



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

## **Gas Tariff Review 2013 - 2014 Quarterly Review Bord Gáis Energy's Residential Customers**

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## Executive Summary

This information note sets out the Commission for Energy Regulation's (CER) decision with respect to the BG Energy Non-Daily Metered (NDM) tariffs for its Residential customers from 14<sup>th</sup> April 2014.

Following on from the annual tariff setting process in CER/13/204 "*Gas Tariff Review 2013-2014 Bord Gáis Energy's Residential Customers*", on 23<sup>rd</sup> December 2013 BG Energy submitted its updated forecast and closeout K factors for 2012/13.

In this submission, BG Energy calculated that an under-recovery of €4.356m would arise at the current tariff levels set in September 2013. After examination, the CER agreed with the level of the expected under-recovery due to the factors outlined below.

On 28<sup>th</sup> February 2014, the CER wrote to BG Energy asking for a revised submission. On 4<sup>th</sup> March 2014 BG Energy made this updated submission, taking into account gas prices on close of business 3<sup>rd</sup> March 2014.

This revised submission, resulted in an expected under-recovery of €3.714m arising at the current tariff levels set in September 2013.

The key factor causing upward pressure on the residential gas tariffs is lower than expected sales volumes.

This was particularly evident in the first quarter of 2013/14. As the majority of gas volumes are sold between October and February significant decreases in volumes during this period increase pressure on tariffs as fixed components such as network charges are divided across a lower number of units.

In addition the volume of sales in the final quarter 4 of 2012/13 was also lower than had been expected. The result of this is that the K-Factors for 2012/13 were lower than expected which also puts upward pressure on tariffs.

Network charges, specifically Transmission costs have also increased slightly for BG Energy. This includes shrinkage charges which are applied to all suppliers by the Transporter (Gaslink).

Under the original Revenue Control Formula (RCF) this under-recovery would be recovered over the remainder of the gas year (up to 30<sup>th</sup> September 2014) leading to a tariff rise of 3.47%.

Noting that deregulation of Bord Gáis' Residential gas tariffs is expected to occur in the near future, the CER considered alternative methodologies in setting the tariff level in the light of the expected under recovery.

The CER considered a methodology whereby the tariff rise would be calculated by reference to a full year's required revenues. In this case the tariff rise would be 1.47% (€3.714m under recovery/€251.919m required revenues for 2013/14). Under this methodology (all other things being equal) the under recovery would be recovered over 12 months and consumers would see a significantly lower rise in tariffs. The approach of correcting the under-recovery over 12 months is consistent with the approach outlined in the Roadmap to Deregulation Decision CER 11/071, which considered that a 12 month approach would temper the effect of seasonality on tariff changes.

The CER has decided to apply this (12 month) methodology.

The CER considers that in selecting this methodology, it is achieving an appropriate balance between the interests of consumers and the interests of suppliers (including BG Energy) in ensuring that tariffs are cost reflective over a reasonable period.

The required revenues for BG Energy are estimated at €251.919m in the current gas year, with an expected under-recovery of €3.714m. Therefore, applying this methodology, the CER has decided to allow a **1.47% increase** in tariffs to be applied to both the standing charge and unit rate.

In setting this tariff, the CER is cognisant to ensure that BG Energy recovers its legitimate under-recovery but that tariff increases are kept to a minimum for consumers.

This tariff increase will come into effect on 14<sup>th</sup> April 2014.

## Background

In June 2011 the CER published the decision paper CER/11/071 “*The Roadmap to Deregulation in the Non-Daily Metered Gas Market*”<sup>1</sup>. This outlined the criteria that would be followed to deregulate Bord Gáis Energy in the Non-Daily Metered (NDM) gas market. This includes both the Revenue Control Formula (RCF) that would be used to review Bord Gáis Energy’s retail gas tariffs, as well as the criteria that must be met for deregulation in the NDM market to occur.

The deregulation criteria as set out in CER/11/071 was confirmed in CER/13/096 “*Review of Non-Daily Metered Retail Gas Market*”<sup>2</sup> which also established the threshold which BG Energy must reach for deregulation to occur<sup>3</sup>.

As part of the annual tariff setting process BG Energy submits their tariff request to CER. A public consultation on the submission is carried out before the annual tariff is set for October of each year.

Following the annual review, BG Energy submits regular revised updates thereafter to incorporate updated forecasts and actual outturn information. These submissions are not consulted upon given the timelines required. The CER examine the submissions and either approve or disallow any tariff changes.

As part of the full annual review process, on 09<sup>th</sup> August 2013 BG Energy made a submission to CER which requested an increase of 7.22% in their residential gas tariffs<sup>4</sup>. This submission together with a Consultation paper was published on that date.

On 21<sup>st</sup> August 2013 the CER published finalised Network Tariffs for 2013/14. These finalised Network Tariffs were used as the basis for a revised BG Energy submission from 23<sup>rd</sup> August. The revised submission requested a 5.43% increase in the then prevailing tariffs for BG Energy gas residential customers.

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1 <http://www.cer.ie/document-detail/Proposals-on-a-Roadmap-for-Deregulation-in-the-Non-Daily-Metered-Retail-Gas-Market/518/3442>

2 <http://www.cer.ie/docs/000861/cer13096---ndm-retail-gas-final-decision.pdf>

3 The threshold was set at 60% of the relevant market where BG Energy decided to rebrand or 55% of the market where a decision not to rebrand was taken.

4 The BG Energy 9th August submission was based on Network transportation costs using figures published on the CER website on 6th August. These figures were indicative.

The key factor providing upward pressure was an increase in network tariffs. The increases were, in turn, due to decreases in capacity bookings on the network, as well as a decline in the expected average consumption per customer.

The fixed nature of a large number of the relevant costs coupled with the expected decline in consumption per customer put upward pressure on the tariff unit rate.

In determining the appropriate volumes with which to calculate the gas tariffs the CER used volumes that were consistent with the network charges submitted by BG Energy. These have been kept under review since the CER decision on annual gas retail tariffs.

In CER/13/204 the CER approved a 2.04% increase in gas retail tariffs to apply from 1st October 2014.

## **1.1. Decision on deregulation**

In CER Decision Paper CER/11/071 and CER/13/096 the CER stated that the following criteria must be met for deregulation in the NDM gas retail market to occur.

- Bord Gáis Energy must hold 60% or less of customers (with rebranding of the retail business) and 55% or less without rebranding.
- There must be at least 3 suppliers in the market, 2 of which must not be Bord Gáis. In addition each of these must have a market share of at least 10%.
- Customer switching rates in excess of 10% per year.

To determine when the above criteria will be met the CER conducts monthly competition reviews. This outlines the current market share of each supplier and the current trends in switching.

The latest Competition Review CER/14/052<sup>5</sup> “*Review of the Regulatory Framework for the Domestic NDM Retail Gas Market*” was published on 03<sup>rd</sup>

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<http://www.cer.ie/docs/000342/CER14052%20NDM%20Competition%20Review%20January%202014.pdf>

March 2014. This indicated that the criteria for deregulation has been met in two categories; namely that there were 3 active suppliers<sup>6</sup> each with at least a 10% market share and that customer switching rates were in excess of 10% per year.

This review indicates that BG Energy currently has a market share of 56.88% (customer numbers) which is above the threshold for deregulation<sup>7</sup>. It is expected that the threshold for deregulation will be reached in May 2014.

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<sup>6</sup> Airtricity, Bord Gáis Energy and Electric Ireland each have a market share above 10%

<sup>7</sup> Which was set at 55% without rebranding

## 2.0 CER Review

As part of the quarterly review of the 13/14 Revenue Control Formula (RCF) the CER has examined the following areas.

- Gas Commodity Purchases 2013/14
- Customer Numbers & Demand
- Network Charges
- Supply Costs
- Outturn adjustments (K-Factors)
- Other RCF Components- Margin & Opex

### 2.1 Gas Commodity Purchases 2013/14

In accordance with the laddered benchmark approach the allowed gas costs for the BG Energy NDM gas portfolio for the gas year 2013/14 have been priced into the RCF model since October 2012. Gas requirements for the 2013/14 gas year have been priced on a gradual basis (using a laddered approach) since October 2012.

In its submission BG Energy included market data on wholesale gas costs. BG Energy submitted the latest market data as of close of business **3rd March 2014 to the CER**. There is, outstanding, a proportion of gas left to be procured for gas year 2013/14. Prices of these future gas contracts are marked to market using the prevailing forward curve prices as of close of business on 3<sup>rd</sup> March 2014. The CER has examined and verified these figures.

In CER/13/204 gas costs included a Z factor give back of €2.98m. Following closeout of 2012/13 the Z factor now stands at €3.025m. This Z factor continues to put downward pressure on gas retail tariffs and is a result of the incentive on BG Energy to share “beating the benchmark” with customers.

The CER has reviewed the gas benchmark costs and is satisfied that they reflect the Weighted Average Cost of Gas (WACOG) up until 3<sup>rd</sup> March 2014.

The total cost of gas under this heading is €119.271m with a gas cost Z Factor give back of €3.025m. The resulting net cost of gas is €116.246m.

## **2.2 Customer Numbers and Demand**

The CER has reviewed the customer numbers and volumes which BG Energy has submitted. The current customer projections are in line with Bord Gáis Networks finalised Annual Quantity (AQ) and Supply Point Capacity (SPC) data submitted to BG Energy in September 2013.

Regarding volumes it should be noted that the annual gas retail tariffs are set using annual volume forecasts from October 2013 to September 2014.

This review was conducted using forecast volumes given average expected weather conditions for each month in the gas year 2013/14.

This current review allows for these volumes (and the associated required revenues) to be adjusted taking account of actual volumes used for October-December 2014 inclusive and updated forecasts based on Bord Gáis Network's latest data.

Regardless of gas volumes, certain fixed costs such as network charges and supply costs, remain broadly static but must be recovered via a smaller number of gas units being sold.

As actual gas volumes for the first quarter were lower than forecast this has put upward pressures on retail tariffs. In particular, gas volumes for the month of October were down significantly.

The CER has examined the actual volumes for October to December 2013 and the forecast for the remainder of the gas year. The CER notes that an under-recovery has been incurred as a result of the lower than forecast gas volumes sold in the period October-December.



## 2.3 Network Charges

Network charges include discounts redistributed to customers as a result of the Interruptible Capacity Sales (ICS) and usage on the South West Kinsale Storage. In CER/13/204 BG Energy allowed an ICS forecast of €3.038m. This allowance has been adjusted to consider lower than expected ICS sales for the remainder of the year.

This benefit has decreased to €2.700m. While this benefit is lower than expected, nonetheless ICS revenues exert downward pressure on tariffs.

The CER has examined the updated Transmission and Distribution charges and is satisfied that they reflect the approved charges as set out in CER/13/192 and CER/13/193 as well as the adjustment in volumes for 2013/14.

## 2.4 Supply Costs

In CER/13/204 CER allowed a supply cost of €21.525m for 2013/14<sup>8</sup>. Additional supply costs in 2013/14 included SEPA<sup>9</sup> related costs, REMIT<sup>10</sup> and increased prepayment meter costs.

In line with the RCF CER allows a 1% of turnover provision for bad debt. Total allowed Supply Costs for 2013/14 was €24.092m to include bad debt provisions.

The revised Supply Costs for BG Energy are €24.025m. This includes the bad debt provision of 1% of turnover, which in turn has been revised down to take account of the now lower than expected overall turnover.

Having examined Supply Costs the CER is satisfied that the Supply Costs as set out in CER/13/204 continue to apply.

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<sup>8</sup> This Supply Cost was determined after a 3% efficiency gains factor had been applied.

<sup>9</sup> Single European Payments Area.

<sup>10</sup> EU requirements for energy trading reporting to facilitate transparency

## **2.5 Outturn Adjustment (Correction K-Factor) 2012/13**

As part of the September decision an over-recovery was anticipated for gas year 2012/13. At the time of BG Energy's submission in August, volumes for the final quarter were forecast. The anticipated K-Factor for the year was €2.316m.

Since then BG Energy has updated the K-Factors for 2012/13, based on finalised volumes for the year. The resulting K-Factor has reduced to €0.983m. This exerts a lower than expected downward pressure on retail tariffs. This is due in part to lower than forecast volumes being sold in the final quarter of the 2012/13 gas year.

The CER has examined the closeout data for 2012/13 gas year against the volumes forecast and will allow a final K-Factor of €0.983m. This is lower than had been expected when the 2013/14 tariffs were first set and this decline in the K-Factor puts upward pressure on retail tariffs.

## **2.6. Other RCF Components**

BG Energy's Margin and Capex allowance will remain as set out in the CER Decision Paper CER/13/204.

The CER has decided that BG Energy's Margin will remain at 2% and that the Capex allowance for 2013/14 of €1.754m will remain.

### 3.0 Decision

This information note sets out the Commission for Energy Regulation's (CER) decision with respect to the BG Energy Non-Daily Metered (NDM) tariffs for its Residential customers from 14<sup>th</sup> April 2014.

Following on from the annual tariff setting process in CER/13/204 "*Gas Tariff Review 2013-2014 Bord Gáis Energy's Residential Customers*"<sup>11</sup>, on 23 December 2013 BG Energy submitted its updated forecast and closeout K factors for 2012/13.

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<sup>11</sup> <http://www.cer.ie/docs/000874/cer13204-bg-energy-retail-tariffs-decision-paper.pdf>

<sup>12</sup> Shrinkage charges are higher than had been anticipated as the cost of gas "on the prompt" has been higher than expected.

Under the original Revenue Control Formula (RCF) this under-recovery would be recovered over the remainder of the gas year (up to 30<sup>th</sup> September 2014) leading to a tariff rise of 3.47%, however consumers would see a significant rise in tariffs.

Noting that deregulation of Bord Gáis' Residential gas tariffs is expected to occur in the near future, the CER considered alternative methodologies in setting the tariff level in the light of the expected under recovery.

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## 4.0 Next Steps

As set out in CER/11/071 and CER/13/096 the CER will notify the market of deregulation of BG Energy a month in advance.

Finally, the CER is currently working on a new Market Monitoring Framework. The implementation of this framework would result in the enhanced monitoring of retail prices in a deregulated environment.