Interim Review on BGN Allowed Revenues and Gas Transmission Tariffs for 2012/13

DOCUMENT TYPE:	**Decision Paper**
REFERENCE:	**CER/13/080**
DATE PUBLISHED:	28th February 2013

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Abstract:

This paper sets out the decision of the Commission for Energy Regulation ('the CER') in relation to an Interim Review of the Bord Gáis Networks ('BGN') Allowed Revenues and Gas Transmission Tariffs for the Gas Year 1st April 2013 to 30th September 2013.

The proposed decision (CER 13/034) considered a 13.2% increase in the cost of transporting UK gas (IC plus Exit tariff) with effect from 1st April 2013.

Following consultation, in order to minimise the number of and scale of tariff changes, while also having regard for the cash flow effect on BGN, the CER has decided to direct a **10.2% increase** in the cost of transporting UK gas (IC plus Exit tariff) with effect from 1st April 2013.

Target Audience:

Gas Customers, Suppliers, Shippers and Producers.

Related Documents:

- CER/13/034 – Proposed Decision – Interim Review of BGN Allowed Revenues 12/13
- CER/13/034a – BGN Submission
- CER/12/145 – Decision on BGN Allowed Revenues and Gas Transmission Tariffs for 2012/13
- CER/12/196 – Decision on October 2012 to September 2017 Transmission Revenue for Bord Gáis Networks (PC3)
- CER/12/197 – Price Control 3 Model

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1.0 Introduction

1.1 Purpose of this paper

This paper sets out the CER's decision in relation to the ***"Interim Review on BGN Allowed Revenues and Gas Transmission Tariffs for 2012/13"***,which among other things proposed an interim increase in transmission tariffs of 13.2% with effect 1st April 2013*.*

1.2 Background Information

Capacity bookings on the gas transmission system have been in serious decline for some months now. In submissions made to the CER, BGN noted that decreases in capacity bookings were leading to a significant under-recovery in their 2012/13 allowed revenues. BGN noted that the decrease in bookings was directly related to the Power and Daily Metered (DM) sectors radically reducing their firm bookings. BGN expressed concerns at this erosion of their revenue base and the resulting cash flow difficulties. As a result of the unprecedented drop off in bookings, BGN made a submission requesting a midyear tariff adjustment along with proposing options to seek to redress this situation. BGN proposed three options to deal with the potential under recovery. BGN's options for dealing with the potential under recovery [1] would result in raising the transmission tariffs from 1st April by between 25%-45%.

The CER share the concern about the forecast BGN under recovery of allowed revenues in '12/13. CER acknowledged BGN's conclusions as to the causes of the drop off in bookings and demand. The CER examined the BGN proposed options. However, it chose not to propose any of the specific options proposed by BGN as the CER had concerns regarding the scale and impact of a significant rise in the cost of transportation of UK gas on consumers. Equally, though, the CER was concerned that if no interim step was taken from April '13 a very significant increase in tariffs (greater than 40%) would need to be implemented in October 2013. Cash flow implications for BGN are another consideration to bear in mind.

[1] See footnote 2 (page 8) in CER 13/034 regarding the use of the phrase "under recovery" in this context.

In order to minimise the number of and scale of tariff changes, while also having regard for the cash flow effect on BGN, the CER proposed a 13.2% increase in the cost of transporting UK gas (IC plus Exit tariff) with effect from 1st April 2013. In carrying out the interim review of transmission tariffs, the CER sought to meet the following objectives:

- Minimise number of and scale of tariff changes;
- Ensure the network is efficiently financed and limit any under-recovery effect on BGN.

The CER also noted it would shortly be consulting on some related but more structural tariff issues, such as:

- The case for removal of secondary capacity trading at the exit.
- Short term tariff – consideration of the case for enhanced incentives towards long term bookings.
- The case for requiring the power sector to book firm capacity.
- The case for moving to a flat revenue profile on the ICs

1.3 Comments Received

The CER received 18 submissions in response to the 8th February 2013 Proposed Decision Paper CER/13/034. The responses themselves are summarised in section 4 below. Responses were received from the following organisations/individuals:

- Airtricity
- Aughinish
- Dairygold
- Dawn Meats
- Electric Ireland
- EMC
- ESB Generation & Wholesale Markets
- Fingleton White
- Flogas
- Glanbia
- IOOA
- Kinsale Energy
- Kore Energy
- Largo Foods
- Michael Creed T.D

- Nutricia
- Pfizer
- Vayu

2.0 CER Decision

Issue at hand

The gas market is facing a serious issue of significant tariff increases as a result of the unprecedented drop off in capacity bookings. The drop off in bookings is having a serious effect on the finances (i.e. cashflow) of BGN. BGN as a regulated natural monopoly is guaranteed its revenue. This is done, in essence, to guarantee that the network operator can ensure that it is possible to efficiently invest in and maintain a network of sufficient size to ensure people have heating in their homes, as well as ensuring the lights stay on even during the coldest winters.
Guaranteeing a network operators revenue is standard practice across Europe.

Under the Gas Act 1976 (as amended), the CER is responsible for regulating charges in the natural gas market. Under Section 10A of that Act (as amended by the Gas (Interim) (Regulation) Act, 2002) the CER may set the basis for charges for transporting gas through transmission and distribution systems.

In accordance with section 9 of the Electricity Regulation 1999, the CER is required *inter alia* to have regard to the need:

– to secure that licence holders are capable of financing the undertaking of the activities which they are licensed to undertake;

– to secure that there is sufficient capacity in the natural gas system to enable reasonable expectations of demand to be met; and

– to secure the continuity, security and quality of supplies of natural gas.

In CER/13/034 the CER proposed an interim measure to allow BGN recoup some of its expected under recovery while at the same time trying to mitigate and potentially negate future significant tariff rises.

Response to Consultation

In general the feedback from the majority of respondents to the proposed interim increase was a resounding request for no change at this time. Respondents cited budgeting and equity as the two main reasons for not pursuing an interim increase at this time.

Indeed it is noteworthy that in bilateral discussions with CER, two LEU's stated a preference for a larger increase in October rather than a smaller intermediate increase, as their business would be better able to budget for the increase.

The CER has listened carefully to the arguments put forward by the respondents. The CER recognises the difficulties faced by industry in having to deal with an unexpected tariff increase in the middle of a year.

While the CER understands the issues being faced by industry today, the CER has a duty to ensure the network operator is capable of financing the activities required to ensure that there is sufficient capacity in the network and to secure the continuity, security and quality of supplies of natural gas.

CER Examination of Budget Impact of Proposal

It is reasonable to state the key concern expressed by end customers, in their responses, was the undesirable consequence of the unexpected rise in transmission tariffs mid-year, especially as budgets would have been set assuming there would be no such change in transmission tariffs.

To examine the likely effect of the proposed 13.2% rise in transmission tariffs, CER examined a number of sites and estimated the impact of the proposed rise on a simulated "annual gas budget" for these customers. This was carried out as a high level examination of the potential impact on these customers. This examination did not purport to mimic the actual position of these customers, but sought to examine potential impacts.

In carrying out the examination, CER set the "budget" for the facilities based on year ahead gas purchases using an exchange rate and gas price taken as a flat average for the year ahead on 30th September 2012. The flat year ahead price was taken to be 78.47c/therm[2].

[2] 62.4p/therm * £/€1.2576

To demonstrate the variability in gas prices, the CER considered similar budget setting exercises on 1st September 2012 at 80.88c/therm (3% higher than the base case above) and on 30th October at 80.37c/therm (2.4% higher). This demonstrates the variability in gas prices given that the net price in c/therm is affected by both changes in the NBP price in Great Britain and the exchange rate movements between Euro and Sterling.

For each of the end customers examined a budget was set on 30 Sept 2012, as described above for the full gas year 2012/13. The effect of the proposed 13.2% increase in transmission tariffs for the second half of the gas year 12/13 was then examined.
In no case, for the customers examined, was the resulting rise greater than 1% of the full year gas budget. To be clear: the increase in gas network charges of 13.2% as proposed in the consultation paper would if implemented on April 1st 2013 be equivalent to under 1% of these customers total gas budgets (the gas commodity itself plus network charges) for the gas year 2012/13. In this context it is important to note that the increase applies for half the year only whereas at least one correspondent considered a full year effect on their overall budget in their response.

Common practice for Large Energy Users (LEU's) would be to leave an element of gas purchases for "on the day purchases". This reflects the fact that exact consumption cannot readily be predicted and futures purchases may not be available in quantities that precisely match the customer's needs. In CER/09/124[3] in the order of 20% of purchases are left to "on the day" purchases. In this context it is likely that even after budget setting a proportion of an LEU's gas bill is left unhedged.

The CER considered the effect of the customers' in question leaving 15% of their gas requirements unhedged (considered a conservative estimate). Expressing the cost of this gas (15% of the total gas requirement) as a percentage of the annual gas bill (including transmission and distribution charges) gives an indication of the potential for variability that an LEU might see on their annual gas bill. The percentages of the total bill left unhedged was found to range from 11% to 14%.

In light of this analysis CER considers that a reasonable amount of variation in annual gas bills to LEU's can be expected even when the budget has been set for a year. In this context the CER considers that a potential rise in costs of less

[3] Gas Tariff Review : BG Energy Residential and I&C customers

than 1% on the annual gas bill can be considered to be broadly in line with what might normally be expected. Admittedly, business customers should normally expect the network tariff element of their gas budget to remain fixed for a year, unless quite exceptional circumstances warrant revisiting that tariff within year (as arguably arises in the present case).

The CER is not suggesting that any customers would have anticipated any such change when setting their budgets. This seeks only to put the magnitude of the change into the context of normal variability in the cost of gas.

The CER does recognise, however, the general undesirability of mid-year network tariff changes. The CER has decided to scale back the originally proposed increase in tariffs for transporting UK gas from 13.2% to 10.2%. This will ease the cash flow impact on BGN by c. €7m, though it will mean that some tariff increases in October 2013 are expected regardless of any future changes in tariff structural policies (see below).

The Equity Issue

A number of respondents considered "*the inequity of energy users in the Daily Metered market segment and the domestic market who have not benefitted from lower capacity bookings made by suppliers now being asked to pay a tariff increase as a result of the reduction in capacity bookings in the Daily Metered segment and in the power generation sector"*.

It is correct to say that the recent drop off in demand is driven more by changes in the power sector than in the DM and LDM I&C sector. This paper does not seek to address such equity issues. These issues *are* very important. They are not addressed in the current decision which focuses only on an interim transmission tariff increase from 1st April 2013, as an immediate step to seek to avoid large tariff rises at a later date.

CER will be consulting on these issues in the near future and the outcome of that consultation exercise will feed in to the 2013/14 network tariffs.

Decision

The CER has decided to direct Gaslink to implement a 10.2% increase in the tariffs for transporting UK gas (IC plus Exit tariff) with effect from 1st April 2013.

This decision is taken in order to reduce the number of, and scale of tariff changes, while also having regard for the cash flow effect on BGN. This decision seeks to balance the above issues with the undesirable effect of an unexpected rise in transmission tariffs on customers.

This is expected to reduce the cash flow effect on the TSO by c.€7m.

3.0 CER Decision on Transmission Tariffs for 2011/12

The CER hereby directs Gaslink to implement the tariffs set out in the table below. These tariffs will be in place from 1st April 2013 to 30th September 2013.

BGN Transmission Tariffs for April to September 2013 *

	€ Apr'13-Sept'13 Tariff	(12/13 Monies)	Published Tariffs 2011/12 €	Published Tariffs 2012/13 €	% Change Nominal from 12/13
Onshore Network					
capacity	**491.313**	per peak day MWh	440.657	463.503	6.0%
commodity	**0.244**	per MWh	0.215	0.230	6.0%
Interconnectors					
capacity	**340.822**	per peak day MWh	189.884	291.301	17.0%
commodity	**0.148**	per MWh	0.082	0.127	17.0%
Inch					
capacity	**103.697**	per peak day MWh	46.697	103.697	0.0%
commodity	**0.091**	per MWh	0.053	0.091	0.0%
Illustrative Transmission Transportation Costs	€		€	€	
Transmission Transportation Cost of UK Gas					
capacity	**832.135**	per peak day MWh	630.541	754.804	10.2%
commodity	**0.392**	per MWh	0.297	0.357	9.9%
Transmission Transportation Cost of Inch Gas					
capacity	**595.010**	per peak day MWh	487.354	567.200	4.9%
commodity	**0.334**	per MWh	0.268	0.321	4.3%

Cost/Therm Comparisons

Annual Consumption	365
Load Factors	1.3

Apr-Sept - 12/13 (12/13 Monies)

Tranportation Cost of Moffat Gas	€	Transportation Cost of Inch Gas	€
Capacity	1,081.78	Capacity	773.51
Commodity	143.02	Commodity	122.05
Total	1,224.79	Total	895.56
Cost/MWh	3.36	Cost/MWh	2.45
Cent/Therm	**9.83**	**Cent/Therm**	**7.19**

Gas Year 12/13(12/13 Monies)

Cent/Therm	**8.92**	**6.86**
% Increase - Nominal	**10.2%**	**4.8%**

* The numbers presented both in the tariff and in the worked example have been rounded.

Table 3.1

3.1 Next Steps

Over the coming months the CER expects to set out consultations on structural changes on the demand side issues mentioned in CER/13/034.

The CER will also consider options with regard to moving to a flat revenue profile on the Moffat Entry tariff.

4.0 Comments Received & CER Response

The CER received eighteen responses to the Proposed Decision Paper CER/13/034. These responses are published along with this decision paper. The CER addresses the principal comments in turn in this section. Responses have primarily come from large energy users and shippers/suppliers. A response was also received from Michael Creed T.D.

Responses from large energy users (Aughinish, EMC, ESB Generation & Wholesale Markets, Dairygold, Dawn Meats, Fingleton White, Glanbia, Kore Energy, Largo Foods, Nutricia & Pfizer) all broadly followed the same line. LEU's objected strenuously to a mid-year tariff change, citing budgeting issues as a major cause of concern. A number of LEU's also voiced concern regarding the perceived inequity in the way the CER proposed to increase transmission tariffs for all users when the cause of the problem was seen to lie with the power and DM sectors. LEU's voiced concerns at the impact such a rise would have on their competitiveness and how such a rise could bring about company closures and job losses. A summary of the main comments received on each, are set out below:

- Object strenuously to the proposed increase. This will impart undue hardship on users.
- The proposed mid-year tariff adjustment proposed by BGN is not within the spirit or letter of the Code of Operations.
- Difficulty in managing budgeted energy spends when midyear tariff changes are implemented at such short notice. This does not allow sufficient time for business to recover these additional costs within the operating year.
- Urge the CER to defer the proposed increase in the transmission tariffs and resolve structural issues in the market as a matter of urgency.
- Activities in the power sector is the main reason for the unprecedented fall off in capacity bookings
- The inequity of energy users in the Daily Metered market segment and the domestic market who have not benefitted from lower capacity bookings made by suppliers now being asked to pay a tariff increase as a result of the reduction in capacity bookings in the Daily Metered segment and in the power generation sector.
- Recover the revenue shortfall from shippers to the Daily Metered and Power generation sectors, without any impact on Transmission tariffs and on end users prices.

- It is unfair that the remaining gas users should pay increased tariffs in order to subsidise renewable electricity generation policy objectives
- Industry in Ireland does not have to use gas or book gas transportation capacity. Industry can retire, relocate to more attractive locations or use alternative fuels and/or processes.

CER Response:

The CER acknowledges LEU objections. The CER has given serious consideration to the arguments put forward by industry. The CER has a duty to ensure the network operator is capable of financing the activities required to ensure that there is sufficient capacity in the network and to secure the continuity, security and quality of supplies of natural gas.

Following examination of the effect of the proposed tariff increase the CER has decided to implement an interim tariff increase that is lower than that originally proposed in the proposed decision.

Responses from Shippers/Suppliers (Airtricity, Electric Ireland, Flogas, IOOA, Kinsale Energy, Vayu) in the majority objected to an interim increase. Respondents have requested that the CER develop, in conjunction with industry a more enduring solution to resolve the issue of the under recovery. Several other comments were made with regard to structural issues in the market. These issues are expected to be addressed in later consultations.

- Believes that the proposed increase in April will only further exacerbate the drop off in bookings and is not a suitable response to the current difficulty.
- It is morally wrong to attempt to transfers these costs on to gas suppliers and their business and residential customers. Recommend that any revenue shortfall be held over until the 30th September 2013 and the appropriate corrective action put in place for the new gas year.
- CER should examine ways of addressing the problem which ensure that the power generation sector which has caused the shortfall, solves the shortfall.
- Believes a wider consultation is required which seeks to provide a long term solution to the under recovery.
- A forum is urgently needed where the regulatory authorities for both gas and electricity are available to meet market participants.

- Do not object to interim reviews in principle, such actions should only be taken in the events of significant factors unforeseen at times of decision making, which clearly does not apply to this situation.
- BGN may be under recovering revenues at the interconnectors and onshore, it is over recovering at Inch. Hence since the CER is proposing to correct for the under recovery at the Moffat entry point and at the onshore exits, KEL requests the CER also corrects for the over recovery that is occurring at Inch by reducing the Inch tariff for the remainder of the 2012/13 period.
- The proposed decision and longer term solution involves the subsidisation of a state monopoly by end consumers who have no real alternative; adding material costs to their already over stretched budgets.
- Does not accept this is a gas only issue and believes the CER should consider other options such as directing BGN and other state owned/or subsidised undertakings to identify internal savings and a levy on wind generators to finance back-up services.

CER Response:

The CER acknowledges Shipper/Supplier objections. The CER acknowledges there are issues regarding how the gas network is remunerated. The CER is committed to extensive consultation on tackling the structural issues in the gas market and will consult in the near future on such issues.

Regarding the unexpected nature of the decline in bookings, the CER confirms that it used BGN's April expectation of bookings when tariffs were set for 2012/13. At that time, BGN was predicting a drop off in demand of c. 5%, these lower figures were not used by CER in tariff setting. In the outturn this has fallen further to 18%, over 3 times greater drop off than BGN had expected. Clearly this increased and significant further drop off was not expected at the time tariffs were set.

The CER acknowledges Kinsale Energy's point with regard to a potential over recovery at the Inch entry point. However as this was not consulted upon in CER/13/034, the CER considers it would be more appropriate at this time to make no change to the Inch entry tariff. Any over/under recovery can be considered when tariffs are set in the Autumn.

- Michael Creed T.D.

- Deputy Creed urges the CER to resist the measures set out by BGN as far as possible. Deputy Creed notes the damaging effect an increase in tariffs can have on business as well as the domestic market. Deputy Creed requests the CER publicise any increase well in advance of implementation so as to allow households and businesses to budget accordingly.

CER Response:

The CER acknowledges the effect a tariff increase has on both business and domestic customers. However, the CER is acting in the interim in order to reduce the number of and scale of tariff changes, while also having regard for the cash flow effect on BGN and on customers.