CER Investigation of Gas Networks Ireland Licence Breach

CER's Project South Final Report- For Publication

Prepared By

CER’s Investigation Team

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1.0 Introduction

1.1. On 26 October 2014, the Commission for Energy Regulation (CER) received an email from a former employee of Bord Gáis Éireann (hereafter referred to as the whistle-blower), which alleged an “act of serious financial impropriety” by a senior member of staff within Bord Gáis Éireann.\(^1\) This email was also issued by the whistle-blower to the Utility Regulator for Northern Ireland (i.e. UREGNI) among others.

1.2. The whistle-blower alleged that the senior member of staff within Bord Gáis Éireann deliberately concealed from Bord Gáis Éireann’s Board the cost overruns associated with a Bord Gáis Éireann gas infrastructure project (i.e. Barnakyle to Coonagh West Gas Pipeline), which was constructed between 2002 and 2003.

1.3. The whistle-blower alleged that the cost overruns resulted in monies being owed to the relevant project contractor (“the Contractor”), engaged by Bord Gáis Éireann as the contractor to construct the Barnakyle to Coonagh West Gas Pipeline.

1.4. The whistle-blower alleged that monies owed to the Contractor arising from the Barnakyle to Coonagh West Gas Pipeline were subsequently paid through other gas infrastructure projects in Ireland (i.e. M50/N7 Diversion Phase 1, M50/N3 Diversion, Craggs to Aughinish Pipeline and an Above Ground Installation Upgrades Project) and in Northern Ireland (i.e. North West Pipeline), which were awarded to the Contractor.

1.5. The gas infrastructure projects as identified by the whistle-blower (i.e. M50/N7 Diversion Phase 1, M50/N3 Diversion, Craggs to Aughinish Pipeline, Above Ground Installation Upgrades Project, and North West Pipeline) were constructed between 2003 and 2007.

1.6. Following receipt of the whistle-blower’s allegations and subsequent communications between the Regulatory Authorities (i.e. CER and UREGNI), the CER contacted Ervia’s\(^2\) Chairperson (during the week beginning 27 October 2014) and informed the Department of Communication, Energy & Natural Resources (DCENR) regarding the whistle-blower’s allegations.

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\(^1\) Prior to the incorporation of Gas Networks Ireland (GNI) in 2015, Bord Gáis Éireann had responsibility for the ownership of Ireland’s gas transmission and distribution assets, which were maintained by a division within Bord Gáis Éireann (i.e. Bord Gáis Networks (BGN)). In order to ensure compliance with the EU Second Package, the operation of Ireland’s gas transmission and distribution assets were undertaken by Gaslink as an Independent System Operator (ISO). In addition to Bord Gáis Éireann’s Irish gas transmission and distribution assets, its wholly owned and controlled subsidiary [now GNI (UK)] was responsible for the ownership and operation of two pipelines in Northern Ireland, namely the South-North Pipeline and the North-West Pipeline. In 2012, the Irish Government announced its intention to sell its energy business (i.e. BG Energy) within Bord Gáis Éireann. During a period of significant company restructuring, Bord Gáis Éireann was renamed as Ervia and BG Energy was sold. The BGN business of Ervia was transferred to GNI, an incorporated wholly owned subsidiary of Ervia.

\(^2\) Section 8 of the *ESB (Electronic Communications Networks) Act*, 2014 provided for the name change of Bord Gáis Éireann to Ervia. As per Section 8 (2) of that Act, “references in any enactment, statutory instrument, legal proceedings, or any other documents to Bord Gáis Éireann or The Irish Gas Board shall, from the appointed day, under subsection (1) be construed as references to Ervia”. S.I. No. 287/2014 provided for that name change to occur on 24 June 2014.
1.7. Ervia’s Chairperson informed the CER that they had not received the whistle-blower’s letter, and the CER subsequently forwarded a copy of the whistle-blower’s letter to Ervia.

1.8. On 31 October 2014, the Board of Ervia resolved that an independent external investigation be undertaken into the allegation of financial impropriety, and engaged the services of KPMG.

1.9. On 5 November 2014, Ervia advised the CER that it received the whistle-blower’s letter via courier on 4 November 2014.

1.10. The investigation undertaken by KPMG (referred to as the Project South Investigation) resulted in KPMG issuing its findings (26 March 2015) to Ervia’s Board of Directors through the production of a “Project South Investigation Report”, hereafter referred to as the “KPMG Report”.

1.11. On 16 April 2015, Ervia and a KPMG representative advised the Commissioners (hereafter referred to as “the Commission”) on the outcome of the KPMG investigation and the findings contained within the KPMG Report. A copy of the KPMG Report was also provided to the Commission.

1.12. The KPMG Report confirmed that a cost overrun had occurred on the Barnakyle to Coonagh West Gas Pipeline, and that it was agreed that the overrun balance would be paid through future projects on which the Contractor was appointed. In addition, the KPMG Report confirmed that Bord Gáis Éireann’s Regulated Asset Base (RAB) in Ireland and Northern Ireland was overstated.

1.13. Following consideration of the KPMG Report, the Commission determined that the CER should undertake its own investigation in order to assess, inter-alia, whether Bord Gáis Éireann breached any conditions of the Natural Gas Transmission Licence dated 17 September 2004 issued to it by CER.

1.14. In order to conduct the investigation, the Commission established an internal Project South Investigation Team (hereafter referred to as the “Investigation Team”).

1.15. The basis for the work of the Investigation Team was approved by the Commission (14 October 2015), and the Investigation Team were to carry out an investigation and produce an Interim Report for the Commission for approval.

1.16. The Investigation Team finalised its Interim Report on 22 February 2016, which was subsequently forwarded to GNI for comment.

1.17. GNI responded to the CER on 1 March 2016 detailing their comments to the Investigation Team’s Interim Report. These comments were considered by the Investigation Team.

1.18. This report represents the Investigation Team’s Final Report ("the Final Report"), and is presented to the Commission for their consideration and approval.
1.19. The Final Report assesses Bord Gáis Éireann’s compliance with the relevant CER licences, relevant Section 39A gas pipeline consents, and identifies what actions have been undertaken for the correction of GNI’s RAB. Furthermore, the Final Report provides recommendations to the Commission regarding the appropriate regulatory actions to be taken.

1.20. The Final Report and the recommendations are based on the information set out below:

- the independent KPMG Report (which is accepted by Ervia/GNI);
- information submitted by Ervia/GNI following requests from the Investigation Team;
- Section 39A Consent material, which was submitted by Bord Gáis Éireann to the CER in order to obtain consent for the construction of the relevant gas infrastructure projects (as identified by the whistle-blower);
- relevant Annual Reports and Regulated Accounts;
- Interim Report; and
- responses received from GNI in their letter dated 1 March 2016.

1.21. The Investigation Team notes that GNI could not provide CER with relevant procurement documentation (i.e. Invitation for Tender and Internal Evaluation Reports) when requested. GNI stated that given the passage of time, it does not have copies of the relevant procurement documentation, and that it is GNI’s policy to hold this type of information for no more than eight years.

1.22. For clarity, the Final Report is structured as follows:

- Section 2: provides an overview of the KPMG Report;
- Section 3: outlines the work undertaken by the Investigation Team;
- Section 4: reviews Bord Gáis Éireann’s compliance with CER issued licences;
- Section 5: reviews Bord Gáis Éireann’s compliance with CER issued Section 39A consents;
- Section 6: reviews Bord Gáis Éireann’s capital expenditures;
- Section 7: reviews Bord Gáis Éireann’s financial reporting;

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3 Pursuant to Section 16 of the Gas (Interim)(Regulation) Act 2002 (as amended), the CER may grant or refuse to grant to a person a natural gas licence to engage in activities, which includes the ownership and operation of a gas transmission and distribution system. Additionally, in accordance with Section 9(1)(g) of the Electricity Regulation Act 1999 (as amended) the CER may revoke a licence.

4 In accordance with Section 39A of the 1976 Gas Act (as amended), a person wishing to construct a downstream gas pipeline within Ireland requires a consent from the CER.

5 Bord Gáis Éireann’s Regulatory Accounts are submitted to the CER only, and are separate from other statutory financial statements of the Licensee. The Regulated Accounts are prepared under the historic cost convention and in accordance with Generally Accepted Accounting Principles (GAAP) in Ireland, as modified by the Regulatory Accounting Guidelines.
- Section 8: examines Bord Gáis Éireann’s use of Quantity Surveyors (QS);

- Section 9: provides a summary of GNI’s response to the Investigation Team’s Interim Report.

- Section 10: presents the Investigation Team’s findings; and

- Section 11: presents the Investigation Team’s recommendations.

1.23. The Investigation Team also submit to the Commission for its consideration a number of internal learnings and associated recommendations.
2.0 Overview of the KPMG Report

2.1 The KPMG Report, which was prepared in accordance with a specific Terms of Reference, contains, inter-alia;

- Key findings;
- Recommendations on issues raised during the investigation;
- The impact on the RAB of Bord Gáis Éireann;
- An outline of the verification procedures for each project; and

2.2 Section 2.3 to 2.23 of the Final Report summarises relevant sections of the KPMG Report.

Key Findings

2.3 Based on information provided to KPMG, the KPMG Report (Section 1.6., Q1) stated that there was an overrun of €522,000 on the Barnakyle to Coonagh West Gas Pipeline, but that cost savings of circa €322,000 arose on other areas of the project. Therefore, the overall overrun for the Barnakyle to Coonagh West Gas Pipeline was €200,000.

2.4 The KPMG Report (Section 1.6., Q2) stated that under the policies and procedures in place in the period from 2004-2007, all costs incurred in excess of Bord Gáis Éireann’s Board approved total costs required further Board approval.

2.5 The KPMG Report confirmed (Section 1.6., Q3) that Bord Gáis Éireann’s Board approval was not sought for the overrun for the Barnakyle to Coonagh West Gas Pipeline and that the overrun was paid via other projects. Furthermore, the KPMG Report confirmed that the systems that were in place within Bord Gáis Éireann at the time to prevent non-authorised cost overruns being paid (Section 1.6., Q3) didn’t prevent the relevant overruns being paid.

2.6 The KPMG Report (Section 1.6., Q4) confirmed that the overruns were not paid exactly as the whistle-blower had alleged. The KPMG Report stated that initially the payments were made via M50/N7 and M50/N3 diversion projects but were subsequently transferred out of these projects to AGI upgrades/Ops 2006 projects. In addition, the KPMG Report confirmed that a proposal to reallocate the amount charged to the North West Pipeline to the AGI Upgrades was not implemented. The issues noted in point 2.16 of the Final Report are also relevant here.

2.7 The KPMG Report (Section 1.6., Q5) confirmed that it was not clear who in Bord Gáis Éireann ultimately approved the overruns for the Barnakyle to Coonagh West Gas Pipeline.
2.8 The KPMG Report (Section 1.6., Q6) indicated that relevant Bord Gáis Éireann employees were aware of the overrun on the Barnakyle to Coonagh West Gas Pipeline, but concluded that it was not evident that the relevant employees were aware whether Bord Gáis Éireann Board approval for the overruns or for the reclassification of the overruns had been obtained.

2.9 The KPMG Report (Section 1.6., Q7) confirmed that a portion of the overrun on the Barnakyle to Coonagh West Gas Pipeline was attributed to the Northern Irish RAB of GNI, and therefore an over-recovery of revenue of £143,000 had occurred in Northern Ireland by October 2014.

2.10 The KPMG Report (Section 1.6., Q9) confirmed that Bord Gáis Éireann had over-recovered in Ireland by an estimated €205,000 as a result of the reclassification of the overrun.

2.11 The KPMG Report (Section 1.6., Q7) confirmed that the amounts classified to M50/N3 and M50/N7 diversions were reclassified to Above Ground Installation (AGI) Upgrades/Ops 2006 and resulted in no overcharging.

2.12 The KPMG Report (Section 1.6., Q10) concluded that there was no financial gain by any individuals referred to in the KPMG Report.

Issues noted during the KPMG investigation and KPMG recommendations

2.13 The KPMG Report (Section 1.6.1) noted that all overruns related to Board approved expenditure required Bord Gáis Éireann Board approval. Bord Gáis Éireann management stated that a purchase order could not now be raised against unapproved expenditure (Section 4 of the KPMG Report).

2.14 The KPMG Report (Section 1.6.2) concluded that relevant Bord Gáis Éireann employees were aware of the allocation of the overrun to the relevant projects. The KPMG Report recommended that the importance of adherence to the company’s Code of Conduct should be reiterated to all employees.

2.15 The KPMG Report (Section 1.6.3) recommended that a final cost reconciliation file should be created to track expenditure on projects and that a senior independent employee should sign off on this. The KPMG Report stated that they understand that these procedures are now in place.

2.16 The KPMG Report (Section 1.6.4) noted that the Contractor had stated that it had a meeting with Bord Gáis Éireann representatives at which it was agreed that the cost overrun on the Barnakyle to Coonagh West Gas Pipeline would be paid through future projects on which it was appointed contractor. The KPMG Report recommended that final account meetings should be documented and minuted (Section 1.6.4).
2.17 The KPMG Report (Section 1.6.5) confirmed that the works (as identified by the whistle-blower) were certified via a mixture of internal and external QSs. The KPMG Report recommended that where external certification is employed it is emphasised that the certification should relate to the specific project only. Furthermore, the KPMG Report recommended that internal certification for variances and transfers between projects should be certified by a senior person within the company who is independent of the project team.

2.18 The KPMG Report (Section 1.6.6) recommended that appropriate RAB corrections should be followed up with the relevant regulatory authorities. With reference to Bord Gáis Éireann’s RAB, the KPMG Report estimated that the RAB was overestimated by €230,322. As a result, Bord Gáis Éireann over-recovered in respect of the CER RAB by an estimated €205,000.

2.19 The KPMG Report (Section 1.6.6) states that the impact on the RAB in the Republic of Ireland for the Barnakyle to Coonagh West Gas Pipeline was undercharged by €522,322. This should have been subject to CER approval. If this had been approved by CER the recovery to date is estimated at €464,000.

Control environment

2.20 The KPMG Report (Section 4.1) noted that a control environment has been put in place within the company, which requires cross functional approval of projects. This is known as the “Investment Approval Committee” (IAC). The IAC is composed of heads of various departments and three heads must be in attendance for project approval.

2.21 The KPMG Report (Section 4.1 - 4.3) confirmed that a gated approval system has been put in place within the company, which includes finalisation of costs at Gate 4. At this stage, variances against the project budget are reviewed and explanations for variances are required. A “Group Investment Approval Committee” (GIAC) is required for projects over a €5m threshold, while Board approval is required for projects over €10m.

2.22 The KPMG Report (Section 4.1.1) confirmed that where a contract for a project is required within the company, then a Contract Approval Committee (CAC) is formed, which is a subset of the IAC. Approval of the CAC is required if the contract amount is “significantly higher than expected”.

2.23 The KPMG Report (Section 4.1.1) confirmed that project work within the company is now tracked on a Maximo job management system, which is linked to an Oracle financial management system. Where a project is close to reaching its approved budget then the project goes on hold and further approval is required.

GNI’s correspondence to the CER stated that the GIAC was introduced since 2007 to oversee projects/contracts in excess of €2.5m. GNI also confirmed to the CER that enhanced controls have been implemented to the company’s financial authorisations and contract approvals policy. Such controls include the lowering of individual approval limits and the establishment of a Group Contracts Approval Committee (GCAC). In addition, it was stated that GNI’s Contract Approval Committee also holds the same status as the Investment Approval Committee, and contracts in excess of €2.5m for pipe projects are escalated to the GCAC.
3.0 Work undertaken by Investigation Team post KPMG Report

3.1 Following the findings contained in the KPMG Report, the CER, on 2 July 2015, raised queries on the proposals made by GNI, firstly to correct GNI’s RAB (and the effect on its allowed revenues), and secondly to ensure that unapproved overruns would no re-occur.

3.2 The corrections to GNI’s RAB were required ahead of the setting of its annual network tariffs in August 2015. GNI responded to this query on 30 July 2015.

3.3 On 30 July 2015, GNI proposed to the CER that the over-recovery on its RAB would be corrected by adjusting all the revenues that were over-recovered to 10/11 monies, and then applying indexation to bring the values into 15/16 monies. Additionally, GNI proposed that the capitalisation of each asset on its RAB would be adjusted so as to correctly reflect its RAB value.

3.4 GNI outlined controls that have been put in place for project management, the procedure for investigating allegations of impropriety and its code of conduct.

3.5 Between July and August 2015, the CER in conjunction with GNI implemented the corrections to GNI’s RAB revenues and capitalisations via the annual network tariff setting (see Section 6 for further detail).

3.7 Between September and October 2015, the Investigation Team reviewed the KPMG Report and the GNI follow up responses to the CER.

3.8 On 16 October 2015, the CER wrote to GNI and requested details on tenders outlined in the KPMG Report, capital projects tendered between 2002 and 2006, and GNI’s QS certification process.

3.9 GNI wrote to CER on 19 November 2015 outlining the details on the areas where information was available. Further information on capital projects completed during the period were submitted to the CER on 30 November 2015.

3.10 As part of its review of Bord Gáis Éireann’s capital projects (between 2002 and 2006), the Investigation Team notes that Bord Gáis Éireann undertook a total of thirty one capital projects, which required the use of external contractors. Specifically, eight separate contractors were engaged by Bord Gáis Éireann for the construction of the thirty one capital projects, and it was found that the Contractor was the most utilised contractor by Bord Gáis Éireann. Additionally, the Investigation Team notes that ten Bord Gáis Éireann capital projects involving external contractors had a variance between the original contract value and the actual spend (seven were attributable to the Contractor).

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7 All revenues in the Price Control 3 (“PC3”) revenue model are in 10/11 monies and this proposed approach was consistent with the revenue profiling of the PC3 model.

8 This correction ensured that the revenue recovery going forward from 15/16 reflected the correct capitalised value of the assets.

9 Section 8 of this Final Report provides further details on Bord Gáis Éireann’s interactions with QSs.

10 In their correspondence of 1 March 2016 to the CER, GNI stated that the tender would have also included re-measurable items. GNI stated that these were items that would have been needed as part of the contract scope but could not be defined at tender stage.
3.11. The Investigation Team concluded its Interim Report on 22 February 2016. The Interim Report was furnished to GNI for comments to be returned within five working days.

3.12. GNI wrote to the CER on 1 March 2016 regarding the Interim Report. In their response, GNI stated that they accepted the findings of the KPMG Report and agreed with the content of the Interim Report, subject to a number of comments (See Section 9).

3.13. On the basis of the information received, the Investigation Team drafted the Final Report for the Commission’s consideration and approval.

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11 The value of the overruns was between 2% and 25% of the total contract value. No financial data was available for two of the thirty one capital projects. Therefore, the Investigation Team cannot determine if a variance between the contract value and the actual spend occurred for these two projects.
4.0 **Review of Bord Gáis Éireann’s Gas Licence Compliance**

4.1 Subsequent to the whistle-blower’s allegations and the findings contained within the KPMG Report, the Investigation Team undertook a review of Bord Gáis Éireann’s compliance with the Natural Gas Transmission Licence dated 17 September 2004.

4.2 The Investigation Team notes that the first Natural Gas Transmission Licence issued by the CER to Bord Gáis Éireann came into force on 17 September 2004 and remained in effect until 3 July 2008. Subsequently, the CER granted a Transmission System Owner Licence to Bord Gáis Éireann and a Transmission System Operator Licence to Gaslink on 4 July 2008.

4.3 The Investigation Team notes that the first Natural Gas Distribution Licence issued by the CER to Bord Gáis Éireann came into force on the 7 October 2004 and remained in effect until 3 July 2008. Subsequently, the CER granted a Distribution System Owner Licence to Bord Gáis Éireann and a Distribution System Operator Licence to Gaslink on 4 July 2008.

4.4 Given that the whistle-blower’s allegations relate primarily to transmission related assets, and that the alleged “act of serious financial impropriety” occurred between 2004 and 2007, the Investigation Team has focused primarily on Bord Gáis Éireann’s compliance with the Natural Gas Transmission Licence dated 17 September 2004.

4.5 Following a review of the Natural Gas Transmission Licence dated 17 September 2004, the Investigation Team focused on Bord Gáis Éireann’s compliance with the following licence conditions for the Final Report:

- Condition 4: Efficient Procurement of Assets;
- Condition 16: Interactions with other Natural Gas Undertakings (NGUs);
- Condition 21: Records & Reporting;
- Condition 24: Availability of Resources;
- Condition 26: Regulatory Accounts;
- Condition 27: Prohibition of Cross-Subsidies;
- Condition 28: Duty of Non-Discrimination; and
- Condition 32: Prohibition of Anti-Competitive Behaviour.

Upon further detailed review, the Investigation Team concluded that Condition 16 (Interactions with other NGUs) was not relevant, and was therefore not considered further by the Investigation Team.

4.6 In consideration of the evidence provided by the whistle-blower, the KPMG Report and the relevant information material submitted by Ervia/GNI and the letter dated 1 March 2016 (above referred), the Investigation Team’s findings determine that Bord Gáis Éireann was in breach of Conditions 21 (Records & Reporting), Condition 26 (Regulatory Accounts), and Condition 27 (Cross Subsidies). This is discussed further in section 4.7 to 4.9 below.
4.7 **Condition 21 (Records & Reporting):**

4.7.1 This licence condition states, inter-alia, that the Licensee shall ensure the accuracy and reliability of any systems, equipment, data and procedures which the Licensee uses, or is required to use, to measure or track the provision of any service authorised by, or provided pursuant to, this Licence and for the calculation of related charges.

4.7.2 Following a review of available information, the Investigation Team has concluded that Bord Gáis Éireann incorrectly assigned costs to projects, which resulted in Bord Gáis Éireann and GNI (UK) receiving over-recoveries from Ireland’s and Northern Ireland’s gas consumers. Furthermore, the Investigation Team considers GNI’s corrections to its RAB, and its disclosure within its 2014 Regulatory Financial Statements (stating that certain capital expenditures were incorrectly capitalised) as an admission of error.

4.7.3 Therefore, the Investigation Team finding is that Bord Gáis Éireann was in breach of Condition 21, as Bord Gáis Éireann did not ensure the accuracy of data that it uses for the calculation of related charges.

4.8 **Condition 26 (Regulatory Accounts):**

4.8.1 This licence condition states, inter-alia, that the Licensee shall:

- make available accounting information that will enable the Commission to assess the financial position of the Licensee and the financial performance of each Separate Business.

- in respect of each Separate Business keep accounting records, so that the revenues, costs, assets, liabilities, reserves and provisions of, or reasonably attributable to, the Business are separately identifiable in the books of the Licensee from those of any other business of the Licensee.

4.8.2 Following a review of available information, and comments as presented in Section 4.7.2 of the Final Report, the Investigation Team's finding is that Bord Gáis Éireann was in breach of Condition 26, as Bord Gáis Éireann's accounting information did not facilitate an accurate assessment of the financial position of the Licensee and its Separate Business.

4.9 **Condition 27 (Cross Subsidies):**

4.9.1 This Licence condition states, inter-alia, that the Licensee shall ensure that the Transmission Business does not give any direct or indirect cross-subsidy to, or receive any direct or indirect cross-subsidy from, any other business or part of a business of the Licensee or of any affiliate or related undertaking of the Licensee (whether or not a Separate Business).

4.9.2 Following a review of the available information, the Investigation Team’s finding is that Bord Gáis Éireann received a cross-subsidy from GNI (UK)
on the basis that Bord Gáis Éireann transferred costs from its transmission business in Ireland to its subsidiary GNI (UK), which was operating in Northern Ireland. Therefore, the Investigation Team’s finding is that Bord Gáis Éireann was in breach of Condition 27.

4.10 In consideration of the evidence provided by the whistle-blower, the KPMG’s Report and the relevant information material submitted by Ervia/GNI, the Investigation Team concluded there was insufficient evidence to make any findings regarding Condition 4 ( Efficient Procurement of Assets), Condition 24 ( Availability of Resources), Condition 28 ( Duty of Non-Discrimination) and Condition 32 (Prohibition of Anti-Competitive Behaviour). This is discussed in section 4.11 to 4.14 below.

4.11 Condition 4 ( Efficient Procurement of Assets):

4.11.1 This licence condition states, inter-alia, that the Licensee shall procure assets and services from the most economical sources available to it having regard to the quantity and nature of the assets and services required to enable it to discharge its obligations under natural gas legislation and this Licence and to the diversity, number, timeliness of delivery, safety and reliability of such assets and services.

4.11.2 The Investigation Team notes that the KPMG Report indicated that the Contractor agreed with Bord Gáis Éireann in 2004 that monies owed would be paid through future projects on subsequent awards to the Contractor. This raised questions regarding the integrity and efficiency of subsequent procurement processes. However, following a review of available information, the Investigation Team has insufficient evidence to form any conclusion regarding a potential breach of Condition 4.

4.12 Condition 24 ( Availability of Resources):

4.12.1 This licence condition states, inter-alia, that the Licensee shall at all times act in a manner calculated to secure that it has sufficient management resources, financial resources and financial facilities to enable it to carry on the Transmission Business and to comply with its obligations under this licence and such of its obligations under natural gas legislation as apply to the Transmission Business.

4.12.2 The Investigation Team notes that Bord Gáis Éireann did not have sufficient Board approved financial resources to pay for services rendered by the Contractor when constructing the Barnakyle to Coonagh West Gas Pipeline. This raises the question of whether Bord Gáis Éireann had sufficient financial resources available to carry out the Transmission Business.

4.12.3 However, the Investigation Team notes that the CER’s price control process included provisions for the completion of the Barnakyle to Coonagh West Gas Pipeline. Given that Bord Gáis Éireann didn’t raise
any concerns about capital financing, and that Bord Gáis Éireann has sufficient financial resources to finance the operation of its business (at an aggregate level), and following a review of available information, the Investigation Team has insufficient evidence to form a conclusion regarding a breach of Condition 24.

4.13 Condition 28 (Duty of Non-Discrimination):

4.13.1 This licence condition states, inter-alia, that the Licensee shall not discriminate unfairly between persons or classes of persons, or between system users or classes of system users, particularly in favour of the Separate Businesses, its subsidiaries, associated or affiliated undertakings, joint ventures or shareholders.

4.13.2 Within GNI’s response to the CER, the Investigation Team notes that GNI stated “that as a matter of fact there was no discrimination against Northern Ireland customers as a class of customers for the purposes of the 2004 Licence. As Irish Transmission System Operator, Gas Networks Ireland had and has no customers in Northern Ireland.”

4.13.3 Following a review of available information, the Investigation Team has insufficient evidence to form any conclusion regarding a potential breach of Condition 28.

4.14 Condition 32 (Prohibition of Anti-Competitive Behaviour):

4.14.1 This licence condition states, inter-alia, that in carrying on the Transmission Business, the Licensee shall not abuse any dominant position it may have.

4.14.2 The Investigation Team notes that the KPMG Report indicated that external QSs certified costs of projects to which the expenditure did not relate (following an alleged instruction from a Bord Gáis Éireann employee). Therefore, it may be suggested that Bord Gáis Éireann potentially exploited a perceived position of dominance in the sector (i.e. Bord Gáis Éireann would be a significant client for a QS company) by instructing QSs to incorrectly certify work (assuming the QSs were concerned of losing potential future contracts with Bord Gáis Éireann).

4.14.3 GNI in their response stated that “the Group does not, nor did at the time, occupy a position of dominance in the market for QS services. As such, we consider that no such exploitation could occur”.

4.14.4 Following a review of available information, the Investigation Team has insufficient evidence to form any conclusion regarding a potential breach of Condition 32.

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12 Bord Gáis Éireann would have had an opportunity to raise any concerns regarding capital financing both as part of its annual tariff setting process and historic reviews of capital expenditure conducted at the beginning of subsequent price controls.
5.0 Review of Bord Gáis Éireann’s Section 39A Consent Compliance

5.1 The Investigation Team conducted a review of Section 39A Consents that were issued by CER to Bord Gáis Éireann for the Barnakyle to Coonagh West Pipeline, Craggs to Aughinish Pipeline, M50/N7 Diversion, and the M50/N3 Diversion. Such consents were issued to Bord Gáis Éireann in accordance with Section 39A (Construction of Pipelines) of the Gas Act, 1976 (as amended).13

5.2 Section 39A of the Gas Act, 1976 (as amended) states that “a person shall not without the consent of the CER, construct a pipeline, other than an upstream pipeline, on, over or under the surface of the land or of any sea bed that is situate in the territorial seas of the State”.

5.3 In order to obtain a Section 39A Consent from the CER, the applicant is required, inter-alia, to provide project details, and submit relevant engineering and environmental reports. Such information is reviewed by the CER, prior to issuing a Section 39A Consent letter, which may include conditions for construction.

5.4 Based on the information available (regarding relevant Section 39A Consents), the Investigation Team notes that the conditions attached by the CER to the Section 39 Consents issued to Bord Gáis Éireann are generic, and pertain predominantly to pipeline standards. Therefore, the Investigation Team does not have evidence to suggest that Bord Gáis Éireann breached its Section 39A Consent conditions.

13 The Project South Investigation Team did not consider consents for Bord Gáis Éireann’s North West Project, as it is located in the territory of Northern Ireland, and therefore did not require a Section 39A Consent from the CER. The Project South Investigation Team review of Section 39A Consents also did not consider Bord Gáis Éireann’s upgrade of AGIs, as Section 39A Consents would typically not be required.
6.0 Review of Bord Gáis Éireann’s Capital Expenditures

Corrections to the RAB

6.1. A number of the projects identified within the KPMG Report related to the RAB in both Ireland and Northern Ireland. Two projects, namely AGI Upgrades and Craggs to Aughinish Pipeline both incurred an overrun allocation, which were incorrectly added to Bord Gáis Éireann’s RAB.

6.2. The overrun for the AGI upgrades was €142,310 and €690. The overrun for Craggs to Aughinish Pipeline was €85,016. The Craggs to Aughinish Pipeline was capitalised on Bord Gáis Éireann’s RAB during Price Control 1 (“PC1”) 2004-2007 and the AGI upgrades were capitalised during Price Control 2 (“PC2”) 2007-2012.

6.3. Up until 2015, Bord Gáis Éireann’s RAB was divided into three separate asset bases (i.e. Interconnectors, Onshore and Inch). The overruns on the AGI Upgrades and the Craggs to Aughinish Pipeline all related to Bord Gáis Éireann’s Onshore RAB. Therefore, all corrections were applied to its Onshore RAB.

6.4. The model used by CER to determine the allowed revenues for Bord Gáis Éireann, functions with PC2 and Price Control 3 (“PC3”) inputs active. This means if a RAB correction is introduced ex-post then the model will automatically update the revenues by adjusting the opening and closing RAB of each year of the price control. The value of the subtractions from the RAB are configured to the correct monies of the price control in question. Therefore, the CER model facilitated the removal of the €143,310 and €690 from the PC2 period.

6.5. However, as a part of the overrun allocation related to PC1, removing the €85,016, required the opening and closing RAB of the final year of PC1 to be corrected manually to take account of the overrun related to the Craggs to Aughinish Pipeline.

6.6. The CER model for price control is designed to profile revenues throughout all five years of a price control. In this instance, the CER model would attempt to give back the revenues in both 15/16 and 16/17. In order that the negative adjustment was all retained in 15/16 (rather than over the 2 years), the outputs of the CER model needed to be adjusted.

6.7 The CER model that is used to determine the allowed revenues is published on the CER website. The RAB corrections are shown on Tabs “PC1” and “PC3 Transmission RABS”, where an adjustment is made for 06/07. In addition, “Outputs 2” is adjusted so that the giveback appears only in 2015/16 tariffs.

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14 06/07 monies
15 05/06 monies
Investigation’s Team findings on Capital Expenditure

6.8 GNI and CER worked on correcting the overrun values on the RAB as well as correcting this via an immediate adjustment to the allowed revenues of GNI for 2015/16.

6.9 The Investigation Team requested a breakdown of the total invoiced cost for the provision of the external QS services for the projects identified in the KPMG Report. GNI stated that between 10% and 15% of project management costs are associated with QS services.

6.10 In accordance with the Gas Act, 1976 (as amended), the CER may direct the transmission system operator on the basis for charges for transporting gas through the system.

6.11 In addition, the CER have a statutory obligation to ensure that tariffs “reflect the actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator and are transparent, whilst including an appropriate return on investments, and, where appropriate, taking account of the benchmarking of tariffs by the regulatory authorities”\(^\text{16}\).”

6.12 As part of a price control, the CER reviews the historical expenditure that GNI incurred, to determine the efficiency of the expenditure. This is demonstrated in Section 3.2. of the CER’s Decision Paper on *Bord Gáis Networks Allowed Revenues between October 2012 and September 2017*, where it is stated the CER reviews historic capital expenditure with a view to ensuring the “appropriateness and efficiency of the investments made during that period.”

7.0 Review of Bord Gáis Éireann’s Financial Reporting

7.1 The Investigation Team conducted a review of Bord Gáis Éireann Regulatory Accounting Guidelines (issued by the CER in November 2005) and Bord Gáis Éireann’s Regulatory Accounts (for the accounting periods 2005 to 2014).\(^{17}\)

7.2 The Investigation Team notes that the financial transactions detailed in the KPMG Report relate (in part) to the accounting periods of 2002 to 2004. Therefore, the Investigation Team acknowledges that the relevant financial transactions occurred (in part) prior to the CER’s issuance of Regulatory Accounting Guidelines to Bord Gáis Éireann (2005) and the imposition of a licence requirement on Bord Gáis Éireann to submit Regulatory Accounts to the CER (2004).

7.3 However, the Investigation Team notes that the KPMG Report has also referred to a financial transaction in 2006/7, which impacted on Bord Gáis Éireann’s RAB. Consequently, Bord Gáis Éireann’s 2006 and 2007 Regulatory Accounts have been reviewed by the Investigation Team.

7.4 Following a review of Bord Gáis Éireann’s 2006/7 Regulatory Accounts, the Investigation Team found that no disclosure by way of a note/appendices to the accounts was provided by Bord Gáis Éireann to CER. This indicates that Bord Gáis Éireann’s Regulatory Accounts may not be a true and fair reflection of the financial position of the Regulated Businesses of Bord Gáis Éireann at that time.

7.5 The Investigation Team notes that in 2015, Ervia submitted its “Regulatory Financial Statements to 31 December 2014”, which contained the following disclosure (following the whistle-blowers allegations):

“In March 2015, Ervia identified that certain capital expenditure was incorrectly capitalised within the CER Regulated Asset Base in 2006. The Regulatory Financial Statements for 2014 include a current year adjustment to reflect the transfer out of the capital expenditure from the Regulated Asset Base. In addition the cumulative depreciation charge on these assets have been reversed in the 2014 Regulatory Financial Statements and this is included as a current year adjustment to the depreciation charge for the period.”

7.6 Following the submission of an information request to GNI, the Investigation Team notes that GNI confirmed that “the issues outlined in the KPMG report did not involve material loss, misstatement, contingencies or uncertainties that would require adjustment in the Financial Statements of the Group”.

7.7 GNI also noted in their response to the Interim Report, that “the issues in the KPMG report did not require adjustment or disclosure under relevant accounting or auditing standards”.

\(^{17}\) The Investigation Team notes that Bord Gáis Éireann applied GAAP for the basis of preparation of Bord Gáis Éireann’s financial reporting until 31 December 2010. Conversion to International Reporting Standards (IFRS) plus adoption to associated standard applied for the accounting periods 2011 to 2014.

The guidelines require the presentation of the separate accounts for each specified licensed businesses (as designated) for an accounting period, consolidated with Bord Gáis Éireann’s other businesses to agree a summarised presentation of Bord Gáis Éireann’s audited statutory financial statements for that period.
8.0 Bord Gáis Éireann’s Use of Quantity Surveyors

8.1 Information provided by GNI indicated that Bord Gáis Éireann engaged the services of external QSs in seven of its thirty one capital projects during the period 2002 to 2006.

8.2 GNI stated that applications for payment of projects were reviewed by the Project Engineer (PE), the QS and signed off by the Project Manager (PM).

8.3 GNI stated that an external PE/QS/PM could not directly make a payment for a project. This was managed by Bord Gáis Éireann via a purchase order. GNI did not state that any specific personnel within Bord Gáis Éireann was responsible for approving the payments.

8.4 CER requested specific information related to the safeguards in place at the time to ensure that the external QS service was fit for purpose and independent. In their response, GNI stated that the competence of the personnel was assessed as part of the project specific submission. This included an assessment of previous projects completed by the tenderer.

8.5 GNI stated that where a project was in excess of the approved amount then such amounts would have to be approved by an internal Project Lead. GNI stated that this required the Project Lead to review any variances before payment was approved.

8.6 GNI stated that the choice to use internal or external QS certification was based on the internal resources available at the time of the project. GNI also stated that where the QS role was outsourced then there were times that the same person acted as PM, PE and QS.

8.7 GNI stated that where external contractors certified a project, then the role of PM and QS was carried out by the same contractor.

8.8 The Investigation Team requested GNI to provide the total invoiced costs of the provision of the external QS service for the projects as identified in the KPMG Report. GNI were unable to provide a precise breakdown of the costs associated with QS services. GNI stated that based on knowledge of previous projects 10%-15% of the construction costs would be related to QS services.

8.9 The Investigation Team requested GNI to provide details on the certification procedures currently in place. In particular, the Investigation Team requested information on how GNI ensured that the QS certification process was independent. GNI stated that the internal process for payment release currently in place differs from what was in place between 2003 - 2007. When a payment certificate is received from an external provider, GNI’s system approvals require an Internal QS, internal Project Lead and internal Construction Manager to approve the payments being requested.

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18 GNI’s response to the CER (1 March 2016) clarified that the percentage related to QS was a subset of the typical project management costs during the construction phase.
8.10 GNI stated that in order to ensure the independence of external QS’s, correspondence has been issued to current service providers setting out their obligations. GNI’s response also stated that if a third party should come across any evidence of non-compliance then they should bring this to the attention of a “responsible person in Ervia”. GNI stated that going forward all Purchase Orders, Invitation To Tenders and Contracts will have these additional obligations included.

8.11 GNI stated that an internal controls process was ongoing internally whereby all final accounts will be reviewed by a manager that is independent of the operations area of the business.

8.12 GNI’s response stated that “The QS service providers certified work on particular projects as instructed by Bord Gáis Éireann. They did not conceal the amount certified that related to alternative jobs and highlighted these amounts separately within the final account information”. GNI stated that their staff have been briefed on the importance of Ervia’s code of business conduct.
Summary of GNI’s Response to Interim Report

9.1 The Interim Report was furnished to GNI in order to provide an opportunity for GNI to comment on the report findings, and submit any further information, which GNI viewed as relevant.

9.2 In the Interim Report, the Investigation Team noted that GNI/Ervia had not confirmed explicitly in writing, their acceptance of the KPMG Report and its associated recommendations.

9.3 GNI stated that they fully accepted the KPMG Report and the associated recommendations. GNI also indicated their acceptance of the Investigation Team's Interim Report, subject to comments.

9.4 GNI stated that the misallocation was inappropriate, not correctly authorised, and not in keeping with their values or high standards of corporate governance. In addition, GNI stated that the unapproved overrun was a cause of great disappointment and regret to GNI.

9.5 GNI also provided comments on the contents of the Interim Report. This included their comments on the Interim Report's findings that certain licence conditions may have been breached by Bord Gáis Éireann.

9.6 GNI commented on the recommendations outlined in the Interim Report. This included providing details on some of the recommendations included in the Interim Report. This included details on the obligations of service providers and the business code of conduct. GNI stated that the current code of business conduct contains a mechanism for employees to escalate concerns to the Group Chief Legal Officer or the Chairman of the Audit and Finance Committee.

9.7 GNI stated that significant changes have been made since the misallocation in 2005, including cross-functional processes with separation of roles and responsibilities. GNI stated that the recommendations outlined in the KPMG report have been actioned, with one currently being finalised.

9.8 GNI stated that "Neither the Board nor the CEO of Ervia had any awareness of the misallocation. This misallocation would never have been sanctioned by the proper authorities within the Group”.

9.9 GNI stated that “the Board of Ervia responded promptly to investigate the misallocation as soon as it became aware of the matter and co-operated fully and frankly with the Commission”.

9.10 GNI reiterated KPMG's findings that there was no personal financial gain by any individuals referred to within the KPMG Report.
9.11 GNI’s stated that “The QS service providers certified work on particular projects as instructed by Bord Gáis Éireann. They did not conceal the amount certified that related to alternative jobs and highlighted these amounts separately within the final account information”.
10.0 Investigation Team’s Findings

10.1 The QS services obtained by GNI to certify the projects are estimated at 10%-15% of the project management costs during the construction stage. The projects in question have been reviewed as part of PC2 historic capital expenditure review, and were approved as efficient expenditure by the CER. In light of the additional information obtained as part of this investigation, it is apparent the QS services were not appropriately allocated to particular projects by Bord Gáis Éireann’s staff. However, GNI response to the Interim Report confirmed that “the QS service providers certified work on particular projects as instructed by Bord Gáis Éireann. They did not conceal the amount certified that related to alternative jobs and highlighted these amounts separately within the final account information”.

10.2 A Bord Gáis Éireann Code of Conduct was in place between 2003 - 2007. However, the Bord Gáis Éireann Code of Conduct did not hinder the internal reclassifications of the overruns on the Barnakyle to Coonagh West Gas Pipeline. The Investigation Team finds that in the context of this project, certain Bord Gáis Éireann staff did not abide by the policies outlined in the Bord Gáis Éireann Code of Conduct.

10.3 The Investigation Team finds that no effective whistle-blower mechanism was utilised by Bord Gáis Éireann staff during the period of the KPMG Report. From the evidence gathered, there is no evidence a whistle-blower mechanism was utilised by Bord Gáis Éireann staff to raise concerns regarding the projects identified within the KPMG Report.

10.4 GNI have accepted that its RAB was overstated, both by their acceptance of the findings of the KPMG Report and the Interim Report. In addition, their acceptance of the RAB being overstated is evidenced by the corrections to their RAB that occurred during the setting of 2015/16 tariffs.

10.5 As indicated in Section 4.6 of the Final Report, the Investigation Team have found that Bord Gáis Éireann was in breach of Condition 21 (Records & Reporting), Condition 26 (Regulatory Accounts) and Condition 27 (Cross Subsidies).

10.6 As indicated in Section 5.5 of the Final Report, the Investigation Team notes that the conditions attached by the CER to the Section 39 Consents issued to Bord Gáis Éireann are generic, and pertain predominantly to pipeline standards. Therefore, the Investigation Team does not have evidence that Bord Gáis Éireann breached its Section 39A Consent conditions.
11.0 Investigation Team’s Recommendations

11.1 Having conducted its investigation and in consideration of its findings, the Investigation Team recommends that the Commission consider taking the following actions, as set out in Section 11.2 – 11.10.

11.2 Instruct GNI to update the Commission on its engagement with the Society of Chartered Surveyors regarding the actions of QSs contracted by Bord Gáis Éireann.

11.3 As part of the CER’s forthcoming price control for GNI, a review of all relevant expenditure relating to the projects identified in this report should be undertaken, and were such expenditure is deemed inefficient, instruct a takeback of such expenditure.

11.4 The Commission engage with DCENR regarding the development of enhanced administrative sanctions for the CER to implement (including the ability to impose financial penalties), as it is the view of the Investigation Team that the CER does not have sufficient vires to impose appropriate sanctions or financial penalties on regulated entities.

11.5 The Commission direct GNI to report the implementation and effectiveness of its Code of Conduct and demonstrate a fit for purpose whistle-blower mechanism is incorporated into its Code of Conduct, and to show how same is demonstrated.

11.6 The Commission instruct GNI to submit a proposal to the Commission outlining the steps it has taken internally to review its regulatory accounting standards and procedures. GNI should submit the details of such a review to the CER for consideration. This review should include recent changes in Regulatory Accounting Guidelines in order to reflect the changeover from GAAP to IFRS accounting standards.

11.7 The Commission instruct Ervia/GNI to appoint a third party, who will be approved by the Commission, to carry out an independent assurance process based on the terms of reference (also to be approved by the Commission), to assess Ervia/GNI’s compliance with the recommendations contained in the KPMG Report and measures set out in the correspondence issued to CER from GNI. The party appointed will report directly to the Commission with its findings.

11.8 Notwithstanding that there is no continuing breach of licence and that the current Board of GNI have moved to deal with the issues raised by the whistle-blower, the Investigation Team recommends that the Commission publish a determination notice, as per Section 25 of the Electricity Regulation Act, 1999 (as amended).\(^\text{19}\)

11.9 The Commission suggest that GNI communicate (in writing) the corrective actions it has undertaken following the KPMG Report to the third parties referred to in the KPMG Report.

\(^{19}\) Section 25 of the 1999 Act states that the Commission may make a determination that the holder of a licence or an authorisation has committed a specified breach of a condition or requirement. As soon as practicable after making a determination, the Commission shall publish a notice of the determination in a newspaper circulating in the State and serve a copy of the notice and a copy of the determination on the holder of the licence or authorisation to whom the determination relates.
11.10 The Commission instruct Ervia/GNI to inform all third parties mentioned in the KPMG Report that the CER has issued a determination notice to Ervia/GNI for breach of Bord Gáis Éireann’s licence conditions.