purposes considers that 20 years is an appropriate time horizon. From this are we to expect that the I/C asset lives will be further reduced in 2014 to 20 years, resulting in an artificial increase in the related tariff.

We also believe that these price control reviews should not be treated as discrete periods in some aspects. For example we note that there has been an under-spend in operational expenditure in the last review period, price control 2 ("PC2"), by €26.6 million. We believe that this should have been brought forward into the current price control review ("PC3") as a way to keep tariff increases to a minimum.

In our view, the CER should consider splitting the PC3 into two discrete periods – from October 2012 to September 2014 and then from October 2014 to September 2017.

Given the significant amount of material to absorb in the consultation paper and supporting material and we think it would be useful to publish a summary table similar to that below, which shows the marginal change from the various revenue drivers.



The CER recently published a paper on the pricing of short term tariffs (CER/12/075), which refers to a potential increase in revenues in the absence of secondary capacity transfers at the exit. We would question why this was not referred to in the consultation paper concerning transmission revenues and the impact of this change on proposed tariffs. We also refer the CER to Vayu's numerous submissions on this matter to state that we do not agree with the proposal to remove this facility.

Regulated Asset Base

The paper looks for views on the treatment of replaced assets in the event that the net book value is greater than zero. The paper could have been clearer in explaining the tariff implications of either treatment. In our view the treatment should be to allocate this amount to the transmission business.

The financial accounting treatment of such items would be that these assets would be written off the balance sheet and the consequent profit or loss recorded in the income statement. We fail to see why the regulatory treatment should be any different. If this results in an over recovery of revenue in the year this can be accounted for in the correction or "k" factor in future periods.

Operational Expenditure

The paper notes that there have been savings of €25 million made on the allowed PC2 pass-through costs, the majority of which being from rates. Given, the fall in the cost of CO_2 emissions in PC2 we would like the CER to identify any savings that were made through the review period and also what assumptions have been made regarding volumes and the price of CO_2 emissions for PC3.

One of the consultants used by the CER in this PC3 process recommends a 1% efficiency on controllable costs. However, the paper does not say how this 1% figure was arrived at. We would like to know if this is a benchmark figure used in other similar exercises or is it based on an historical figure used previously.

Over the past 4 years we have dealt with a number of prospective end-users who have expressed interest in a new connection to the gas network. In almost all situations these entities have said that the associated planning and design costs were exorbitant compared to market prices. In our view this aspect of BGN's business, if not already being done, should be periodically outsourced on a competitive tender basis to ensure costs are competitive.

The concept of the innovation fund is not new, but we believe that some innovation could be used to structure its costs more economically. In our opinion, the pass-through savings from PC3 could have been used to offset the proposed innovation spend of €8 million in PC3.

The table on the proposed operational expenditure (Table 7) details the costs associated with various categories of the business. Included in this table is a credit for what is termed “Barclays lease buyout” of €2.5 million in 2012/13. We would appreciate a fuller explanation of this credit, why it arises and why it did not arise in PC2.

Capital Expenditure

The paper notes that certain capital expenditure costs have been excluded from that proposed by BGN. The main projects being disallowed at this stage are the twinning of the South West Scotland Onshore System (“SWSOS”) of €91.8 million and the Curraleigh West to Goat Island pipeline reinforcement of €44.7 million. There is no doubt that if these projects proceeded as proposed the impact on transmission tariffs would have been even greater than the proposed increases in capacity and commodity charges.

It is worth highlighting that the external consultants only disallowed the SWSOS costs as a decision on the options for Moffat capacity constraints had not been made by the CER by the time this work had been completed.

However, the transmission consultation paper notes that the CER is not approving the reinforcement of the SWSOS and we welcome this. Our views on this consultation still stand in that we believe that the range of measures, rather than one single measure, can be effectively used to mitigate the capacity constraints at Moffat during PC3.

We also concur with the decision to disallow the Curraleigh costs on the basis of the “uncertainty of PSE Kinsale Energy’s plans for the future operation of the gas storage facility.”

In light of the number of projects that were not allowed in both transmission and distribution e.g. SWSOS, Curraleigh, new towns and smart metering we would appreciate if the CER would confirm how it intends to adjust the tariffs if any of these projects proceed in the PC3 timeframe. It would be useful to give a signal to industry as to the impact on tariffs of each those listed above as they are the more expensive disallowed projects.

Cost of capital

The proposal to review BGN’s cost of capital throughout the PC3 period is a pragmatic approach in light of the uncertainty in the Eurozone market. However, we believe this adjustment mechanism approach could be refined somewhat. Coupled with the mechanism to review BGN’s cost of capital, the review could also include an analysis of BGN’s refinancing schedule and requirements. In this way the rates should not necessarily rise or fall in line with market conditions unless BGN’s own debt profile has also changed.

We would be grateful if the CER considers these preliminary views and we are happy to discuss these further.

Yours sincerely,
Bryan Hennessy