Commission for Energy Regulation
An Coimisiún um Rialáil Fuinnimh

Gas Networks Ireland Allowed Revenue and Distribution Tariffs 2016/17

Decision Paper

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Regulating Water, Energy and Energy Safety in the Public Interest

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Executive Summary

This Decision Paper sets out the update to the Allowed Revenues that Gas Networks Ireland may recover during the course of Gas Year 2016/17. This includes updates on additional revenue requests from GNI that the CER has approved. These revenues are required for the operation and maintenance of the low pressure distribution system. Updates on revenue requests for 2016/17 include the connection of Listowel Co. Kerry, additional funding for the entry of an Post into the prepayment top up market and GNI technical training and apprenticeship scheme. The revenues for the Distribution network are €188m which are down from €196m in 2015/16.

In addition, this paper updates key inputs such as the Cost of Capital, the inflation rate and the forecast bookings which all influence the level of GNI's transmission tariffs. The Cost of Capital (WACC) is set at 5.2%, the floor of the current Price Control cost of capital. Inflation rates have been updated to indicate both actual rates as well as forecast inflation for 2016/17.

Forecast capacity bookings have decreased at the distribution level. This is being driven by lower peak day bookings on the system, which are an outcome of the Supply Point Capacity (SPC)[1] and Annual Quantity (AQ)[2] setting process within GNI. However, Commodity forecasts have remained largely in line with 2015/16 forecasts.

In nominal terms Capacity charges have increased by 0.5% versus 2015/16 and Commodity charges have decreased by 1.2%. The Weighted tariff has increased by 0.2% in nominal terms.

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[1] Relates to the capacity for the peak day reserved for a gas supply point,
[2] Estimated amount of gas that a supply point will use in a given gas year.

Public/ Customer Impact Statement

The CER is legally responsible for regulating network charges in the natural gas market.

The CER sets the basis for charges for using the distribution system. The CER does this in the best interests of the consumer. Our goal is to ensure that gas is safely and securely supplied and that the charges are fair and reasonable.

The key customer impacts are as follows:

- All domestic customers and most business customers are connected to the distribution network. These customers therefore pay distribution network tariffs as part of their natural gas bills.

- Each year the CER agrees the level of revenues that GNI may collect through distribution network tariffs. These revenue cover a 12 month period from 1st October 2016 to 30th September 2017.

- This paper explains how the CER gas set GNI's revenues and how these are charged to customers. These revenues have decreased vis-à-vis 2015/16 by c. €5m from €196m to €191m.

- Distribution Network Tariffs for 2016/17 have increased by 0.2% compared to 2015/2016. Network tariffs are charged to gas suppliers who may choose to pass them on to their customers. At present distribution network tariffs make up approximately 30% of a domestic customers bill. The network tariff changes in this paper will equate to c. 0.06% of an average residential gas customer's bill. On an average customers bill this tariff change would equate to c. €0.50 of an average residential gas customers annual bill.

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Glossary of Terms and Abbreviations

Abbreviation or Term	Definition or Meaning
Allowed Revenues	The sum of revenues that the TSO is entitled to obtain in a given period, as approved by the CER.
Price Control	A 5- yearly review of GNI's allowed revenues.
Extra-over items	Work items not envisaged in the Price Control
Pass-through items	Work items not included in the Price Control but where the costs were not certain at the time of the Price Control.
Euribor	Euro Interbank Offered Rate indicating the average interest rates at which Eurozone banks offer to lend to other banks.
GNI	Gas Networks Ireland
PC	Price Control
HICP	Harmonised Index of Consumer Pricing
Cost of Capital	The return that GNI are permitted to earn during a given year.
Correction Factor	An adjustment of revenue applied to rectify over or under recoveries.
Supply Point Capacity (SPC)	Capacity in kilowatt-hours (kWh) at a Supply Point that is deemed to be reserved for the peak day. A "1-in- 50" peak day is used, which is based on weather conditions so severe that statistically they are only likely to occur once every 50 years.
Annual Quantity (AQ)	The estimated amount of gas in KWh that a gas point will use in a gas year

1 Introduction

1.1 Background

Under the Gas (Interim) (Regulation) Act, 2002, the CER is responsible for regulating charges in the natural gas market. Under Section 14 of that Act the CER may set the basis for charges for transporting gas through distribution systems.

This paper outlines the CER's decision in relation to the Gas Networks Ireland (GNI) Allowed Revenues and gas Distribution tariffs that will apply from 1st October 2016 to 30th September 2017.

The calculation of these revenues for the forthcoming gas year is based on GNI's Price Control which is the revenue setting process that the CER conducts every five years. GNI is currently in its third Price Control (PC3) with 2016/17 being the final year of PC3.

In addition, as part of the annual process of setting network tariffs, GNI also submit additional items that were not included as part of the PC3. This paper details the extra over-items which the CER has allowed GNI to revenues for.

1.2 Related Documents

Decision on October 2012 to September 2017 Distribution revenue for Bord Gáis Networks

Decision on BGN Allowed Revenues and Gas Distribution Tariffs for 2014/15

1.3 Structure of Paper

This Paper is divided into three primary sections.

Section one details the revenue inputs that GNI are allowed to obtain in the coming Gas Year (2016/17). This includes updates on the extra items requested and pass-through items. In addition, Correction Factors from previous years are outlined.

Section 2 outlines the updated forecast bookings for the forthcoming years, and includes some details on the changes from the PC3 decision and from the forecast bookings for 2015/16.

Section 3 details the forecast network bookings and network tariffs to apply from 1st October 2016- 30th September 2017.

2 Background to CER Tariff setting

2.1 Revenue Setting process and inputs

In November 2012 the CER published its Decision Paper on Distribution revenue (CER/12/194). This paper allowed €996 million to be recovered for Distribution over a 5 year period. Of this €392 million was allocated to Operating Expenditure.

The Allowed Revenues are subject to annual review when the tariffs are set. In August 2016 GNI submitted estimates of distribution tariffs for the forthcoming year. This included:

- Revised expected pass through costs for 2016/17;
- Allowance requests for items not included in the PC3 Decision;
- Finalised pass through costs for 2014/15; and,
- A WACC of 5.2%. This is the floor of the WACC range allowed in the PC3 Decision.

3 Pass-through and Extra over items

In addition to the revenues allowed in the PC3, each year GNI submits requests for items that are either considered “pass-through” or “extra-over”. Pass though items are those for which at the time of the Price Control, the exact expenditure was not finalised. Extra over items are requests from GNI for items that were not included in the Price Control.

3.1 Pass-through costs

Pass through costs have been updated for the coming year to reflect the following changes to the revenue inputs.

The variance in the pass-through items in 2016/17 monies is reflected below vis-a-vis the original PC3 Decision forecasts. A plus (+) indicates that the variance is above what was forecast in the PC3 Decision Paper. A minus (-) indicates that the variance is below what was forecast in PC3.

Pass-through	Saving or Charge	Rationale	(Saving)/Charge €m
Local Authority Rates	⬇	Local Authority Rates have decreased in relation to the forecasts at the time of the Price Control.	-1.23
Safety advertising	⬆	Additional costs have been incurred for Safety advertising due to a new campaign.	+1.81
CER Levy	⬇	Over-recovery giveback in Levy.	-0.497
Gas Shrinkage	⬇	GNI have an incentive to reduce Shrinkage as a percentage of throughput.	-1.08
Total Variance			**+0.404**

For rates 50% of the variance between the allowed costs in the Price Control and the updated forecast variance are passed through.

3.2 Items not finalised in the PC3 Decision (Extra-over)

In addition to pass-through items GNI have also submitted a request for additional items that were not identified in PC3. CER receives requests for additional items as part of the annual tariff setting process and also throughout the year as different work items or projects are approved e.g. the connection of a new town to the gas network.

Details on the extra-over items that the CER has approved an allowance for are outlined below.

3.2.1 Apprenticeship Scheme

As part of 2015/16 tariffs the CER approved an allowance for GNI's Apprenticeship Programme, which began in January 2015 with an initial intake of 14 apprentices. The CER was supportive of the scheme on the basis that it was important that the technical skills associated with operating and maintaining the natural gas network are maintained.

An allowance of €300,364 was approved last year which reflected the salary costs of the first year of the programme. As the salary costs for year 2 have increased the CER is approving an allowance of €419,043 to reflect the higher salary cost.

As the apprenticeship programme will provide training across both the Transmission and Distribution systems the allowance will be recovered 50% from Transmission tariffs and 50% from Distribution tariffs.

3.2.2 Technical Competency

In 2014, as a result of a review of the technical competency of GNI conducted by the Safety Division in CER, a recommendation was made that the competency development within GNI be improved in core network functions. GNI implemented a Technical Competency Development framework which included investment in training facilities, field assessments and external assessments.

The CER has approved an allowance of €605,000 for 2016/17.

As Technical Competency applies across both the Transmission and Distribution networks the allowance will be recovered 50% from Transmission Tariffs and 50% from Distribution tariffs.

3.2.3 Listowel

As per the New Towns Connection Policy in March 2016, the CER approved the connection of Listowel Co. Kerry to the natural gas network. The extension of the natural gas network to Listowel will require capital investment in the network of €7m which will be recovered over a number of years.

3.2.4 An Post prepayment meter top-up entry

At present where a pre-payment meter customer wishes to purchase meter credit the customer must use a Payzone unit to do so. In 2015, An Post indicated that they wished to enter the pre-payment top-up market as a front-office provider. This will allow PAYG gas customers to top up their gas credit via a Post Office or a Post Pay point when the facility is fully rolled out. To facilitate this work will be undertaken by Siemens and GNI as the back office provider to facilitate this entry. This reduces reliance of a single provider and lessens the risk of system failure.

The CER has therefore approved an allowance of €490,000 for work related to this item.

3.2.5 Digital Strategy and Towns Refresh

As part of GNI's growth strategy, there has been an increased focus on GNI's digital strategy, in particular on how the GNI website can be enhanced to allow customers more ability to interact digitally with GNI. In addition, GNI is proposing to focus on increasing the number of households and businesses connected to gas in existing towns which will require an increased spend on sales on marketing in these towns so as to achieve new connections.

GNI intend to partially fund the workstream with revenues from the current Price Control, but have requested additional funding for the digital strategy and the towns refresh campaign. The CER has at this time approved an allowance request of €185,000 to cover a trial campaign to run in two existing towns.

3.2.6 Innovation

Over the course of PC3, an allowance of €8m was allowed for innovation funding, of which €7.2m was collected from transmission. Thus far innovation funding has focused on Compressed Natural Gas (CNG), Renewable Natural Gas (RNG) and research grants.

In 2015, GNI requested an additional allowance of €800,000 to support the conversion of fleet vehicles to CNG, the CER approved an additional allowance of €400,000. Under the PC3 initiative, approximately 22 vehicles were identified for conversion to CNG. GNI predict that this will result in an additional 15GWh of gas consumption per annum.

Innovation funding is divided between the Transmission and Distribution networks in a ratio of 90:10 (Transmission/Distribution) and therefore €40,000 will be included in Distribution revenues.

3.3 Summary of extra-over allowances

Item (2016/17)	GNI Request	CER allowance	Allowance to Distribution
Apprenticeship Programme	€499,043[3]	€419,043	€209,522
Technical Competency	€605,000	€605,000	€303,000
Listowel	€7,000,000	€7,000,000	€7,000,000*
An Post Prepayment market entry	€510,000-€540,000	€490,000	€490,000*
Digital Strategy and Town Refresh	€670,000	€185,000	€185,000
Innovation	€800,000	€400,000	€40,000
TOTAL	**€10,114,043**	**€9,099,043**	**€8,227,522**

***These items are capitalised on the RAB meaning the expenditure is recovered over a number of years**

[3] Including requested recovery of an over-spend in 2015/16 which was not approved by CER

4 Correction Factor

The application of a Correction Factor adjusts for the difference between 2014/15 actual revenues and pass-through costs versus the ex-ante projections for these revenues, which were forecast at the time of setting tariffs in August 2014.

In general, Correction Factors are applied one year after the actual revenues are obtained for the year in question. As part of previous Price Controls the CER has indicated that where a correction factor exceeds more than 5% of allowed revenues in the year in which the under/over recovery occurred then the correction factor would be spread over two years, with the excess over the 5% carried over to the second year rather than being recovered in the one year.

4.1 2012/13 Correction Factor

In 2012/13 there was an under-recovery of €5.63 million. At the time of applying the correction in 2014, the CER decided that the giveback would be done in equal increments over a three year period i.e. between the gas years 2014/15 -2016/17.

The final third of this over-recovery is now being applied in 2016/17 in an NPV neutral way resulting in €2.38m being applied i.e. uplift of the 1/3 giveback.

4.2 2014/15 Correction Factor

In 2014/15 there was an over-recovery of € 2.284m on the Distribution network. This over-recovery will be given back as part of the normal revenue reconciliation process.

Below indicates the outturn under or over recoveries for the pass-through items which were forecast at the time of setting tariffs in 2014/15, and the corrected actual over/under recovery for the year.

14/15 Actual outturn (Kt-1)	Over/under recovery	€m	Cumulative additional revenue required
KT-1 Over-recovery	Over	-2.28	-2.28
Rates	Over	-0.12	2.40
Safety	Over	-0.14	-2.54
CER Levy	Over	-0.08	-2.62
Gas Shrinkage	Under	+0.11	-2.51
Revenue Protection	Over	-0.560	-3.07
Total 14/15 over-recovery			-3.07
Interest Rate Multiplier			1.065%
Correction inclusive of multiplier			**-3.22**
Final Correction Factor from over – recovery in 2012/13		-2.38	**-5.60**

4.3 Euribor rates and Inflation

4.3.1 Euribor Rates

The Euribor rate plus 2% is applied where under/over recoveries are below 3% of the allowed revenues. Where under/over recoveries are above 3% then a Euribor plus 4% rates applies.

In the case of the 13/14 recovery the over-recovery is under 3% and therefore the Euribor plus 2% rate will apply.

Euribor 14/15	0.35%	Euribor +2%	2.35%	Euribor +4%	4.35%
Euribor 15/16	0.08%	Euribor +2%	2.08%	Euribor +4%	4.08%

4.3.2 Inflation

At the time of setting the 2014/15 tariffs an inflation rate of 3.74% was assumed for the allowed revenues of the Price Control which were set in 10/11 monies. This has been corrected to actual realised inflation[4] of 2.81% which is applied to close out the revenues for that year.

In setting the 2016/17 tariffs an inflation rate of 1.3% is assumed for the time period from April 2016 to March 2017.

[4] Source: Central Bank, ESRI, Department of Finance

5 Demand projections

As part of the PC3 Decision demand projections were estimated for each of the five years of the control period. As part of the setting of annual tariffs these demand figures are adjusted to consider the latest forecasts.

For the forthcoming year Commodity forecasts have increased slightly on the previous year, which is due, in part to the strong level of new connections from the Daily Metered (DM) and Large Daily Metered (LDM) sectors. However, the strong growth in business connections is being offset by energy efficiency across all sectors as well as lower connection numbers at a residential level.

Capacity forecasts have decreased by 1.3% over 2015/16 forecasts, and have decreased by 5.2% against the PC3 forecast. This is reflective of the lower SPC bookings required for the NDM (primarily residential) sector. This is influenced by one-in-50 peak demand booking requirements which have been reduced.

Commodity	**GWh**
Original PC3 Projections	14,626
Current 16/17 Projections	15,372
% Change	+5.1%

Table 5.1 Commodity Projections

Capacity	**GWh/per peak day**
Original PC3 Projections	118.27
Current 16/17 Projections	112.15
% Change	-5.2%

Table 5.2 Capacity Projections

6 CER Decision on Distribution Tariffs for 2016/17

Previous sections outline the elements affecting the Distribution tariffs to apply from October 2016.

The five year revenue review5 profiles the revenues over the five years and sets a revenue for each year. The total revenue allowed was €943m, on average €189m all of which is in 2010/11 monies.

The 2016/17 revenues (€191.2m) are 1.7% higher than the 15/16 revenues (€188m).

These revenues have been adjusted for inflation and for any additional revenues required for 2016/17 and for corrections in previous years, including the final give back of the correction factor for 2012/13.

The CER hereby directs Gas Networks Ireland to implement the tariffs set out in the table below from 1st October 2016 – 30th September 2017.

Volume Range (MWh)		**Capacity Charge(c/peak day kWh)**		
>	< or=	A	B	Total
0	73	154.5120		
73	14,653	136.7805	3.9764	A - B *Ln(PDV[MWh])
14,653	57,500	341.7271	49.0381	A - B *Ln(PDV[MWh])
57,500		42.1410		42.1410

Table 6.1 Capacity charges

Volume Range (MWh)		**Commodity Charge(c/ kWh)**		
>	< or=	A	B	Total
0	73	0.3370		0.3412
73	14,653	0.2692	0.0262	A - B *Ln(PDV[MWh])
14,653	57,500	0.3137	0.0414	A - B *Ln(PDV[MWh])
57,500		0.0613		0.0613

Table 6.2 Commodity charges

[5] http://www.cer.ie/docs/000404/cer12194.pdf

	2015/16 Tariff 15/16 charge in 15/16 monies (Nominal)	2016/17 Tariff 16/17 charge in 16/17 monies (Nominal)	15/16 charge vs. 15/17 charge (Nominal)	15/16 charge vs 16/17 charge (Real)
Capacity Charge	153.6833	154.5120	0.5%	-0.8%
Commodity Charge	0.3412	0.3370	-1.2%	-2.5%
% change in Weighted Tariff			0.2%	-1.1%

Table 6.3. Tariff comparison for standard domestic dwelling