

Northern Ireland's Electricity's  
Transmission System Operator Business

Decision Paper

Price Control Decisions issued by the Director General of Electricity  
Supply (NI)  
for the period April 2002 – March 2005

October 2002

## **Chapter 1**

### **Introduction**

Ofreg issued an initial consultation paper in February 2002 in relation to price control proposals for the System Operator Northern Ireland (SONI Ltd.). A limited number of responses were received in relation to the initial proposals. Therefore in order to progress the price control decisions a number of meetings were held between Ofreg, NIE and SONI Ltd.

The initial price control proposals suggested by Ofreg were in essence acceptable to NIE and SONI. The main discussion points centred on unforeseen or unquantifiable costs which SONI may incur as a result of future market developments. SONI may incur additional costs as a result of, for example further market opening, a single all-island market or the divestment of SONI from the Viridian Group. These are discussed further in Chapter 2.

Ofreg feels that the decisions presented below adequately fund the TSO and allows it the necessary revenue to meet its costs and assume its increased responsibilities.

### **Background**

SONI is a separate business under NIE's combined Transmission and Public Electricity Supply Licences. The legal separation of SONI from NIE was initiated in order to fulfil the requirements of the European Union Directive on the Internal Market in Electricity (IME), which came into force in Northern Ireland in February 1999. The Directive required, amongst other things, that the transmission system should be separate at least in management terms from generation and supply.

The TSO own cost allowance for the period up to 31 March 2002 was set as a fixed amount. The revenue allowance was set at £5.95 million (2000/01 prices). This nominal amount is increased annually by inflation (RPI) less 0.5%. This revenue is recovered as part of the charge under the System Support Services (SSS) levy. SSS charges are recovered across all customers in the Northern Ireland market. The previous TSO price control is as laid out in Schedule 5B of NIE's combined Transmission and Public Electricity Supply Licences.

SONI has to date made significant contributions to the introduction of the IME Directive. Market opening, and other market changes, have required SONI to implement various changes to operational procedures, modify existing support systems, introduce new systems and to generally facilitate trading settlement arrangements. These additional roles/functions have been managed in a cost-effective way.

Ofreg has undertaken an initial consultation entitled "An Independent Transmission System Operator for Northern Ireland". The results of this consultation have been discussed with NIE, SONI and DETI. The next step in the process for the establishment of an independent transmission system operator will be taken forward by DETI. DETI will develop their ideas in terms of how they would like to see the

transmission system operator owned, sold etc. as it will be the ultimate decision maker and provider of appropriate legislative direction.

Ofreg is currently consulting on payments for generation capacity margin for Northern Ireland. This consultation paper discusses an additional role for SONI i.e. the management of a Generation Security Standard for Northern Ireland, including the production of a statement for future generation capacity. Ofreg and SONI have agreed that these obligations should be re-instated as part of the TSO licence section and will be a core duty of SONI.

SONI is also currently involved in an-island dispatch study. This is being carried out jointly with ESB National Grid and it aims to give an indication of variable production cost savings achievable using an all-island dispatch, volume and timing of unrestricted energy transfers and sources of cost savings by plant type.

## Chapter 2

### The Next Regulatory Period

#### Duration of the Price Control

This price control will be for a period of three years with the provision that the DGES may shorten the duration to two years dependent on future market circumstances. Therefore this price control will cover the period April 2002 – March 2005.

#### TSO Revenues

Over the price control period April 2002 – March 2005 the DGES proposes that there be no radical change to the funding of the TSO business. The revenue levels as set in 2000 when the TSO was split from PPB, should be carried forward for the next three-year period (based on 2000 prices).

The TSO price control revenues will be set as fixed (indexed) amounts in each year. The short duration of the control does not lend itself to a RPI-X incentive mechanism. This effectively removes the link between revenue and the asset base of the TSO business for the new price control period. However the implicit link between assets and revenue was established when the revenue levels were set in the 2000 split from PPB will be preserved for the purpose of the subsequent price control commencing in April 2005, and/or for the purpose of any disposal of the TSO business.

#### TSO Costs

The DGES acknowledges that over the duration of this price control the TSO costs are likely to rise rather than fall. This is essentially due to costs associated with: (1) further market opening, (2) the potential implications of an all-island electricity market and (3) the future divestment of the TSO. Thus SONI will experience considerable changes to its workload and responsibilities.

The current level of revenue to be applied is likely to be unrepresentative of SONI's future cost base. There is a high degree of uncertainty surrounding the level of resources which may be required to effect the above changes. However SONI has developed a considerable body of knowledge regarding the categories of expenditure required. Therefore SONI has supplied Ofreg with broad cost estimates for expenditures relating to the above three categories. SONI has provided Ofreg with a cost estimate of £3 million for the new price control period as a basis from which to proceed. Any claims for additional expenditure will be submitted to the DGES for prior approval.

The DGES accepts in principle that provision should be made for the recovery of legitimate additional costs. SONI will be required to present such claims for additional cost recovery/expenditure for approval from the DGES before any action is undertaken. Such additional costs would be recoverable via the  $D_{TSO_t}$  term.

### TSO Incentives

The initial price control proposals issued in February 2002 discussed performance incentives. Examples of potential incentive areas include:

- Management of system costs where the TSO could retain a proportion of the system benefits that accrue
- Trading of ancillary services between the TSOs
- Incentives to minimise generation costs
- Incentives to minimise transmission capex

However the nature of any appropriate incentives will depend on the future ownership structure of the TSO. Therefore this price control does not include any specific incentives but further work will be carried out in examining future possibilities.

### Price Control Formula

The price control formula for the period April 2002 – March 2005 will take the following form:

$$M_{TSO_t} = A_{TSO_t} + B_{TSO_t} + D_{TSO_t} + K_{TSO_t}$$

The  $A_{TSO_t}$  term will remain unchanged from the existing control.

Under the proposed control  $B_{TSO_t}$  would be modified such that it becomes:

$$B_{TSO_t} = B_{TSO_{t-1}} \times (1 + RPI_t / 100)$$

Where  $B_{TSO_{t-1}} = £6.02$  million in the relevant year commencing 1 April 2001. This would be uplifted by inflation to set the opening allowance for the first year of the interim control.

$D_{TSO_t}$  will be adjusted in order to allow for the recovery of legitimate additional costs related to either further market opening, the potential implications of an all-island market and/or the future divestment of the TSO. Claims for this additional expenditure will be submitted to the DGES for prior approval.

$K_{TSO_t}$  remains unchanged

### Conclusion

The proposals outlined above allow the TSO to operate on effectively the same terms as at present. However they also acknowledge that TSO costs are likely to rise rather than fall. Therefore provision has been made under the  $D_t$  term to allow for the uncertainty surrounding the level of resources required for future market changes. In the past SONI has managed additional functions in a cost-effective way and I see no reason why this will not be the case in the future.