

GD23 Draft Determination

NIE Networks' Response to the UR's Consultation Paper of 9 March 2022

26 May 2022

INTRODUCTION

NIE Networks welcomes the opportunity to respond to the Utility Regulator's (UR) draft determination (DD) on GD23. Our comments are as follows.

GENERAL COMMENTS

NIE Networks is of the opinion that the gas industry has an important role to play in the energy transition and journey towards net zero in Northern Ireland. In this context we consider it very important that sufficient allowances are made available to the GDNs, either on an ex-ante basis or through the use of appropriately designed uncertainty mechanisms and/or incentives which can unlock additional allowances at a later stage. The GDNs will also require a fair and reasonable return to be achievable from their investments, to ensure they can engage proactively in the energy transition.

However, the UR's DD appears to offer the GDNs very limited opportunity to secure satisfactory outcomes in this regard. The GD23 DD offers limited ex-ante allowances, and limited uncertainty and incentive mechanisms; instead the UR is relying to a greater extent on ex-ante business planning with sharing rates as a key mechanism for managing uncertainty, and incentivising innovation. We consider that such a regime creates uncertainty (or at best delays when certainty is obtained) regarding allowed levels of capex, which is likely to result in under-investment and/or missed opportunities to invest optimally for future net zero pathways.

This is a cause for concern as it will not allow the GDNs to participate fully in required trials and collaborations to deliver 'whole system' solutions.

By way of comparison, to date Ofgem's RIIO-2 determinations have offered a suite of uncertainty and incentive mechanisms that are absent from GD23 and which could otherwise facilitate the energy transition. For example, in Ofgem's RIIO-2 approach it offers –

- appropriately designed uncertainty mechanisms;
- various substantive innovation funds;
- financial incentives for high-quality ambitious business plans including net zero ambitions;
- allowances for anticipatory investments, bespoke outputs and 'customer value propositions' where there is a probabilistic net benefit to consumers.

In this context, we would encourage the UR to re-consider the totality of its GD23 package, lest an opportunity be missed to enable the full and meaningful involvement of the gas industry to contribute towards NI's net zero ambitions.

SPECIFIC COMMENTS

Frontier shift – approach to Real Price Effects (RPEs)

At Annex E the UR sets out its approach to determining allowances which account for frontier shift. We note that the UR is proposing to retain the approach it has used in previous price controls of determining fixed ex-ante allowances as part of the determination.

However, the UR may be aware that Ofgem has made a significant change to its approach to RPEs in RIIO-2, whereby instead of granting fixed ex-ante allowances, RPE allowances are now indexed and subject to an ex-post ‘true-up’ adjustment. We consider Ofgem’s approach is more appropriate in the current context of mounting supply chain pressures and uncertainties, and the unpredictable and high levels of inflation.

Treatment of business rates

We note that the UR has granted an ex-ante allowance for ‘Network Rates’ (the equivalent of business rates for NIE Networks) but that the allowance will eventually be updated through the GD23 uncertainty mechanism to reflect actual costs. We agree with this approach as companies have limited ability to influence the level of these costs i.e. they are essentially uncontrollable. We would welcome a similar approach being adopted for business rates at RP7.

Cost of capital and financeability

We note that the UR’s proposals for the WACC for GD23 assume the GDNs in NI have a lower asset beta than their counterparts in GB. Some justification for this assumption is provided by the UR’s consultants First Economics at Annex I; but ultimately the UR’s proposed decision rests on a subjective judgement call, and in this instance the UR has chosen to ‘aim down’.

NIE Networks is of the view that if/when making comparisons to GB on such cost of capital parameters, the appropriate ones to adopt for NI should be no lower than GB in the first instance. In fact, there is justification to support the case that they should be higher to reflect the smaller market and the more limited understanding by investors of the particulars of the regulatory arrangements in NI.

With regards to financeability, we are concerned with the thrust of the approach taken by UR. Our observation is that in the DD the UR appears to be ignoring or dismissing evidence of problems with financeability for the GDNs. The UR’s suggestion that financeability problems are matters for the companies to resolve is at odds with established regulatory practice.

We would caution against the UR’s ‘aiming down’ approach in respect of the WACC, and also the lack of appropriate importance placed by the UR on its duty to ensure regulated companies remain financeable. Ultimately this could end up harming consumers in the medium- to long-term if in adopting such approaches the UR weakens the perceived regulatory compact, leading to a higher financing costs in future.