Public Consultation on Transmission and Distribution Revenues for Gas Networks Ireland (GNI) from Oct. 2017 to Sep. 2022, (CER/17/127 and CER/17/128)

Submission to Public Consultation

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Via Email to Daniel Ward

Background and Introduction

1. The Commission for Energy Regulation (CER) has published two consultation documents setting out the revenue profiles it proposes to award to GNI for the latter’s transmission and distribution networks for the five years to end September 2022. These documents are accompanied by reports on GNI’s operating and capital expenditure and on the cost of capital by the CER’s advisers and by Excel models. The Excel models present an indication of the tariffs that will be applied to recover the network revenues. Once it makes its final decision on the network revenues the CER will publish the transmission and distribution tariffs that will be applied to generate these revenues about one month in advance of these tariffs being applied on 1 October 2017. GNI will derive the transmission tariffs using its licensed model. This model is not freely available to the public and is available only to those parties who are prepared to pay a fee and to comply with the licence issued by GNI. An outline description of the transmission tariff derivation method is presented in CER/15/140, but it is understood that the precise derivation of the transmission tariffs and their relationship to the profile of allowed transmission revenue and to the projected configuration of gas flows will not be made publicly available.

2. The European Commission, via the Directorate-General for Energy (DG ENER), has drafted and enacted on 16 March 2017 a network code on harmonised transmission tariffs for gas – EU Regulation 2017/460. It is understood that the CER believes that the

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Beginning with significant involvement in gas market liberalisation in Great Britain – including advising the gas regulator and the then Monopolies and Mergers Commission (subsequently re-configured, via the Competition Commission, as the Competition & Markets Authority) - the geographical scope of his work has expanded and he has considerable international experience throughout Europe, Africa, the Middle East, Russia and East Asia. He has provided advice to the European Commission on its gas market liberalization programme and evaluated gas interconnection and storage projects under the European Energy Programme for Recovery. He has worked for gas market participants throughout the EU in the context of gas market liberalization and is involved in the development of the EU’s Gas Target Model being facilitated by the Directorate-General for Energy of the European Commission (DG ENER), the grouping of national energy regulators for the Member States (ERGEG) and the Agency for Co-operation of Energy Regulators (ACER). He has written a paper which sets out a basis for developing the mandated Entry-Exit pricing of gas transmission in the context of the EU Gas Target Model:

method of deriving transmission tariffs employed by GNI and approved by the CER is compliant with the provisions of Regulation 2017/460. It is also understood that GNI will apply this method to derive the structure of tariffs for the 2017/18 Gas Year and that the CER, at a later stage, will conduct a public consultation on the tariff method with a view, presumably, to demonstrate its compatibility with Regulation 2017/460.

3. In the normal course of events and in the context of a public consultation of this nature that sets the allowed revenues of the allegedly regulated firms, it would be futile making a submission that contested in any way the decision the CER proposes to make. The CER routinely ignores, rejects or dismisses any evidence or analysis that might compel it to review its approach. It refuses to engage with any evidence or analysis presented because the CER is determined to maintain its denial that it is compelled to overstate the network revenues it allows. This overstatement is partly in response to the refusal by successive governments to part-finance large-scale network investments, but it is primarily in response to the rent-seeking objectives of the boards, managements and trades unions in the commercial semi-state firms it is ostensibly regulating.

4. It overstates these revenues via the use of a number of ruses. One such ruse is the inflation of the value of network assets in place prior to the application of regulation. Another is the generation of inflated estimates of the cost of capital. Under the current proposals it is assumed that the debt beta is zero, which generates an overestimate of the equity beta and an excessively high cost of equity. Yet its point estimate of the cost of debt suggests that the debt beta is in excess of 0.1. In addition, its treatment of taxation overstates the pre-tax cost of equity. The result is an estimate of the cost of capital of 4.63% when the actual cost is likely to be closer to 4%. The effect of the inflation of asset values and the overestimate of the cost of capital is that network revenues are approximately 20 per cent higher than they should be – and final prices are up to 8 per cent higher than they should be. A further ruse is the failure to reconcile the revenue awarded with the regulated revenues reported by the regulated firms.

5. There is no effective means of contesting this overcharging because the CER is a regulatory body in name only and there is no effective appeal mechanism. The CER is, in effect, a policy implementing agency. In this respect, not only was the illusion it was projecting of functioning as an economic regulator shattered, but its effectiveness as a policy implementing entity was seriously damaged when sufficient numbers of citizens rejected the water charges it proposed in October 2014. However, and unfortunately for all final energy consumers, it retains its effectiveness in pandering to the desires of powerful special interests in the energy sector at the expense of final consumers.

6. Nevertheless, when it comes to the design and application of gas transmission tariffs the existence of Regulation 2017/460 provides the basis and rationale for a brief submission that seeks to highlight both serious defects in the current transmission tariff method being applied by GNI and approved by the CER and glaring compliance failures. Such an exercise becomes even more relevant and pressing in the context of the future monitoring of, and reporting on, the national implementation of this regulation by the Agency for Co-operation of Energy Regulators (ACER) and the association of European Gas Transmission System Operators – ENTSO-G.

**Actual and Potential Non-Compliance with Regulation 2017/460**

7. Given their behaviour to date there has to be a major concern about the extent to which GNI and the CER will comply with the provisions relating to the publication of tariffs and the basis on which tariffs are derived. Chapter VIII of Regulation 2017/460 covering publication requirements comes in to effect on 1 October 2017. This is the date from which the gas transmission and distribution tariffs derived by GNI and approved will come in to effect. It is to be hoped that GNI and the CER are not taking advantage of the
1 October 2017 date in the Regulation, but the refusal of GNI to make its tariff derivation model publicly available and the unwillingness of the CER to require publication runs counter to the spirit, if not precisely counter to the letter, of the Regulation. Unfortunately, such devious behaviour would be characteristic of both GNI and the CER.

8. In a similar way, applying a tariff method whose compliance with the Regulation has not been tested does not comply with the Regulation and undermines the enforcement of the Regulation. Although conducting a public consultation sometime in the future to determine the compliance of the current tariff method with the Regulation is required by the Regulation, applying the current tariff method in advance of this consultation will render the consultation another exercise in futility.

9. In addition, the Reference Tariff Method applied by GNI and approved by the CER in 2015 differs from the preferred Reference Tariff Method (the Capacity Weighted Distance (CWD) method) set out in the Regulation. At the very least, the current method should have been bench-marked against the CWD method as required by the Regulation. There is no reason why this could not have been done between 16 March and 1 August 2017.

10. Article 7(c) of the Regulation requires the chosen reference tariff method to aim at “ensuring non-discrimination and prevent undue cross-subsidisation”. The annual costs established by the CER of using the interconnectors from Scotland and of using the gas input facilities at Inch up to the connection points with the onshore gas transmission system amount to approximately 33 per cent of the allowed annual transmission costs. These costs are recovered in entry tariffs levies on users of these entry points and on the users of all other entry points. In the latter case these costs are ultimately borne by the suppliers at these entry points. This is both blatant and undue cross-subsidisation. It is also blatant discrimination and a barrier to entry in that prospective gas suppliers at other entry points would be compelled to contribute to this cross-subsidisation.

11. What is even more serious is that GNI is recovering, and the CER is allowing the recovery of, the inflated costs of interconnector assets that are temporarily stranded ultimately from final consumers and from suppliers at other entry points. GNI is the sole recipient of these subsidies. It is true that the interconnector entry tariffs are far higher than they should be, but the costs are being passed through to final consumers. Without the subsidies from suppliers at other entry points the costs passed through to final consumers would be even higher. The excessive and unjustified cost burden on final consumers and on suppliers at other entry points was made larger following the decision in the late 1990s to construct a second interconnector from Scotland, rather than develop alternative sources of supply and modes of delivery. At the time the decision was egregiously stupid, but it aligned with a policy willingness to pander to the empire-building desires of Bord Gáis. Following the UK’s decision to exit the EU this stupidity is highlighted even more forcefully. Regulation 2017/460 does not explicitly provide any remedy, but there are other EU instruments which may.

12. The use of an Entry-Exit methodology to derive gas transmission tariffs is significantly inferior to the methods used in other jurisdictions – in particular, to those in the US - and the EU’s institutions chose it for a number of reasons, both honourable and dishonourable. In the same way that the transposition and enforcement of previous EU directives and regulations have been deliberately distorted by politicians, senior officials, the CER, the ESB and GNI’s predecessor, Bord Gáis, to their own advantage and to the detriment of consumers’ interests, the EU’s institutions’ commitment to this method has been cunningly exploited by GNI and the CER at the expense of final gas consumers. It is to the shame of Irish politicians and policy-makers that they have authorised and permitted this. And it is even more to their shame that any possibility of redress or remedy has to be addressed to EU institutions and agencies.