

# BGE (NI) Ltd Price Control 2012-2017

## Determination

5 October 2012

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# 1 INTRODUCTION

## Purpose of this Document

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- 1.1 This document sets out the Utility Regulator's determination of the allowances BGE (NI) will receive for the next five year price control period commencing on 1 October 2012 and ending 30 September 2017. Allowances have been set for;
- Operating Expenditure, both Controllable and Uncontrollable;
  - Capital Expenditure; and
  - Cost of Debt component of Cost of Capital.
- 1.2 Prior to this determination the Utility Regulator has, in addition to ongoing discussions with BGE (NI), conducted three separate public consultations on various aspects of the Price Control Review. These were;
- December 2011 – Consultation on Process, Timetable and Approach to Review;
  - April 2012 – Initial Proposals on Operating and Capital Expenditure; and
  - August 2012 – Consultation on Cost of Debt.
- 1.3 We would like to thank all respondents for their input into this Price Control Review process. All responses not marked as confidential have been published alongside this determination on the Utility Regulator website.

## Structure of this Document

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- 1.4 This determination is broken down into the following sections.
- Part 1 – Introduction and Our Approach
  - Part 2 – Controllable Operating Expenditure
  - Part 3 – Uncontrollable Operating Expenditure
  - Part 4 – Efficiency Factor
  - Part 5 – Capital Expenditure
  - Part 6 – Cost of Debt

- 1.5 Please note that as with previous papers relating to this Price Control Review all figures quoted are in 2011 monies.

## Our Statutory Duties

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- 1.6 The conduct of this Price Control Review has been guided by our statutory duties as set out in the Gas Order (Northern Ireland) 1996 and the Energy Order (Northern Ireland) 2003.
- 1.7 Our principal objective in carrying out our gas functions is to promote the development and maintenance of an efficient, economic and coordinated gas industry in Northern Ireland. Our principal objective must also be pursued in a way that is consistent with the objectives defined in Article 40 of the Gas Directive, the most relevant of which – in the context of carrying out price controls – are promoting an efficient market, and protecting consumers.
- 1.8 In carrying out our gas functions, we are also required to further this principal objective in the best manner that we see fit whilst also having regard to a number of other considerations. The key relevant one being the need to ensure that licence holders are able to finance their licensed activities.
- 1.9 We therefore interpret our duties, in the context of carrying out price controls, as a mandate to secure the most cost efficient outcome for the consumer that also allows the company to continue financing its activities. This has been the overarching philosophy that has guided our approach to this price control.

## Our Regulatory Principles

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- 1.10 The aim of this Price Control Review has been to ensure the revenues and resulting tariffs are:
- Sustainable;
  - Stable;
  - Transparent;
  - Predictable; and
  - Cost-reflective.
- 1.11 These are based on best practice regulation of natural monopolies. Our task essentially consists of creating a framework within which, in return for providing monopoly services to an acceptable quality, the company receives a reasonable assurance of a revenue stream in future years that will cover its efficient costs.

## Our Approach

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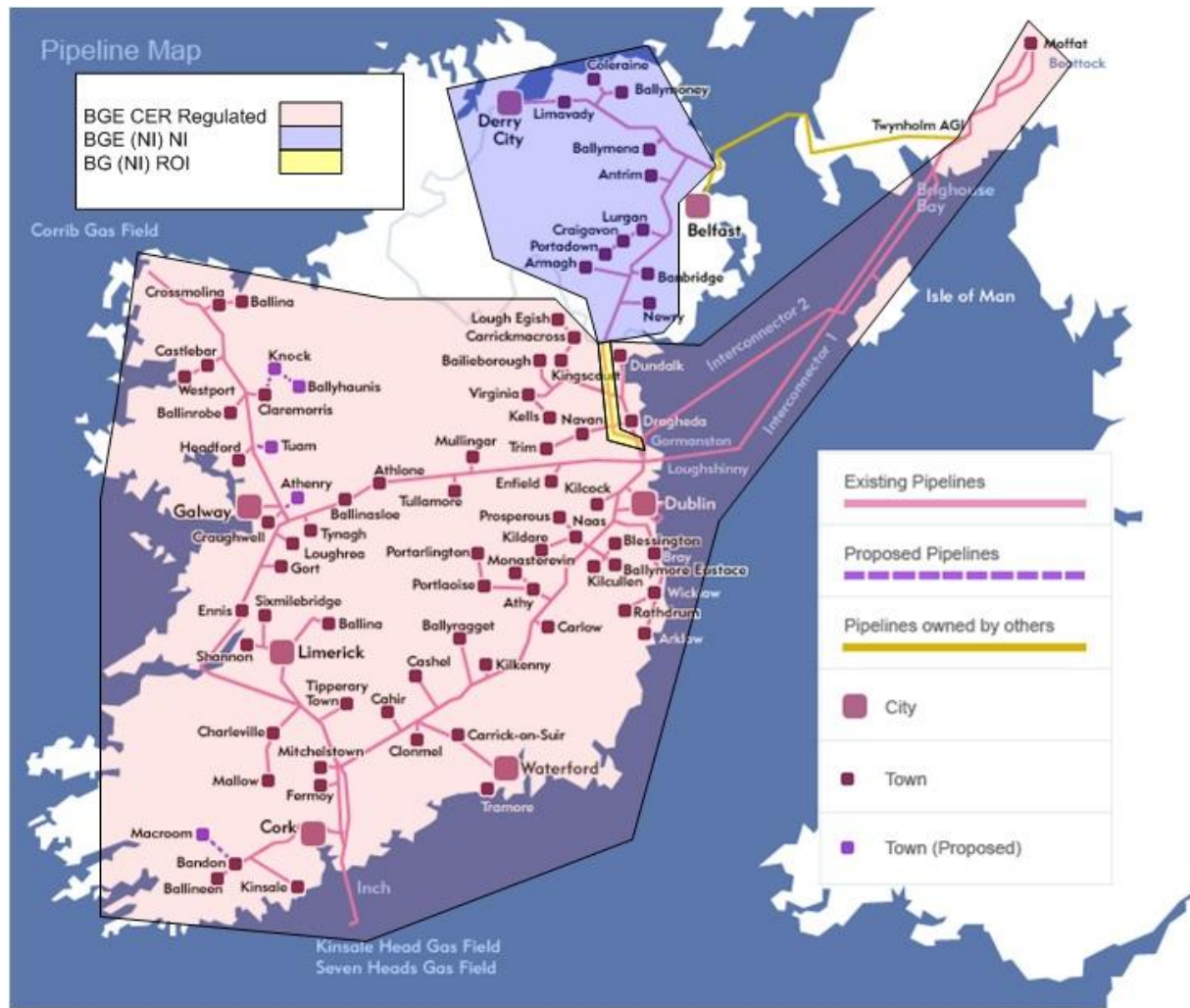
- 1.12 We consulted on the approach we should adopt to this Price Control Review in December 2011. Following this consultation:
- We commissioned engineering consultants to give advice and make comment on the engineering aspects of the BGE(NI) expenditure submissions;
  - We asked our consultants to consider whether or not benchmark comparisons with the operating expenditure of other energy/utility companies would be appropriate;
  - We used the actual level of operating expenditure incurred by BGE(NI) in the previous price control period as a for trend analysis going forward;
  - We reviewed the capital expenditure requested by BGE(NI) and determined whether it could be justified in terms of delivering benefits to Northern Ireland consumers;
  - We considered whether or not the requested capital expenditure could be moved into future price control periods;
  - We determined whether allowed capital expenditure might be more properly considered as being operating expenditure;
  - We considered which of the components of cost of capital defined in the licence should be included in this review; and
  - We determined an appropriate level for these various components using the same methodology as in previous reviews.

## Context for the Price Control Review

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- 1.13 BGE (UK) holds a gas conveyance licence to own and operate two high pressure gas transmission pipelines, the Northwest pipeline from Carrickfergus to Coolkeeragh power station and the South North Pipeline (SNP) from Carrickfergus to Gormonston in the Republic of Ireland. Trading under the brand name BGE (NI) in Northern Ireland, BGE (UK) is a fully owned subsidiary of Bord Gais Eireann the semi state gas company in the Republic of Ireland. The parent company acts as a service provider to BGE (UK), to the extent that BGE (UK) has no Northern Ireland based staff or office. The gas conveyance licence was first issued to BGE (UK) in 2002, with the present revenue related licence condition (2.2) being established in 2007. There have been two previous price control determinations in 2004 and 2007.
- 1.14 A schematic diagram of the transmission assets to which this price control applies is shown below, as at 1 October 2012 the regulatory asset value of these assets will be some £140m.

**Figure 1 BGE (NI) assets in Northern Ireland & Republic of Ireland**



Network Section	Length km
North West Pipeline	112.0
NW Spur from Aghadowey to McFinn Lower	9.0
NW Spur from Dunaird to Caherty.	6.0
South North Pipeline total	156.0
SN Spur from Kernan to Derryhale	12.2
<b>Total BGE (NI)</b>	<b>295.2</b>
South North Pipeline in ROI	56.0
<b>BGE (NI) north of border</b>	<b>239.2</b>

- 1.15 Over the next price control period it is anticipated that the commercial regime made available to network users by BGE (NI) will be reviewed as a consequence of the implementation of Regulation 715 2009/EC in Northern Ireland including compliance with a standardised European network code.
- 1.16 As part of this project, the Utility Regulator will consider whether it will be appropriate to create a single system operator for gas transmission pipelines. As yet no decision has been reached on this and other related matters, including the Common Arrangements for Gas (CAG) project. However it is recognised that this decision may impact on the scope of activities funded under the BGE (NI) gas conveyance licence. As a consequence it may be necessary to re-open this price control should a single system operator be created.
- 1.17 We have also noted BGE (NI) comments on the possibility of licence modifications in relation to the cost of capital licence conditions. We will consider the need for significant changes to the cost of capital licence conditions in the near future taking on board whether the conditions which applied at the time the conditions were put in place still apply and BGE (NI) views.

## 2 CONTROLLABLE OPERATING EXPENDITURE

### Summary of Initial Proposals

2.1 Our Initial Proposals for controllable operating expenditure, as set out in our Initial Proposals consultation in April 2012, are replicated below in table 1.

**Table 1 Initial Proposals - Controllable Operating Expenditure £'000 – April 2011 Prices**

Cost Item	BGE Submission						UR Proposed Allowance					
	12/13	13/14	14/15	15/16	16/17	Total	12/13	13/14	14/15	15/16	16/17	Total
Maintenance	1,691	1,675	1,654	1,692	1,665	8,377	1,639	1,623	1,602	1,640	1,612	8,116
Training	5	5	5	5	5	25	5	5	5	5	5	25
Safety Campaign	138	108	108	108	108	570	110	80	80	80	80	430
Admin & Utilities	108	108	108	108	108	540	108	108	108	108	108	540
Grid Control	248	249	250	250	251	1,248	248	249	250	250	251	1,248
Asset	64	64	64	65	65	322	-	-	-	-	-	-
Detailed Design	25	25	25	25	25	125	-	-	-	-	-	-
Scheduling &	60	61	62	63	64	309	-	-	-	-	-	-
HSQE <sup>1</sup>	5	5	5	5	5	25	-	-	-	-	-	-
Wayleaves	13	14	15	16	16	73	-	-	-	-	-	-
Transportation	300	302	305	306	302	1,514	149	154	155	156	152	766
Consultancy/Legal	20	20	20	20	20	100	20	20	20	20	20	100
ALO <sup>2</sup> &	200	175	150	150	100	775	200	175	150	150	100	775
Insurance	262	262	288	288	288	1,388	195	195	195	195	195	975
<b>Shared services</b>							268	268	268	268	268	1,340
IT	223	257	306	322	301	1,408	-	-	-	-	-	-
Secretariat	105	103	102	102	103	515	-	-	-	-	-	-
Finance	129	131	133	134	135	662	-	-	-	-	-	-
HR	48	48	49	49	49	243	-	-	-	-	-	-
Facilities	111	112	112	111	113	559	-	-	-	-	-	-
Group recharge	104	104	104	104	104	552	-	-	-	-	-	-
<b>Total excluding</b>	<b>3,859</b>	<b>3,828</b>	<b>3,864</b>	<b>3,923</b>	<b>3,825</b>	<b>19,300</b>	<b>2,942</b>	<b>2,877</b>	<b>2,833</b>	<b>2,872</b>	<b>2,791</b>	<b>14,315</b>
Capex							12	12	12	423	12	472
<b>Total including</b>							<b>2,954</b>	<b>2,889</b>	<b>2,845</b>	<b>3,296</b>	<b>2,803</b>	<b>14,787</b>
<b>Efficiency 1.5%</b>								43	84	144	163	434
<b>Total including</b>							<b>2,954</b>	<b>2,846</b>	<b>2,762</b>	<b>3,152</b>	<b>2,641</b>	<b>14,355</b>

Source: BGE (NI) and the Utility Regulator

2.2 Our Initial Proposals were comparable to BGE (NI)'s actual operating expenditure for the years 2007/08 to 2009/10 as set out in table 2 below.

<sup>1</sup> This category refers to site visits and interactions with BGE (NI) relating to health, safety, quality and environmental issues.

<sup>2</sup> ALO stands for Agricultural Landowner liaison.



**Table 2 Actual – Controllable Operating Expenditure, £'000 – April 2011 Prices**

<b>Cost Item</b>	<b>2007/2008</b>	<b>2008/09</b>	<b>2009/10</b>
Maintenance	1,271	1,388	1,353
Training	11	-3	-
Safety Campaign	11	13	42
Admin & Utilities	120	89	133
Security	48	57	58
Transmission support (inc. Grid Control)	399	476	449
Transportation Services	172	295	276
Consultancy/Legal	47	20	2
ALO & Agricultural Remedials	153	336	256
Insurance	180	226	179
Shared Services	261	295	281
<b>Total Controllable Opex</b>	<b>2,673</b>	<b>3,192</b>	<b>3,029</b>

Source: Utility Regulator

## Responses and Discussion

- 2.3 We received two responses to our Initial Proposals for operating and capital expenditure – one from BGE (NI) and the other from the Consumer Council for Northern Ireland (CCNI). These have been published alongside this determination. The CCNI was of the view that our initial proposals were overall, in the best interests of Northern Ireland customers. The BGE (NI) response was more detailed and is discussed below.

### **Maintenance**

- 2.4 In their response BGE (NI) stated that our calculation, indicating that maintenance costs per kilometre are higher in the Republic of Ireland than in Northern Ireland sections of the pipeline, was inaccurate. In addition they provided their own calculation of maintenance costs per kilometre.
- 2.5 Because there were a number of significant differences between BGE (NI) categorisation of items in its historic and forecast operating information, direct comparison was difficult. Our consultants therefore had to map cost items between the actual and forecast years and this resulted in different figures from those provided by BGE (NI). We have reviewed the calculation with our engineering consultants and remain confident that our calculation is correct.

### **Safety campaign**

- 2.6 BGE (NI) requested that the Utility Regulator reconsider its proposed allowance for safety related activities including those relating to public awareness of safety. The Utility Regulator has accepted the BGE (NI) request for both;

- Close Interval Protection Survey (CIPS), the need for which was identified as a result of the BGE (NI) Affirmation of Maximum Operating Pressure process for its pipelines in Northern Ireland; and
  - Pressurised System and Safety Regulations (PSSR) which require BGE (NI) to prepare a Written Scheme of Examination (WSOE).
- 2.7 With regard to other safety expenditure this allowance was reduced in line with actual expenditure levels reported by BGE (NI). No convincing argument has been provided as to why the costs of these activities should increase during the next price control period.

### ***Transportation services***

- 2.8 Our Initial Proposals did not include an allowance for a dedicated Northern Ireland Affairs Manager as we considered that BGE (NI) should already have a dedicated resource for managing Northern Ireland affairs. BGE (NI) responded that they do not have a dedicated resource for Northern Ireland affairs. They also resubmitted costs for Transportation Services which included an increased cost for regulatory controls which matched the request they had previously made for a Northern Ireland Affairs Manager. The Utility Regulator has considered this revised submission but remains unconvinced that the apparent re-categorisation of this cost has increased its validity.
- 2.9 We find it surprising that BGE (NI) believe they now need a dedicated Northern Ireland Affairs Manager given that consumers have been paying for BGE (NI) regulatory staff since 2004. We expect BGE (NI) to ensure that allowances for regulatory staff are used to deliver a clear and strong focus on Northern Ireland regulatory issues including factoring in the interests of Northern Ireland consumers.
- 2.10 BGE (NI) has also requested an additional allowance for routine code development work. This was not included in the original submission as a code moratorium was in place. In the previous price control period BGE (NI) had been allowed £30k per annum for external consultancy and legal resources which included an allowance for code modifications. We consider that an allowance of £10k per annum for routine code modifications should be added to the allowance for external consultancy and legal services raising our allowance for this activity to £30k per annum.

### ***ALO and Agricultural remedial***

- 2.11 No comment was made by BGE (NI) in response to our Initial Proposals for this cost line and we remain satisfied with our allowance for this activity.

### ***Insurance***

- 2.12 Given the complex nature of the insurance market BGE (NI) consider it extremely difficult to forecast this cost line for a five year period. The allowance we have proposed of £195k per annum is in line with average reported expenditure in the previous price control period and no evidence has been produced to convince us that going forward insurance costs will deviate from this level.

### **Shared services**

- 2.13 BGE (NI) responded that our proposal to roll over the current allowance of £268k provides an insufficient allowance to carry on the various activities included in this cost line. BGE (NI) also requested that we break down the global allowance into separate allowances for each of the activities included in Shared Services.
- 2.14 A key feature of the review has been the fact that BGE (NI) has changed the way it reports its costs to the Utility Regulator following an internal review. The consequence of this review has been an increase in shared service costs attributable to Northern Ireland. There is now an observable trend by which BGE (NI) request increased allowances for this activity based on revised cost attribution data.
- 2.15 We note that at the time of the 2007 price control BGE (NI) requested increased funding on the basis of having revised their cost allocation methodology and a significant increase was allowed. It does not appear reasonable that a further increase should be requested on the basis of revising this cost allocation methodology only five years later. Accordingly, we remain of the view that BGE (NI) has failed to justify any increase in the allowance for shared services.
- 2.16 BGE (NI) has also requested that the shared service allowance should be further divided into a number of sub allowances. We do not consider that such an approach would be appropriate, this is a generic allowance to fund all the shared services provided by the parent group to BGE (NI) and is not an allowance built up from a number of discrete component parts
- 2.17 In relation to the following four cost lines – asset management, detailed design, scheduling & dispatch and HSQE - BGE (NI) requested that the Utility Regulator reconsider its position and allow the submitted costs as these were not factored into the acceptance by BGE (NI) of the current price control allowance. BGE (NI) provided an additional paper on these four cost lines for our consideration.
- 2.18 We note BGE (NI)'s statement that it did not factor these costs in when it accepted the previous determination. However, at the last review BGE (NI) assured the Utility Regulator that they had performed an extensive review of cost apportionment and the increased costs were approved on this basis to cover all its shared services costs.
- 2.19 The operating expenditure allowance for the price control period should therefore be taken to include all shared service costs which will be incurred. New cost areas will only be considered if there is a material change in the range of activities necessary to continue normal operation of the infrastructure. BGE (NI) has not persuaded us that their operational requirements have materially changed since the last price control period.

## **Final Decision**

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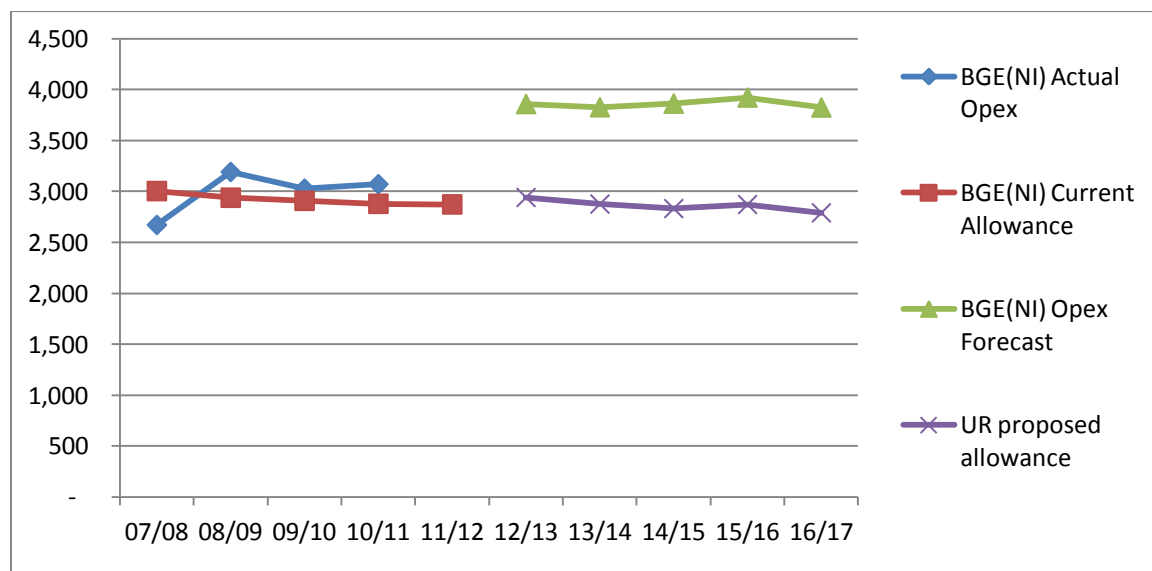
- 2.20 The table below sets out the Utility Regulator's determination of the annual allowance for controllable operating expenditure that, we have determined that it is sufficient for BGE (NI) to carry on its licensed activities. The only line which has changed from the Initial Proposals is transportation services where an additional £10k for routine code modifications has been added for the reasons explained above.

**Table 3 Determination - Controllable Operating Expenditure, £'000 – April 2011 Prices**

Cost Item	UR Allowance					Total
	12/13	13/14	14/15	15/16	16/17	
Maintenance	1,639	1,623	1,602	1,640	1,612	8,116
Training	5	5	5	5	5	25
Safety Campaign	110	80	80	80	80	430
Admin & Utilities	108	108	108	108	108	540
Grid Control	248	249	250	250	251	1,248
Transportation Services	149	154	155	156	152	766
Consultancy/Legal	30	30	30	30	30	150
ALO & Agricultural Remedials	200	175	150	150	100	775
Insurance	195	195	195	195	195	975
<b>Shared services</b>	268	268	268	268	268	1,340
<b>Total excluding capex</b>	<b>2,952</b>	<b>2,887</b>	<b>2,843</b>	<b>2,882</b>	<b>2,801</b>	<b>14,365</b>

Source: Utility Regulator

- 2.21 Figure 2 below illustrates the determination versus BGE (NI)'s current allowance and their actual controllable operating expenditure. This illustrates that our determination for controllable operating expenditure is consistent with our previous decisions and BGE (NI)'s actual expenditure.

**Figure 2 Controllable Operating Expenditure, £'000 – April 2011 Prices**

Source: BGE (NI) and the Utility Regulator

- 2.22 This determination is on the basis that BGE (NI) will be both asset owner and system operator for the period 2012-17. As stated above in paragraph 1.16 should it be decided to change the manner in which system operation is provided in Northern Ireland, we will need to re-open the BGE (NI) price control.

# 3 UNCONTROLLABLE OPERATING EXPENDITURE

## Summary of Initial Proposals

- 3.1 In the table below we reproduce a summary of our Initial Proposals for BGE (NI)'s uncontrollable operating expenditure allowance. In relation to uncontrollable operating expenditure the key issue is the scope of the non-routine cost line. We proposed to define the following activities as non-routine development and to fund efficiently incurred costs relating to these activities as and when they are incurred. We did not propose to provide specific allowance for these projects at this point in time as their timing and scope remains uncertain;
- Delivery of the Common Arrangements for Gas project; and
  - Implementation of Regulation 715/2009 EC including the establishment of an entry exit regime and compliance with European network codes.

**Table 4 Initial Proposals - Uncontrollable Operating Expenditure £'000 – April 2011 Prices**

Cost Item	BGE Submission						UR Proposed Allowance					
	12/13	13/14	14/15	15/16	16/17	Total	12/13	13/14	14/15	15/16	16/17	Total
Uncontrollable	6,251	TBC	TBC	TBC	TBC	6,251	-	-	-	-	-	-
Non routine	100	100	100	100	100	500	-	-	-	-	-	-
Innovations	80	80	80	80	80	400	-	-	-	-	-	-
Rates	425	432	440	464	487	2,248	425	432	440	464	487	2,248
UR Licence	390	390	390	390	390	1,950	390	390	390	390	390	1,950
CER Licence	TBC	TBC	TBC	TBC	TBC	TBC						
PSA Admin			30			30			30			30
<b>Total</b>	<b>7,246</b>	<b>1,002</b>	<b>1,040</b>	<b>1,034</b>	<b>1,057</b>	<b>11,379</b>	<b>815</b>	<b>822</b>	<b>860</b>	<b>854</b>	<b>877</b>	<b>4,228</b>

Source: BGE (NI) and the Utility Regulator

## Responses and Discussion

### ***Business Restructuring - Internal Market for Energy Third Package***

- 3.2 BGE (NI) requested that we provide a rationale for not providing an allowance for the restructuring costs associated with the creation of an Independent Transmission Operator. We wrote to BGE (NI) on this issue in October 2011 stating that we did not believe that Northern Ireland consumers should be asked to fund the restructuring decisions of the owner, decisions over which the Utility Regulator had no legal authority. In addition we pointed to the precedent in Great Britain where Ofgem did not provide an allowance for these activities.

### ***Non-routine costs***

- 3.3 The Consumer Council agreed that it would not be appropriate to approve expenditure in these areas at this time. BGE (NI) responded that they could not accept our position with regard to non-routine developments and that it was unreasonable that they should be expected to bear financial risks associated with changes in law and other unforeseen factors.
- 3.4 We consider that BGE (NI) receives a sufficient return on capital to accept the level of risk associated with being required to fund a very limited level of operating expenditure risk. In addition, BGE (NI)'s current licence provides real protection in relation to operating expenditure. Condition 2.2.4(i) allows BGE (NI) to request a special operating expenditure review if actual operating expenditure in any gas year differs from the most recently agreed forecast by more than 15%. The Utility Regulator may substitute an amended figure following such a review. In addition Condition 2.2.4(j) allows BGE (NI) to seek the Utility Regulator's approval to recover unforeseen operating expenditure. The Utility Regulator may approve this in its absolute discretion although any expenditure must be genuinely unforeseen.
- 3.5 One option would be to make an ex-ante allowance for these non-routine projects; however we have concluded that the level of uncertainty that exists with regard to the timing and delivery requirements of each is such that this would impose an unacceptable level of risk on both BGE (NI) and consumers. Therefore, we expect BGE (NI) to submit forecast cost estimates for each project once the project requirements have been agreed. The Utility Regulator will then make an assessment of what it considers to be an efficient level of expenditure for project delivery, and an appropriate allowance will then be included in the annual Forecast and Actual Revenue Requirement process.
- 3.6 This process will follow the following steps:
- **Step 1:** - Project deliverables to be agreed with the Utility Regulator;
  - **Step 2:** - Estimated cost requirement to deliver agreed project submitted to the Utility Regulator for consideration;
  - **Step 3:** - Utility Regulator determines the allowance to be recovered through the postalised transmission tariff; and
  - **Step 4:** - Monthly cost reporting, as necessary, to the Utility Regulator during project delivery phase.

### ***Innovation***

- 3.7 BGE (NI) were disappointed that the Utility Regulator had not recognised the potential benefits that innovation could deliver. The Utility Regulator agrees that innovation can deliver benefits for customers. However, BGE(NI) have yet to determine the projects and associated benefits that would be delivered and therefore we are not in a position to determine whether these would be of value to Northern Ireland consumers.

### ***ENTSOG Membership Fee***

- 3.8 BGE (NI) have asked us to consider including, as a pass through cost, the ENTGOG (European Network of Transmission System Operators – Gas) annual membership fee, which they did not include in their original submission. The annual fee would come to approximately £7,500 per annum.

- 3.9 The Utility Regulator has included an allowance for the annual membership fee which will be treated as cost pass through for this control period. Once the actual fee is observed over the period 2012-17 we will consider whether it is more appropriate to set a specific allowance to be included in controllable operating expenditure.
- 3.10 We expect that BGE (NI) and Premier Transmission Ltd to come forward with a joint proposal for Northern Ireland participation at ENTSOG which minimises duplication and regularly updates to the Northern Ireland gas industry on European developments.

## Final Decision

- 3.11 This table below sets out the Utility Regulator's determination for the annual allowance for uncontrollable operating expenditure. It should be noted that the following items, will be treated as pass through items with the final allowance being equal to actual expenditure;

- Rates;
- Licence Fees;
- Postalisation System Administrator Fee; and
- ENTSOG membership fee.

- 3.12 The exhaustive list of non-routine projects is set out below;

- Delivery of the Common Arrangements for Gas project; and
- Implementation of Regulation 715/2009 EC including the establishment of an entry exit regime and compliance with European network codes.

- 3.13 An allowance for non-routine developments will be determined when the scope of each project has been agreed with the Utility Regulator. As per the previous price control, this list is exhaustive. BGE (NI) will therefore be expected to bear the risk of costs associated with other non-routine projects as they arise, subject to licence conditions 2.2.1 (g) and 2.2.4 (i – j).

**Table 5 Determination - Uncontrollable Operating Expenditure, £'000 – April 2011 Prices**

Cost Item	UR Allowance					Total
	12/13	13/14	14/15	15/16	16/17	
Non routine development	-	-	-	-	-	-
Rates	425	432	440	464	487	2,248
UR Licence Fee	925	925	925	925	925	4,625
CER Licence Fee						
PSA Admin Fee			30			30
ENTSOG membership fee	8	8	8	8	8	40
<b>Total</b>	<b>1,358</b>	<b>1,365</b>	<b>1,403</b>	<b>1,397</b>	<b>1,420</b>	<b>6,943</b>

Source: Utility Regulator

## 4 EFFICIENCY FACTOR

- 4.1 Our Initial Proposals included an efficiency factor of 1.5% per annum applied on a compounded basis to total controllable operating expenditure, including any capital expenditure allowance which the Utility Regulator deemed to be more appropriately treated as operating expenditure.
- 4.2 In response BGE (NI) indicated that the capacity did not exist to achieve these efficiency gains. And that the use of the same efficiency factor as was applied by Ofgem in TPCR4 one year roll over was not supported by relevant data and was arbitrary.
- 4.3 As with any price control, the reason for the inclusion of an efficiency factor is to provide an incentive for BGE (NI) to continue to improve operational efficiency. This principal would apply whether or not the licence holder was at the efficiency frontier, the only difference would be the size of the efficiency factor. An efficiency factor of 1.5% is in line with our recent decisions on the Premier Transmission and Belfast Gas Transmission shadow price controls.

### Final Decision

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- 4.4 The Utility Regulator's final decision therefore is that an efficiency factor of 1.5% per annum will be applied on a compounded basis to total controllable operating expenditure, including any capital expenditure requests which the Utility Regulator deemed to be more appropriately treated as operating expenditure.



# 5 CAPITAL EXPENDITURE

## Summary of Initial Proposals

- 5.1 The table below sets out our Initial Proposals on capital expenditure allowances compared to the BGE (NI) request. We will consider each of these items in turn.

**Table 6 Initial Proposals - Capital Expenditure £'000 – April 2011 Prices**

<i>Cost Item</i>	<i>Total 2012/13 -2016/17</i>	
	<i>BGE Submission</i>	<i>UR Proposed Allowance</i>
Carrickfergus Automation	1,450	-
Carrickfergus C&I	326	-
Coolkeeragh Controls Update	700	-
Coolkeeragh C&I	165	-
AGI Security System	674	-
Transmission Marker Posts	600	-
Pipeline Remediation Works	300	-
Code Compliance (pipeline	500	-
Online Inspection NW Pipeline	588	411
Remote Activation of Line	100	-
C&I AGI Refurbishment	320	-
Cathodic Protection	180	61
IT	1,500	-
<b>Total</b>	<b>7,404</b>	<b>472</b>

Source: BGE (NI) and the Utility Regulator

## Responses and Discussion

### ***Carrickfergus Automation***

- 5.2 The stated purpose of this investment was to enhance operational flexibility by replacing the existing manual system for changing the direction of gas flows with an automated system. In our Initial Proposals we stated that as this investment was dependant on the outcome of the Common Arrangements for Gas project we did not propose to make an allowance in advance of these requirements being finalised. In their formal response, and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that this investment was required to improve security of supply, by facilitating the supply of gas to the Greater Belfast area via the South North pipeline, and to comply with the EC Security of Supply Directive 994. The Utility

Regulator has considered this response, and based on discussions with our engineering consultants, remains satisfied that a manual system offers the level of flexibility required for security of supply reasons. Indeed it is likely that any automated system might also include a manual system as back up.

### ***Carrickfergus Communication and Instrumentation Refurbishment***

- 5.3 The stated purpose of this investment was to replace aging and obsolete equipment and to facilitate automation of flow direction control. In our Initial Proposals we stated that as the detail of this investment was dependant on the outcome of the Common Arrangements for Gas project, we did not propose to make an allowance in advance of these requirements being finalised. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that this investment was required to ensure the ongoing reliability of the BGE (NI) network, irrespective of the Common Arrangements for Gas project. The Utility Regulator has considered this response and based on discussions with our engineering consultants remains satisfied that should BGE (NI) wish to make the investment on the basis of ongoing network reliability they should bring forward detailed proposals and justification for consideration by the Utility Regulator.

### ***Coolkeeragh Controls Upgrade***

- 5.4 The stated purpose of this investment was in response to changes in the method of operating the Northern Ireland transmission system as a result of the Common Arrangements for Gas project. In our Initial Proposals we stated that as the detail of this investment was dependant on the outcome of the Common Arrangements for Gas project we did not propose to make an allowance in advance of these requirements being finalised. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that this investment was required to ensure the ongoing reliability of the BGE (NI) network irrespective of the Common Arrangements for Gas project. The Utility Regulator notes that while BGE (NI) expressed concerns with regard to operations at Coolkeeragh and stated that dealing with these was a high priority, they failed to provide robust evidence to justify this investment. The Utility Regulator has considered this response and based on discussions with our engineering consultants remains satisfied that should BGE (NI) wish to make the investment on the basis of ongoing network reliability, they should bring forward detailed proposals and justification for consideration by the Utility Regulator.

### ***Coolkeeragh Communications and Instrumentation Upgrade***

- 5.5 The stated purpose of this investment was to replace aging and obsolete equipment. In our Initial Proposals we stated that as the detail of this investment was dependant on the outcome of the Common Arrangements for Gas project we did not propose to make an allowance in advance of these requirements being finalised. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that this investment was required to ensure the ongoing reliability of the BGE (NI) network irrespective of the Common Arrangements for Gas project. The Utility

Regulator notes that while BGE (NI) expressed concerns with regard to operations at Coolkeeragh and stated that dealing with these was a high priority, they failed to provide robust evidence to justify this investment. The Utility Regulator has considered this response and based on discussions with our engineering consultants remains satisfied that should BGE (NI) wish to make the investment on the basis of ongoing network reliability, they should bring forward detailed proposals and justification for consideration by the Utility Regulator.

### ***Above Ground Installations Security System***

- 5.6 The stated purpose of this investment was to modernise existing security arrangements and bring them up to best international practice standards. In our Initial Proposals we noted the absence of any requirement by the Centre for the Protection of National Infrastructure (CPNI) for this investment. In the absence of such a requirement we have not been convinced that the security installations, given their age, require the expenditure BGE (NI) have proposed. Should BGE (NI) wish to make the investment on the basis of increased security requirements, they should bring forward detailed proposals and justification for consideration by the Utility Regulator. It is however for BGE (NI) to decide the basis for this justification.

### ***Transmission Marker Posts***

- 5.7 The stated purpose of this investment was to ensure that the marker posts along the transmission systems met the requirements of the IGEM-TD1 standard. In our Initial Proposals we stated that as BGE (NI) should have ensured compliance with the standard at the time of pipeline construction, we did not propose to make an allowance for this investment. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that the provision of marker posts at the time of pipeline construction did meet the required standard, but that degradation and evolving policy, resulted in further investment was now required. The Utility Regulator has considered this response, and based on discussions with our engineering consultants, remains satisfied that BGE (NI) has failed to justify this investment. Should BGE (NI) wish to make the investment on the basis of increasing policy requirements, they should bring forward detailed proposals and justification for consideration by the Utility Regulator.

### ***Pipeline Remediation Works***

- 5.8 The stated purpose of this investment was to carry out remedial works on pipelines in flood plains which had been affected by recent extreme weather events. In our Initial Proposals we stated that should BGE (NI) be able to provide Northern Ireland specific evidence, we would give consideration to making an allowance for this activity. In their formal response, and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that no Northern Ireland specific information was available. The Utility Regulator has considered this response, and based on discussions with our engineering consultants, remains satisfied that BGE (NI) has failed to justify this investment.

### ***Code Compliance***

- 5.9 The stated purpose of this investment was to carry out remedial works on pipelines as a consequence of property developments close to the transmission pipeline. In our Initial Proposals we stated that should BGE (NI) be able to provide Northern Ireland specific evidence of previous expenditure, we would give consideration to making an allowance for this activity. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that no Northern Ireland specific information was available. The Utility Regulator has considered this response, and based on discussions with our engineering consultants, remains satisfied that BGE (NI) has failed to justify this investment.

### ***Online Inspection of the North West Pipeline***

- 5.10 The stated purpose of this investment was to carry out a planned inspection of the Northwest pipeline in 2016 in compliance with regulatory requirements as set out in IGEM-TD1. In our Initial Proposals we stated that while we agreed that this expenditure was necessary we did not believe that the level requested could be justified. In addition, we took the view that such expenditure would be more appropriately considered as being operational in nature rather than capital formation. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that the Utility Regulator had not properly justified the reductions to temporary filtration, cleaning and inspection. However no justification was provided in support of this statement. The Utility Regulator has considered this response, and based on discussions with our engineering consultants, remains satisfied that BGE (NI) has received a sufficient allowance to fund this activity. At the time the pipeline was commissioned, and at the time of first inspection in 2006, the pipeline would have been cleaned to remove dust and debris. In addition, regular cleaning of filters should prevent debris entering the pipeline. BGE (NI) has not suggested that this regular cleaning of filters indicates a problem of debris entering the pipeline. Taken together, this suggests that pipeline cleaning and filtering prior to inspection should not be a major cost driver and the allowances for these activities have been reduced by 40%.

### ***Remote Activation of Line Valves***

- 5.11 The stated purpose of this investment was to accommodate the remote activation of certain valves. In our Initial Proposals we stated that as BGE (NI) had failed to provide a robust justification for this investment, we did not propose to make an allowance. In particular, we could not ascertain any benefits to consumers of remote activation as opposed to the existing method. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) made no response to our draft proposals. The Utility Regulator, based on discussions with our engineering consultants, remains satisfied that BGE (NI) has failed to justify this investment.

### ***Above Ground Installation Refurbishment***

- 5.12 The stated purpose of this investment was to replace old and obsolete equipment, and in addition, upgrade to local SCADA and graphical interfaces. In our draft proposals we stated that as BGE (NI) had failed to provide a robust justification for this investment, we did not propose to make an allowance. In particular, we considered that the equipment considered for replacement would still be within its normal life at the end of the price control period. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that the investment was needed because of obsolescence not just age. The Utility Regulator has considered this response, and based on discussions with our engineering consultants, remains satisfied that BGE (NI) has failed to justify this investment.

### ***Cathodic Protection***

- 5.13 The stated purpose of this investment was to replace three 'ground beds' nearing the end of their lives as well as for general equipment refurbishment. In our Initial Proposals we stated that while we agreed that the general expenditure was necessary, we did not believe that replacement of the ground beds was justified. In addition, we took the view that such expenditure would be more appropriately considered as being operational in nature rather than capital formation. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that the ground beds would be at the end of its useful life during the price control period. The Utility Regulator has considered this response, and based on discussions with our engineering consultants, remains satisfied that BGE (NI) has received a sufficient allowance to fund this activity. In the case of ground beds, BGE (NI) has not identified those to be replaced. However, at the end of the price control period the oldest ground beds on the North West pipeline will have been in use 13 years. This is less than the 15 years identified by BGE (NI) in their relevant asset policy document as being the typical design life of ground beds.

### ***IT Capex***

- 5.14 The stated purpose of this investment was to contribute to general investment in IT infrastructure to deliver enhanced performance. In our Initial Proposals we stated that as BGE (NI) had failed to provide a robust justification for this investment, we did not propose to make an allowance. In particular, we were concerned that Northern Ireland consumers were being asked to fund enhanced performance with no obvious benefit to them being delivered. In their formal response and in subsequent meetings with both the Utility Regulator and our engineering consultants, BGE (NI) stated that in their view they had provided the necessary justification for this expenditure. And that much of this expenditure was for run mandatory replacement, to, for example replace software packages no longer supported, which was necessary to maintain the present level of service.
- 5.15 The Utility Regulator has considered BGE (NI)'s response, and based on discussions with our engineering consultants, remains satisfied that BGE (NI) should not receive a specific additional allowance for this activity over and above the shared services allowance. It is clear from correspondence between the Utility Regulator and BGE (NI) at

the time of the previous price control determination that IT capex would be funded as part of the shared services allowance. We do not propose to alter this position for the purposes of this price control.

### **Gate Approval Process**

- 5.16 BGE (NI) subsequently provided additional information regarding their capital expenditure process. This information explained that they have a 'five gate model' as part of the investment lifecycle. Gate one being 'approve progress to undertake conceptual design'. They argue that they cannot progress to gate two of the process 'approval to develop detailed costing and investment case' until they have received an allowance from the Utility Regulator.
- 5.17 In relation to BGE (NI)'s arguments about its 'gate process model', we cannot approve an allowance until BGE (NI) demonstrates that the investment proposals would benefit customers. This should not require detailed design plans and therefore we do not consider that their arguments about the gate process have any real bearing on our proposed decision.

## **Final Decision**

- 5.18 The table below sets out the Utility Regulator's determination for the annual allowance for capital expenditure, this has not changed from the Initial Proposals. As with the initial proposals, only two areas of expenditure will be allowed and these will be treated as operating expenditure.
- 5.19 For the other items of capital expenditure which BGE (NI) proposed, the Utility Regulator will consider an appropriate allowance for these items if BGE (NI) can demonstrate that the proposals would benefit customers.

**Table 7 Determination - Capital Expenditure £'000 – April 2011 Prices**

<b>Cost Item</b>	<b>UR Allowance</b>					<b>Total</b>
	<b>12/13</b>	<b>13/14</b>	<b>14/15</b>	<b>15/16</b>	<b>16/17</b>	
Online Inspection	-	-	-	411	-	<b>411</b>
Cathodic Protection	12	12	12	12	12	<b>60</b>
<b>Total</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>423</b>	<b>12</b>	<b>471</b>

Source: Utility Regulator

# 6 COST OF DEBT

## BGE (NI) Submission

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6.1 As part of the price control review process, BGE(NI) submitted a paper to the Utility Regulator on cost of debt. The main points raised by BGE (NI) in this paper are set out briefly below:

- Only the cost of debt is open for review. The cost of equity, gearing and 'gearing adjustment' are fixed for the lifetime of the licence;
- The cost of debt calculation is focused on the overall cost of debt, rather than built up by an estimate based on separate calculations for the risk-free rate and the debt premium. The reason for this is that there is such volatility in the data on the individual parameters as a result of the turmoil in financial markets;
- The allowed revenues are indexed using CPI rather than RPI, and therefore the allowed cost of debt needs to be adjusted to reflect the average difference between CPI and RPI. BGE(NI) estimates this difference at 1.1%;
- There is a risk premium for investing in Northern Ireland, rather than Great Britain. BGE (NI) estimates this effect at 1.5%, on the basis of a comparison between National Grid, SSE and NIE. This was then cross checked with the comparison between National Grid and Phoenix Natural Gas; and
- A summary of recent British regulatory decisions gives some form of average for the real cost of debt in Britain of 3.9%.

6.2 The BGE (NI) methodology for calculating the cost of debt involves taking their average for the real cost of debt in Britain of 3.9%, adding a Northern Ireland risk premium, and a CPI adjustment to give a real cost of debt for BGE of 6.5% (excluding the gearing adjustment). BGE (NI) then propose adding the gearing adjustment of 0.38% making their proposal for the real cost of BGE (NI) debt 6.88% (including the gearing adjustment). This compares to the real cost of debt allowed in 2007-12 of 3.71%.

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**Table 8 – Summary of BGE (NI) cost of debt request**

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<b>Component</b>	<b>BGE Submission</b>
Regulatory Precedent (GB)	3.90%
CPI Adjustment	1.10%
NI Premium	1.50%
Gearing Effect	0.38%
<b>Total</b>	<b>6.88%</b>

Source: BGE (NI)

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## Summary of Initial Proposals

- 6.3 The cost of capital which BGE (NI) receives is calculated from three basic elements: cost of debt, cost of equity and the gearing ratio between debt and equity. The BGE (NI) licence is unusual in that only the first of these, cost of debt, is specifically referred to as being reviewed at the time of the price control review. Therefore, for the purpose of this price control, the Utility Regulator proposed only to consider the cost of debt component of cost of capital.
- 6.4 Risk free rate - our consultation paper proposed that the risk free rate should be set at 2.0% for the price control. This represented a decrease of 0.5% from the previous price control period. As at the last review, the proposed rate is in excess of the prevailing UK Government bond yield but is in line with the practice of other UK utility regulators.
- 6.5 Debt premium - in our consultation paper we proposed that the debt premium should be set at 1.2% for the price control. This represented a decrease of 0.01% from the previous price control period. A range of possible debt premium levels was derived from other comparable utility bonds including the Ofgem iBOXX index, used in RIIO-T1 and GD1 price controls. While a debt premium level of 1.2% was at the higher end of this range it was felt that this level was in line with previous decisions.
- 6.6 The table below sets out our proposals for cost of debt for the BGE (UK) 2012 – 17 price control.

**Table 9 Initial Proposals – Cost of Debt**

<i>Component</i>	<i>2007 -12</i>	<i>UR Proposal 2012-</i>
Risk Free Rate	2.50%	2.00%
Debt Premium	1.21%	1.20%
<b>Total</b>	<b>3.71%</b>	<b>3.20%</b>

Source: Utility Regulator

## Responses and Discussion

- 6.7 Three non-confidential responses were received to this consultation. These were from ESB, the Consumer Council for Northern Ireland and Phoenix Natural Gas.

### ***Risk Free Rate***

- 6.8 Three responses were received on this issue. One respondent accepted that 2.00% was a reasonable estimation of the risk free rate given the unusual conditions in the sovereign debt market. The other considered that the Utility Regulator should not be generous but instead opt for the lowest rate of 1.75% applied by other regulators. Two of the three respondents also argued that the risk free rate should be adjusted to take account of the difference in the level of inflation as calculated by the CPI and RPI, which



has a negative impact on BGE (NI) revenues as a consequence of capital revenues being indexed to the former.

- 6.9 Regarding the risk free rate the Utility Regulator recognises that at this time it is difficult to estimate the risk free rate from the returns received on UK gilts. Although a lower risk free rate could be chosen, for example 1.75%, and still be regarded as being acceptable, we have taken the view that we should conform to the present consensus amongst UK regulators that a rate of 2.00% represents the fairest reflection of medium term risk free investments.
- 6.10 As regards the need for an adjustment to compensate BGE (NI) for the spread between the CPI and RPI, the Utility Regulator remains of the view, as at the 2007 price control, that Licence Condition 2.2 as accepted by BGE (NI), does not provide for any adjustment in this regard. However, should BGE (NI) wish to bring forward a modification to the terms in this Licence Condition, the Utility Regulator will give it due consideration in the light of our statutory duties.

### ***Debt Premium***

- 6.11 Two respondents made comments on the proposed level of the debt premium. One respondent was of the view that the range of applicable debt premiums within which the BGE (NI) debt premium should sit, is higher than indicated by the Utility Regulator and that this is as a result of applying a higher than appropriate estimate of inflation to the nominal returns on comparator bonds. However, the other respondent expressed the view that the appropriate debt premium would be at the lower end of the range given the lower level of risk experienced by BGE (NI) in comparison to network utilities in Great Britain.
- 6.12 Three respondents made extensive comment on the issue of whether or not there should be a Northern Ireland specific debt premium. The observed higher cost of debt on bonds issued by NIE and PNGL as compared to bonds issued by utilities in Great Britain, was cited by respondents as evidence that there was an observable Northern Ireland specific risk premium. One respondent went so far as to claim that this position had been supported by the Competition Commission in their provisional decision on the PNGL price control.
- 6.13 Two respondents commented on the application of the gearing effect term in the BGE (NI) licence, stating that it should be added to any estimated debt premium rather than being incorporated into the debt premium estimate through the use of 'BBB' rated bonds as comparators.
- 6.14 On the issue of a Northern Ireland specific risk premium, the Utility Regulator finds the evidence presented to be unconvincing. As previously stated, it is recognised that for the two companies quoted (NIE and PNGL) premiums are above the average for similar utilities in Great Britain. However, it does not seem credible based on two company specific examples to draw the conclusion that there is an economy wide systematic Northern Ireland specific risk premium. In particular, none of the respondents made any attempt to explain why such a premium might exist.

- 6.15 In relation to PNGL, the Competition Commission concluded that they could not identify the reason for the differential in bond yields as being due to the regulatory regime in Northern Ireland.<sup>3</sup> Moreover the Competition Commission stated:

*'we cannot rule out the possibility that the differential in yields is due to specific features of the PNGL bond which we cannot readily observe in the market data. For example, we have noted comments from market participants at the time of PNGL's debt issue which suggest that the market took into account unique features of PNGL in pricing the bond: 'There are no real direct comparables for Phoenix in terms of pricing. It carries a slight premium to the sector – and also this is potentially because of the ownership structure.'*

- 6.16 In relation to NIE, discussions with investors and credit ratings agencies highlight the importance of its ownership by the ESB, the state owned electricity company in the Republic of Ireland, and consequently how investors might view the credit outlook of ESB.
- 6.17 On the issue of determining an appropriate range within which the debt premium should fall and the treatment of the 0.38 gearing effect component, the Utility Regulator has carried out additional analysis in response to the feedback received from the consultation.
- 6.18 The analysis that follows is based on data taken from the iBOXX 10+ years Non Financials bond index used by Ofgem to set the cost of debt for both the RIIO-T1 and RIIO-GD1 price control periods commencing April 2013. This data can be downloaded from the Ofgem [website](#). Ofgem have chosen to use a ten-year trailing average of the yield on both 'A' and 'B' rated bonds to set the cost of debt allowance. As can be seen from the table below, the real cost of debt fell steadily between 2003 and 2006. This was followed by a pronounced spike in late 2008 and early 2009 as a consequence of the financial crisis. Since then however, debt costs have fallen back to a level below that which was observed prior to the financial crisis. Ofgem has noted that while the risk free rate is at historically low levels, the debt premium on A and B rated bonds have returned to pre-crisis levels.<sup>4</sup>

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<sup>3</sup> See paragraph 8.91 and 8.92 of the Competition Commission provisional determination for Phoenix Natural Gas Ltd.

<sup>4</sup> See paragraph 3.23 of Ofgem's Decision on Strategy for the next transmission and gas distribution controls – Financial Issues (March 2011).

**Table 10 – iBOXX Real Cost of Debt 2003-11**

<b>Year</b>	<b>Average</b>	<b>'A' Rated Bonds</b>	<b>'B' Rated Bonds</b>
2003	3.26%	3.02%	3.51%
2004	2.97%	2.76%	3.18%
2005	2.67%	2.48%	2.87%
2006	2.43%	2.28%	2.57%
2007	2.78%	2.66%	2.90%
2008	3.86%	3.35%	4.36%
2009	3.88%	3.24%	4.53%
2010	2.40%	2.25%	2.56%
2011	2.23%	2.13%	2.33%

Source: Ofgem

- 6.19 The BGE (NI) licence states that the risk free rate and market debt premium should be based on prevailing market rates. If we take prevailing to mean premiums as reassured over the previous 12 months and assuming a risk free rate of 2.0%, this would suggest setting the risk premium, based on 'B' rated bonds at 0.33%. Such an approach however would be inconsistent with that taken for setting the risk free rate and that followed for the 2007 price control where premiums over longer periods of up to five years were considered. In addition, it would seem inappropriate to follow a methodology which could lead to violent swings in the level of allowance from one price control to the next.
- 6.20 The table below sets out the trailing average of debt premium for both A and B rated bonds measured over a range of time periods, assuming a risk free rate of 2.0%.

**Table 11 – iBOXX Debt Premium Trailing Averages**

<b>Period to 31/12/11</b>	<b>Average</b>	<b>'A' Rated Bonds</b>	<b>'B' Rated Bonds</b>
1 year	0.23%	0.13%	0.33%
3 years	0.84%	0.54%	1.14%
5 years	1.03%	0.73%	1.34%
10 years	1.03%	0.77%	1.29%

Source: Ofgem

- 6.21 At the time of the 2007 price control, the level of gearing assumed in the BGE (NI) licence (72.5%) and the consequent gearing effect (0.38%) was taken account of by considering only those bonds with a B rating. The alternate methodology (which has been suggested by some respondents), would calculate the debt premium of a standard transmission utility and add the gearing effect of 0.38%. We believe A rated bonds, would be a good indication of a standard transmission utility and the table below sets out the results of applying these two alternate methodologies.

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**Table 12 – iBOXX Debt Premium with Alternate Treatment of Gearing Effect (0.38%)**

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<i>Period to 31/12/11</i>	<i>'A' Rated Bonds + Gearing Effect</i>	<i>'B' Rated Bonds</i>
1 year	0.51%	0.33%
3 years	0.92%	1.14%
5 years	1.11%	1.34%
10 years	1.15%	1.29%

Source: Ofgem

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- 6.22 The Utility Regulator believes that this analysis is more robust than that presented in the consultation paper. It provides an even larger database to assess and appropriate rate and sets out two methodologies for calculating the BGE (NI) debt premium. Indeed it could be argued that using an A rated bond and adding the gearing effect would give a lower figure than the initial proposal of 1.20%. However, on balance, we have determined to leave the figure for BGE (NI) debt premium at 1.20% which lies within the range set out in the table above.

## Final Decision

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- 6.23 The Utility Regulator's determination for the cost of debt is summarised in the table below.

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**Table 13 Determination – Cost of Debt**

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<i>Component</i>	<i>UR Proposal 2012-</i>
Risk Free Rate	2.00%
Debt Premium	1.20%
<b>Total</b>	<b>3.20%</b>

Source: Utility Regulator

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- 6.24 We have also noted BGE (NI) comments on the possibility of licence modifications in relation to the cost of capital licence conditions. We will consider the need for significant changes to the cost of capital licence conditions in the near future, taking on board whether the conditions which applied at the time the conditions were put in place still apply and BGE (NI) views.

# APPENDIX 1

## BGE (NI) Price Control Determination 2012 -17

### Controllable Operating + Capital Expenditure + Efficiency Factor & Uncontrollable Operating Expenditure

Controllable	UR Proposed Allowance					
	12/13	13/14	14/15	15/16	16/17	Total
<b>Maintenance</b>	<b>1,639</b>	<b>1,623</b>	<b>1,602</b>	<b>1,640</b>	<b>1,612</b>	<b>8,116</b>
Training	5	5	5	5	5	25
Safety Campaign	110	80	80	80	80	430
Admin & Utilities	108	108	108	108	108	540
Grid Control	248	249	250	250	251	1,248
Transportation Services	149	154	155	156	152	766
Consultancy/Legal	30	30	30	30	30	150
ALO & Agricultural Remedials	200	175	150	150	100	775
Insurance	195	195	195	195	195	975
<b>Shared services</b>	<b>268</b>	<b>268</b>	<b>268</b>	<b>268</b>	<b>268</b>	<b>1,340</b>
<b>Total excluding capex</b>	<b>2,952</b>	<b>2,887</b>	<b>2,843</b>	<b>2,882</b>	<b>2,801</b>	<b>14,365</b>
Capex Reclassified	12	12	12	423	12	471
<b>Total including capex</b>	<b>2,964</b>	<b>2,899</b>	<b>2,855</b>	<b>3,306</b>	<b>2,813</b>	<b>14,837</b>
Efficiency 1.5% factor		43	84	144	163	434
<b>Total including impact of</b>	<b>2,964</b>	<b>2,856</b>	<b>2,771</b>	<b>3,161</b>	<b>2,651</b>	<b>14,404</b>

Uncontrollable	UR Proposed Allowance					
	12/13	13/14	14/15	15/16	16/17	Total
Non routine development	-	-	-	-	-	-
Rates	425	432	440	464	487	2,248
UR Licence Fee	925	925	925	925	925	4,625
CER Licence Fee						
PSA Admin Fee			30			30
ENTSOG membership fee	8	8	8	8	8	40
<b>Total</b>	<b>1,358</b>	<b>1,365</b>	<b>1,403</b>	<b>1397</b>	<b>1420</b>	<b>6,943</b>

Source: Utility Regulator