

**BGE (NI) Ltd
Price Control Review
2012/2013 - 2016/2017**

**Consultation on Process,
Timetable and Approach to
the Review**

14 December 2011

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1. Introduction

- 1.1 This document outlines the Utility Regulator's process, timetable, and approach to the BGE (NI) Price Control, beginning 1st October 2012. This is the first consultation paper on the Price Control 2012–2017. Further work will continue on the components of the price control during the remainder of 2011 and into 2012 and these will also be consulted on in due course.
- 1.2 The Utility Regulator has been in discussions with BGE (NI) regarding their 2012-2017 Price Control with the three primary aims being:
- (i). To set the BGE (NI) Allowed Operating Expenditure for gas year 2012/13 and the following four gas years;
 - (ii). Review BGE (NI)'s proposals on capital expenditure for gas year 2012/2013 and the following four gas years; and
 - (iii). To set the BGE (NI) Weighted Average Cost of Capital going forward for five years from 1st October 2012.
- 1.3 This consultation paper contains a number of specific questions which we invite stakeholders to express a view on. However, respondents are welcome to express views on any related matter which they feel is appropriate. Responses should be received by **5.00 pm on Wednesday 8th February 2012** and should be addressed to:
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E-mail: linda.beirne@uregni.gov.uk
- 1.4 Our preference would be for responses to be submitted by e-mail.
- 1.5 Individual respondents may ask for their responses in whole or in part, not to be published, or that their identity should be withheld from public disclosure. Where either of these is the case, we will ask respondents to also supply us with the redacted version of the response that can be published.
- 1.6 As a public body and non-ministerial government department, we are bound by the Freedom of Information Act (FOIA) which came into full force and effect on 1 January 2005. According to the remit of FOIA, it is possible that certain recorded information contained in consultation responses can be put into the public domain. Hence it is now possible that all responses made to consultations will be discoverable under FOIA – even if respondents ask us to treat responses as confidential. It is therefore important that respondents note these developments and in particular, when marking responses as confidential or asking to treat responses as confidential, should specify why they consider the information in question to be confidential.
- 1.7 This paper is available in alternative formats such as audio, Braille etc. If an alternative format is required, please contact the office and we will be happy to assist.

2. Process and Timetable

2.1 The table below sets out our proposed timetable and process for putting in place the price control to commence on 1 October 2012.

| Activity | Date |
|---|---|
| Process, timetable and approach – Public Consultation | 14 th December 2011 to 8 th February 2012 |
| Price Control Proposals – Public Consultation | End of March 2012 to End May 2012 |
| Price Control – Determination | Early July 2012 |
| Licence Modification – Public Consultation | July 2012 |
| Licence Modification – Determination | Early September 2012 |
| Price Control – Operational | 1 st October 2012 |

Question 1:

Do respondents have any comments on the process and timetable as set out in the above table?

3. Duration

- 3.1 Historically, the BGE (NI) price control has been set for five years as this duration was necessary for a transmission business to fully plan ahead its expenditure profile and to provide sufficient opportunity to deliver efficiency gains. A longer duration, say seven years may be appropriate for transmission due to limited uncertainty around development of the pipeline network. The Utility Regulator's initial expectation is that five years remains an appropriate duration for the price control.

Question 2:

Do respondents have views on whether five years is an appropriate duration for the price control?

4. BGE (NI) Operating Expenditure

- 4.1 One requirement of the BGE (NI) price control will be to set an appropriate level of operating costs that BGE (NI) will be allowed to recover in gas year 2012/13 and the following four gas years. Once set, BGE (NI) will then have an incentive to create efficiencies in operating the North West Pipeline, South North Pipeline and associated Spurs.
- 4.2 In August 2011 BGE (NI) submitted, as required by their licence, an estimate of their annual operating expenditure for the gas years 12/13 and subsequent four years. In November 2011 they updated their opex submission with two additional items. A summary of the information submitted by BGE (NI) is presented below.

Approach

- 4.3 Our primary objective is to ensure that costs are incurred as efficiently as possible. The Utility Regulator therefore will be taking the following approach in setting an appropriate level of allowed operating expenditure for BGE (NI) for gas year 2012/13 and the following four gas years:
- (i). we have commissioned engineering consultants, PB Power, to give advice and make comment on the engineering aspects of the BGE (NI) operating expenditure submissions;
 - (ii). where appropriate the benchmarking of BGE (NI) operating expenditure costs against the operating expenditure of other energy/utility companies;
 - (iii). the use of actual operating expenditure costs incurred by BGE (NI) between 2004 and 2010 as a benchmark for operating expenditure costs going forward;
 - (iv). the consideration of a level of efficiency that we feel is achievable in the business over the five years of the price control; and
 - (v). all submissions will be analysed on a line by line basis to ensure a detailed analysis of the operating expenditure costs.
- 4.4 We will also examine whether a rolling mechanism would be appropriate for specific cost lines, whereby, for those cost lines, the actual controllable Opex in each year of the current price control period is rolled forward with RPI indexation to become the controllable Opex allowance for the corresponding year in the next period.
- 4.5 Operating expenditure is divided between controllable expenditure and uncontrollable expenditure.

Controllable Operating Expenditure

- 4.6 Controllable opex are those operating costs which BGE (NI) are deemed to be able to control. Currently, the main costs deemed to be controllable are:
- Maintenance Charges
 - Admin and Utilities
 - Vendor Maintenance Contracts
 - Grid Control

- Transportation Services
- Consultancy/Legal
- ALO & Agricultural Remedials
- Insurance
- Shared Services

Uncontrollable Operating Expenditure

4.7 Certain BGE (NI) operating expenditure costs will be defined as uncontrollable as per condition 2.2.4 of the licence. Uncontrollable opex are those costs which fall within the operating expenditure category, but over which the actions of which the regulated company have been deemed to have little or no impact. For this reason such opex is treated as a pass through cost and is not subject to normal price control mechanisms. We are currently reviewing the appropriate items to be treated as uncontrollable. Currently, the following costs are classed as uncontrollable opex:

- Rates;
- Utility Regulator Licence fees; and
- Postalisation System Administrator (PSA) fees.

4.8 Rates are the annual business property rates paid by BGE (NI). Licence fees are an annual payment made by BGE (NI) to the Utility Regulator.

4.9 Although we will use the best estimate for uncontrollable costs, the Utility Regulator accepts that there will be a difference between this estimate and the actual cost.

Summary of BGE (NI)'s operating expenditure submission

4.10 The Utility Regulator is currently analysing an appropriate level of operating costs that BGE (NI) should be allowed to recover in 2012/13 and the following four gas years.

4.11 Table 1 below shows BGE (NI)'s initial proposals for their forecast annual operating expenditure for gas year 2012/13 and the following four years. More detail of the build-up of many of the individual cost lines was also provided by BGE (NI).

4.12 Table 2 below shows BGE (NI)'s actual costs for the periods 2007/08, 2008/09 and 2009/10 uplifted to April 2011 monies. Note the actual costs for 10/11 are not available as yet – under the licence they are required to be submitted on the 1st April 2012. We will take into consideration the 10/11 actual costs when they are submitted.

4.13 BGE (NI)'s opex submission indicated that BGE has undergone internal restructuring and consequently a number of costs have been re-categorised. This makes detailed comparison between actual costs and forecast costs difficult for some cost lines.

Table 1 – Operating Expenditure Submission, £'000

| Cost Item | 2012/2013 | 2013/2014 | 2014/2015 | 2015/2016 | 2016/2017 |
|---|------------------|------------------|------------------|------------------|------------------|
| Maintenance | 1,691 | 1,675 | 1,654 | 1,692 | 1,664 |
| Training | 5 | 5 | 5 | 5 | 5 |
| Safety Campaign | 138 | 108 | 108 | 108 | 108 |
| Admin & Utilities | 108 | 108 | 108 | 108 | 108 |
| Grid Control | 248 | 249 | 250 | 250 | 251 |
| Asset Management | 64 | 64 | 64 | 65 | 65 |
| Detailed Design | 25 | 25 | 25 | 25 | 25 |
| Scheduling & Dispatch | 60 | 61 | 62 | 63 | 64 |
| HSQE | 5 | 5 | 5 | 5 | 5 |
| Wayleaves | 13 | 14 | 15 | 16 | 16 |
| Transportation Services | 300 | 302 | 305 | 306 | 302 |
| Consultancy/Legal | 20 | 20 | 20 | 20 | 20 |
| ALO & Agricultural Remedials | 200 | 175 | 150 | 150 | 100 |
| Insurance | 262 | 262 | 288 | 288 | 288 |
| IT | 223 | 257 | 306 | 322 | 301 |
| Secretariat | 105 | 103 | 102 | 102 | 103 |
| Finance | 129 | 131 | 133 | 134 | 135 |
| HR | 48 | 48 | 49 | 49 | 49 |
| Facilities | 111 | 112 | 112 | 111 | 113 |
| Group recharge | 104 | 104 | 104 | 104 | 104 |
| Total Direct | 3,860 | 3,828 | 3,864 | 3,923 | 3,826 |
| Uncontrollable Opex - Projects | 6,251* | TBC | TBC | TBC | TBC |
| Non Routine Development | TBC | TBC | TBC | TBC | TBC |
| Innovations | 80 | 80 | 80 | 80 | 80 |
| Other Pass Through Costs | | | | | |
| Rates | 425 | 432 | 440 | 464 | 487 |
| UR Licence Fee | 390 | 390 | 390 | 390 | 390 |
| CER Licence Fee | TBC | TBC | TBC | TBC | TBC |
| PSA Admin Fees | - | - | 30 | - | - |
| Total Pass Through Costs | 7,146 | 902 | 940 | 934 | 957 |
| INTERIM OPEX TOTAL* | 11,005 | 4,730 | 4,804 | 4,857 | 4,783 |
| *Costs relating to CAG, Project 3, NRD, and CER licence fee to be confirmed | | | | | |

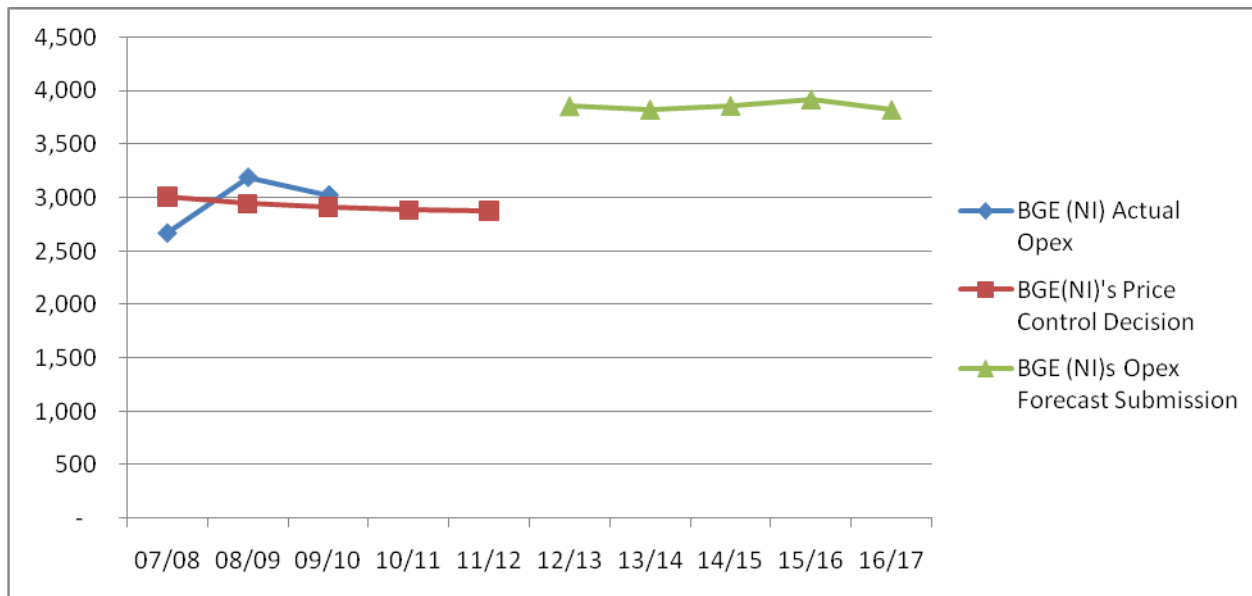
Source: BGE (NI)

Table 2 – Operating Expenditure Actual Costs, £'000

| Cost Item | 2007/2008 | 2008/09 | 2009/10 |
|--------------------------------|------------------|----------------|----------------|
| Maintenance | 1,271 | 1,388 | 1,353 |
| Training | 11 | -3 | - |
| Safety Campaign | 11 | 13 | 42 |
| Admin & Utilities | 120 | 89 | 133 |
| Security | 48 | 57 | 58 |
| 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 |
| Total Controllable Opex | 2,673 | 3,192 | 3,029 |

Source: UR

4.14 Graph 1 below shows BGE (NI)'s allowed opex (for years 07/08 to 11/12) and BGE (NI)'s actual opex (for years 07/08 to 09/10) against their forecast opex. As above the actual for 10/11 are not available as yet.

Graph 1 – Total Controllable Operating Expenditure, Decision and Actual V Forecast, £'000


Source: UR

Question 3:

Have respondents any views on our approach to setting the operating expenditure?

Question 4:

Have respondents any views as to whether the scope of the controllable/uncontrollable opex is appropriate?

5. Capital Expenditure

- 5.1 As part of their submission on the price control, BGE (NI) have also proposed a number of projects, to be undertaken during the price control period, which they believe would incur capital expenditure. The price control review will therefore determine, in accordance with condition 2.2.2 of the licence, the efficient level of capex expenditure (if any) in relation to these that BGE (NI) may incur during the control period.

Approach

- 5.2 The Utility Regulator will be taking the following approach to examining BGE(NI)'s proposals on capital expenditure for gas year 2012/13 and the following four gas years:
- (i). We have commissioned engineering consultants, PB Power, to give advice and to allow expert examination of the capital proposals for BGE (NI) for the gas year 2012/13 and the following four gas years ;
 - (ii). We will review the capital expenditure forecasted by BGE (NI) and determine if all the proposed expenditure is capex;
 - (iii). We will consider the impact of the proposed capital expenditure on the level of operating expenditure, whether the capex will result in benefits and or is necessary for other reasons, e.g. to meet international standards or for safety reasons;
 - (iv). We will consider the phasing of the capex and determine if all capex projects should be done during the lifetime of the price control; and
 - (v). We will consider whether or not the capital expenditure, if deemed necessary, is being efficiently incurred.

5.3 Table 3 below sets out a summary of the overall capex allowance requested by BGE (NI). The total capital expenditure requested by BGE (NI) for the five year is £7,404,000. More detail of the build-up of many of the individual cost lines was also provided by BGE (NI).

Table 3 – Capital Expenditure Submission, £'000

| Cost Item | 2012/2013 | 2013/2014 | 2014/2015 | 2015/2016 | 2016/2017 |
|-----------------------------------|------------------|------------------|------------------|------------------|------------------|
| Carrickfergus Automation | | 250 | 750 | 450 | |
| Carrickfergus C&I Refurbishment | 163 | 163 | | | |
| Coolkeeragh Controls Update | 200 | 200 | 300 | | |
| Coolkeeragh C&I refurbishment | | 165 | | | |
| AGI Security System Upgrades | 185 | 185 | 175 | 65 | 65 |
| Transmission Marker Posts | 450 | 150 | | | |
| Pipeline Remediation Works | 100 | 200 | | | |
| Code Compliance | 100 | 100 | 100 | 100 | 100 |
| Online Inspection NW Pipeline | | | | 588 | |
| Remote Activation of Line Valves | | | 50 | 50 | |
| C&I AGI Refurbishment | 64 | 64 | 64 | 64 | 64 |
| Cathodic Protection | 36 | 36 | 36 | 36 | 36 |
| | | | | | |
| Total Proposed Works Costs | 1,298 | 1,513 | 1,475 | 1,353 | 265 |
| CAG Phase 1 | TBC | TBC | TBC | TBC | TBC |
| CAG Phase 2 | TBC | TBC | TBC | TBC | TBC |
| Project 3 | TBC | TBC | TBC | TBC | TBC |
| IT | 300 | 300 | 300 | 300 | 300 |
| Interim Capex Total* | 1,598 | 1,813 | 1,775 | 1,653 | 565 |

Source: BGE (NI)

Question 5:

Have respondents any views on our approach to setting the Capital Expenditure?

6. Cost of Capital

- 6.1 Our principal objective in carrying out our gas functions is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland, and to do so consistently with our fulfilment of the objectives set out at Article 40 of the Gas Directive.
- 6.2 In fulfilling our functions, we must act in the manner that we consider best calculated to further this objective, and have regard to a number of matters set out more fully at Article 14 of the Energy (Northern Ireland) Order 2003. In light of this, we will need to consider the appropriate Rate of Return for the business.
- 6.3 In September 2011 BGE (NI) provided the Utility Regulator with a submission on the appropriate cost of debt for the control period to commence on 1 October 2012. This submission will form part of our wider considerations on Rate of Return.

Question 6:

Do respondents have any views on what factors we should consider when reviewing the appropriate Rate of Return?

7. Financeability

- 7.1 In carrying out our gas functions, we are required to further the principal objective in relation to gas whilst also having regard to the financial health of the companies we regulate. Therefore any decisions we make in our price control reviews should not compromise the ability of a regulated company to finance its licensed activities.
- 7.2 We further recognise that maintaining financeability is also in the consumer interest (as consumers are exposed to the resulting cost of capital), and therefore take the issue seriously. As part of this price control review therefore, we are carefully considering how our draft proposals impact on the financeability of BGE (NI).

APPENDIX 1

Summary of Questions

Question 1:

Do respondents have any comments on the process and timetable as set out in the above table?

Question 2:

Do respondents have views on whether five years is an appropriate duration for the price control?

Question 3:

Have respondents any views on our approach to setting the Operating Expenditure?

Question 4:

Have respondents any views as to whether the scope of the controllable/uncontrollable opex is appropriate??

Question 5:

Have respondents any views on our approach to setting the Capital Expenditure?

Question 6:

Do respondents have any views on what factors we should consider when reviewing the appropriate Rate of Return?