The Utility Regulator's RP7 Price Control 2025-2031 Draft Determination

Consultation response from

Consumer Council for Northern Ireland

22 March 2024

Contents

Executive summary

We welcome the opportunity to respond to the RP7 Draft Determination published by the Utility Regulator (UR) and the engagement with the UR and NIE Networks that helped inform this response.

The Draft Determination highlights the essential role that NIE Networks will play in facilitating the delivery of Net Zero and takes some positive steps to enable NIE Networks to play this role, while protecting consumers.

The Draft Determination envisages notable cost increases for RP7: a 58% increase in totex from RP6, with an overall RP7 totex allowance of £2.21 billion, including £1.35bn capex. Compared to the final year of RP6 (which is already an uplift from previous years in RP6), this is a 24% increase in average annual distribution expenditure and a 73% increase in average annual transmission expenditure.[1] The magnitude of this cost increase reflects the step change required in network capacity and operation. However, the scale of the increase also underlines the necessity to ensure these costs are appropriately scrutinised, service standards increase, and consumers are appropriately protected.

Despite this large cost increase, the UR forecasts that domestic customers will see a 2% drop in tariffs by the end of RP7 (assuming stable consumption). Larger customers face large bill increases, up to 19% for large energy users. We understand this difference in bill increases per customer group is due to the methodology for allocating revenues to tariff (which is different for transmission and distribution).

[1] These figures do not include additional allowances which may be provided under uncertainty mechanisms.

We have identified areas where we think the Draft Determination could have provided more evidence to justify the costs proposed and where we consider the UR might have additional opportunities to protect consumers:

- **The UR should go further in scrutinising NIE Networks' business plan, particularly to justify the proposed cost increases**. The Draft Determination provides generous cost allowances, with a 58% increase in totex compared to RP6. This stands in contrast with the approach adopted by Ofgem during the last electricity network price control – Ofgem allowed a 17% increase in average annual totex across all Great Britain (GB) distribution companies compared to the previous price control (RIIO-ED1), even though these companies face very similar pressures to NIE Networks. We would have welcomed further evidence from both NIE Networks and the UR to justify the level of anticipated costs and to provide greater confidence that the UR applied appropriate scrutiny. In this context, we observe that the UR itself noted that *"further information would be required to justify the proposed services, with more reason for the proposed increases in expenditure and importantly, what value it will all generate for consumers"*.[2]
- **We would like to see a greater focus on quality of service**: We are concerned the Draft Determination does not sufficiently incentivise NIE Networks to deliver a good service to consumers. For example:
    - Although the UR proposes to rely on a wider range of consumer measures, we note that many measures do not have a target. Where the measures do have targets, we are not convinced they are stretching enough. We make proposals below as to how these can be enhanced.
    - The UR could do more to incentivise NIE Networks to develop its support to vulnerable consumers. We make concrete proposals below to introduce new measures, building on those in place for NI Water.

[2] RP7 Draft Determination, Annex T - Business Plan Assessment Utility Regulator, Nov 2023, p.1

    - The proposal to reduce the weight of planned interruptions from the network reliability incentive, reduces incentives on NIE Networks to minimise the impact associated with the delivery of its capital investment programme.
    - We disagree with the UR rejection of NIE Networks' request for an allowance to reduce the number of worst served customers by 50% and ask that measures to address worst served customers are reinstated.
- **There appears to be some ways in which the cost of capital analysis could be improved in line with best practice***.* First, we note the importance of using the most recent data available in the Final Determination, particularly to capture recent volatility in the yield of index-linked gilts and the most recent information on inflation. Second, in line with now standard regulatory practice, we encourage the UR to use only index-linked gilts as a proxy for the risk-free-rate. Third, we suggest that the asset beta may have been over-estimated due to the impact Covid-19 had on companies' beta during 2020 and 2022. The CMA has recently "weighted down" the impact of Covid-19 on beta. We encourage the UR to confirm it has made a similar adjustment and present the results of its analysis in its Final Determination.
- **The Draft Determination misses the opportunities offered by flexibility**. Flexibility is key to delivering the Net Zero transition at the lowest cost. We support the adoption of a "flexibility-first approach" by NIE Networks, and we recognise that significant work is required to make this a reality. We think the UR could do more to encourage the development of flexibility markets. NIE Networks should be funded and incentivised to develop flexibility markets and to consider flexibility as an alternative to reinforcement.
- **It is unclear whether the current design of the Evaluative Performance Framework is in line with the UR's intentions**:
    - While we support the introduction of financial incentives to encourage NIE Networks to improve service, we note that the outcome of the incentive will depend on the assessment of a panel. The UR stated the panel should be independent but also proposed its members would be appointed by NIE Networks itself. In our view, there is a conflict between these two proposals -

panel members will owe their appointment to NIE Networks. It also breaks with standard regulatory practice.

  - The current grading system presented by the UR means the overall score NIE Networks would obtain will be an average of the grade of its forecast plan and its actual delivery. We think greater weight should be given to actual delivery to avoid a situation where NIE Networks would earn a reward by presenting an ambitious forward plan that it does not deliver.

- NIE Networks' development of an Environmental Action Plan (EAP) is a positive move, particularly given the importance of environmental protection and carbon emissions reduction to consumers. **We would support the introduction of an Annual Environmental Report for NIE Networks to report progress made against its EAP commitments**. This is in line with the approach in RIIO-ED2.
- **Stakeholders and customers would benefit from greater transparency from both NIE Networks and the UR**. We welcome the engagement with the Utility Regulator and NIE Networks that has helped inform this response. However, we note it is now standard regulatory practice for network companies in GB to publish their business plan in full, including annexes referred to in the main business plan document and sources for key information (such as EV and heat pump forecasts). NIE Networks has not followed this practice. There is still time for NIE Networks to publish these annexes before the Final Determination, which will give stakeholders a better opportunity to understand and scrutinise their plans. Similarly, we have found the UR's decisions and the underlying rationale in the Draft Determination are not sufficiently transparent. This makes it difficult for stakeholders to understand how and why NIE Networks and the UR came to many of their decisions.

More generally, given the significant cost increases proposed by NIE Networks and the UR, it is crucial that the UR ensures that this translates into an improved service for customers and that NIE Networks is robustly held to account for spending the funding in an efficient manner. We are looking forward to continuing to engage with the UR on these issues.

About us

The Consumer Council is a non-departmental public body (NDPB) established through the General Consumer Council (Northern Ireland) Order 1984. Our principal statutory duty is to promote and safeguard the interests of consumers in Northern Ireland.

The Consumer Council has specific statutory duties in relation to energy, postal services, transport, water and sewerage, food accessibility and financial services. We are an insight-led, evidence based organisation:

- Providing consumers with expert advice and confidential guidance.
- Engaging with government, regulators and companies to influence public policy.
- Empowering consumers with the information and tools to build confidence and knowledge.
- Investigating and resolving consumer complaints under statutory and non-statutory functions.
- Undertaking best practice research to identify and quantify emerging risks to consumers.
- Campaigning for market reform as an advocate for consumer choice and protection.

Consumer Principles

We use the eight consumer principles shown in Figure 1 as a framework that asks important questions about service design and delivery, consumer impact and how services should look and feel to the consumer, and that helps assess regulatory decisions from a consumer perspective.

Figure 1: Consumer Principles

The principles provide a framework for working out how particular issues or policies are likely to affect consumers, help identify key issues and risks, ask questions on consumer issues about service design and delivery, consumer impact and how services should look and feel to the consumer.

The principles also ensure we apply a consistent approach across our statutory and non-statutory functions, and in all our engagement with consumers and stakeholders.

Our Response

We provide detailed analysis and our views on the following points:

- **Incentives**: We suggest that the UR reconsiders the reduced focus on planned interruptions as part of the reliability incentive. We also suggest the UR reconsiders its assessment of NIE Networks' proposed improvements for worst served customers.
- **Evaluative Performance Framework**: We support the introduction of the evaluative performance framework and the related panel. However, we have some suggestions for ensuring the panel is impartial and for the Evaluative Performance Framework process. When calculating the overall grade, we would also encourage the UR to reduce the weight attached to the ambition of the forward plan.
- **Consumer measures**: We encourage the UR to set stretching but realistic targets for the consumer measures they have proposed, in collaboration with the Consumer Engagement Advisory Panel (CEAP). These targets should ideally be in place well in advance of the start of RP7 and clearly set out in the Final Determination.
- **Uncertainty mechanisms**: We are broadly supportive of the UR's approach and have not identified strong areas of concern. However, we consider uncertainty mechanisms should be used only where necessary, and appropriate controls should be in place to ensure consumers do not pay more than they should for an output.
- **Cost of capital**: We are broadly supportive of the UR's decision on cost of capital which is generally in line with current practice. However, we suggest that the UR confirms its approach is in line with the recent practice of the CMA. We would also suggest that the UR updates its estimates in light of up-to-date market information.
- **Environmental Action Plan (EAP)**: We support NIE Networks' initiative to develop an EAP. We recognise the UR's proposal to assess performance against

the EAP commitments through the Evaluative Performance Framework. We suggest the UR should adopt Ofgem's approach in RIIO-ED2 to request an annual report on progress made against EAP commitments.

1. Incentives

1.1 Weakening the customer minutes lost incentive will not support the energy transition and could be detrimental to consumers

The Customer Minutes Lost (CML) incentive is designed to encourage NIE Networks to improve network reliability and reduce the frequency and duration of interruptions. Measures of CML distinguish between planned interruptions (which are usually the result of planned works on the network) and unplanned interruptions (which are the result of unforeseen events).

The UR made the following key proposals regarding CML:

- The UR rejected NIE Networks' proposal to remove planned CML from the incentive and included it instead in the new Evaluative Performance Framework. The UR proposed to maintain both planned and unplanned CML but to reduce the weight of planned CML from one third to one fifth of the incentive.
- Targets for unplanned CML will be set using a four-year average (to calculate the start point) and then apply a yearly reduction of 2% per annum.
- Targets for planned CML will be calculated annually using the 3-year rolling average with a 2-year lag.
- The CML incentive makes available an equal reward and penalty (i.e., it remains symmetrical).

Our views

The CML incentive is key to supporting the energy transition. It incentivises NIE Networks to deliver a reliable network as consumers take up electric vehicles and heat pumps and become increasingly reliant on the network. Since its introduction, it has led to very significant improvements in performance from NIE Networks. **Therefore, we strongly agree with retaining both planned and unplanned CML.**

We would expect many factors to have bearing on the CML performance that NIE Networks can reasonably be expected to deliver. We understand that Ofgem has sought to take account of factors that are outside the control of network companies when it set CML targets in GB. We would encourage the UR to develop an appreciation of the approach that Ofgem used, to consider whether Ofgem's approach is relevant to NIE Networks' performance, and hence to set CML targets for NIE Networks that reflect its comparative performance. We are not in a position to undertake this analysis, however, a simple comparison with the performance that NIE Networks has delivered leaves us to believe that robust benchmarking will be necessary to provide confidence that the target the UR is proposing is appropriate.

For example. while NIE Networks has significantly improved performance since the introduction of CML, the unadjusted data suggests that it might continue to lag behind that of Distribution Network Operators (DNOs) in GB, including compared to DNOs which have a high proportion of overhead lines like National Grid Electricity Distribution (South Wales and South East networks).

Figure 2 – Planned CML performance

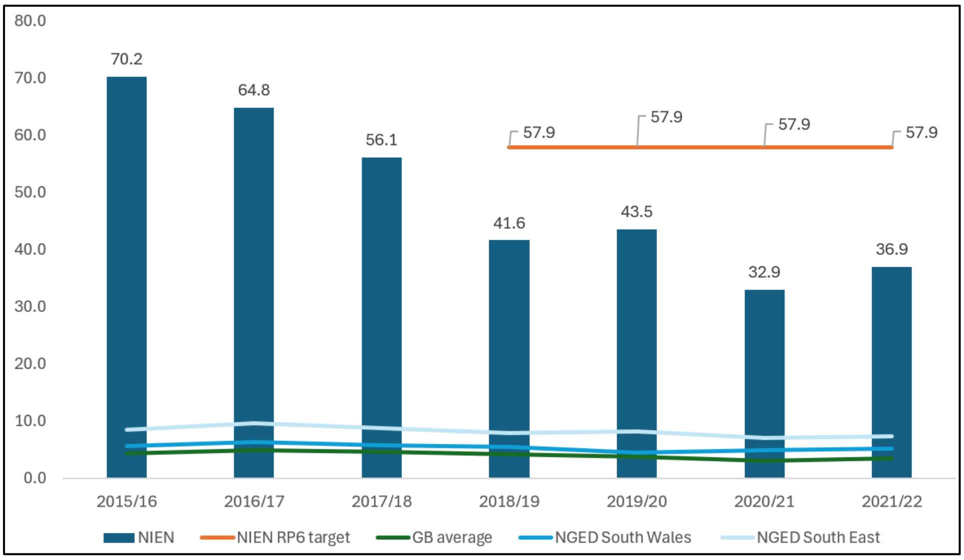
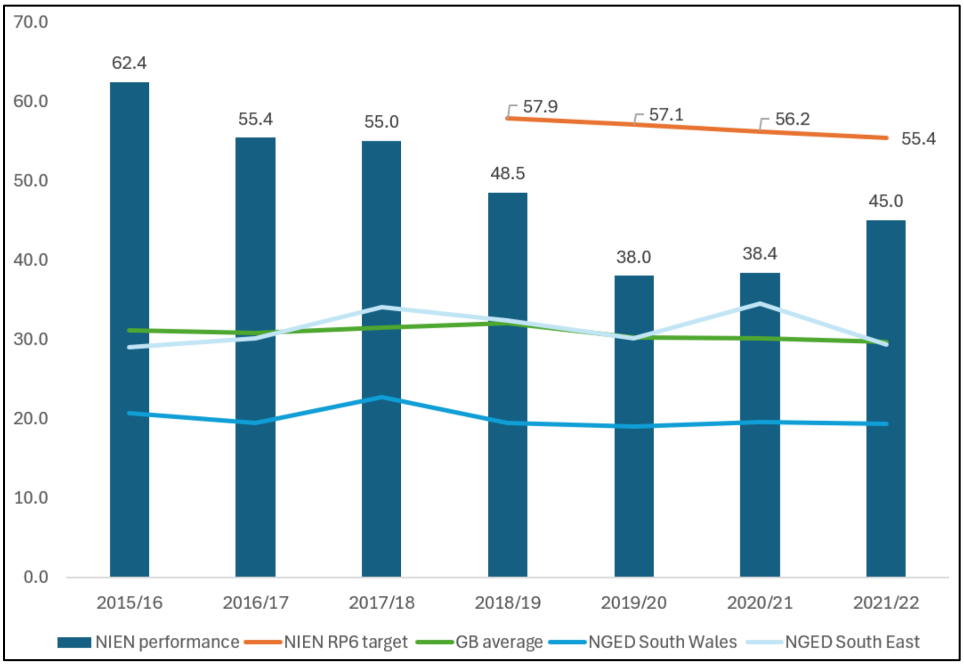


Figure 3 – Unplanned CML performance



Sources: RP7 Draft Determination, RIIO-ED2 Final Determinations

So far in RP6, NIE Networks has significantly and consistently outperformed both planned and unplanned CML targets. This indicates that CML should be recalibrated. A common regulatory principle is that targets should be stretching but realistic.

We disagree with the UR's proposal to reduce the weight of planned CML, from one third of the total incentive to one fifth. This will weaken the incentive for NIE Networks to minimise planned CML. We understand NIE Networks justified its request for removing planned CML from the incentive by the fact that a larger investment programme will necessarily increase planned CML. While we accept this, we note that GB DNOs face similar challenges which have not led Ofgem to weaken incentives on planned CML. In our view, the fact that NIE Networks will deliver large capital investment programmes reinforces the need to incentivise NIE Networks to minimise the associated disruption.

We would also encourage the UR to ensure the design of incentive mechanisms does not have unintended consequences. In this context, we have heard concerns that the current design may lead to a deterioration in CML performance at the beginning of the period and that the scale of network reinforcement may necessitate consideration of qualitative measures to address the wider customer experience related to planned CML.

We agree with the proposal to retain the value of lost load and adjust the figure to reflect inflation, in line with Ofgem's approach in RIIO-ED2. We note that Ofgem indicated they will undertake a review of the value of lost load. We would expect the UR to consider the results of this review once they are available.

Recommendations

- To consider how best to compare the CML performance delivered by NIE Networks with the performance delivered by the GB DNOs and to set the target for unplanned CML; accordingly, and
- To keep the weights of planned and unplanned CML unchanged, at 33:66 respectively.

1.2 We are concerned the UR has missed an opportunity to deliver improvements for "worst served" customers

The UR rejected NIE Networks' proposal for an allowance of £3m to reduce the number of "worst served customers" by 50% during the price control period. The UR considered that these actions would already be rewarded through the CML incentive.

Our views

It is unclear if the UR's rationale for rejecting the proposed funding is valid for the following reasons:

- CML is an average measure which does not consider which consumers have been impacted by disruptions on the network. It therefore does not provide an incentive for NIE Networks to target worst served consumers and improve its service for them.

- Some of NIE Networks' capital investment programme will focus on reducing the duration of interruptions, to improve performance on CML. The allowance requested by NIE Networks for worst served customers is to reduce the number of customer interruptions to customers who have experienced unusually poor service. NIE Networks considers that the CML improvement programme and the "worst served customer" improvement programme will not result in the same benefit[3]. We agree.
- We understand the UR did not grant the requested allowance out of a concern that NIE Networks would be rewarded for these actions through CML already, resulting in NIE Networks being funded twice. However, we assume it is possible to model the impact on CML of the actions NIE Networks proposed to undertake for "worst served customers" to net it off and mitigate any risk of double-funding.
- Finally, we note that DNOs in GB have both CML and a use-it-or-lose-it allowance for "worst served customers", which suggests the UR may be overstating concerns about double funding.

Overall, the rationale for rejecting the allowance set out in the Draft Determination does not appear strong. We also note that allowing the funding for "worst served customers" would only have a limited impact on customer bills.

Recommendation

We suggest the UR continues to engage with NIE Networks on this issue and investigates whether its concerns about double funding could be alleviated so that the funding can be granted.

If the UR were to allow the requested funding, we suggest the UR strongly encourages NIE Networks to consider a range of options to improve service to "worst served customers" in the most cost-effective way.

[3] Network performance strategy, NIE Networks, 2023

2. Evaluative Performance Framework

2.1 We broadly support the introduction of an Evaluative Performance Framework to incentivise NIE Networks to deliver better service for customers

We support the introduction of an **Evaluative Performance Framework**.

As demonstrated by the introduction of the CML incentive (which accompanied a notable improvement in network reliability), financial incentives can positively influence the behaviour of companies and deliver tangible benefits to customers.

We broadly agree with the framework and guidance proposed by the UR, particularly that:

- NIE Networks should only be rewarded for going beyond “business as usual”, and undertaking new activities or existing activities in new, innovative ways;
- It will be important that there is clarity for NIE Networks and the Panel on what is expected in the year and what NIE Networks will be assessed against;
- The incentive rate applied to over- and under-performance against the target should be equal (symmetrical). The maximum value of the revenue at stake as a reward and as a penalty (cap and collar) should also be equal (symmetrical).
- Documentation associated with the process should be published; and
- It should be possible to review and amend where appropriate the operation of the framework during the price control.

We consider that customer service should have been excluded from the scope of the Evaluative Performance Framework. This is not an area that goes beyond “business as usual” and it can be tracked with quantitative measures. We think that the use of measures such as customer satisfaction attached to a financial incentive would have been preferable and could have delivered significant benefits to consumers, as is being achieved via the CML incentives.

However, whilst we support the introduction of the framework, we have some fundamental concerns about key aspects of the proposals which we set out below.

2.2 The proposal that NIE Networks should appoint panel members breaks with standard practice and undermines the independence and credibility of the Evaluative Performance Framework

The UR stated that the panel should be independent from NIE Networks. At the time, the UR has proposed assigning NIE Networks the role of appointing and maintaining an evaluation panel. The UR retains the ability to veto any appointment.

Our views

We believe that the objective to establish a panel that is independent from NIE Networks is not compatible with a process by which NIE Networks appoints panel numbers, even if the UR can veto appointments. It is widely accepted that independence is only possible where appointees do not owe their appointment to the organisation they are evaluating, and where conflicts of interests are effectively prevented. The current process puts panel members in a difficult position. The panel members could fear they will be dismissed by NIE Networks or that their appointment will not be renewed if they expressed unfavourable views about NIE Networks' performance.

It also breaks with standard regulatory practice. For example, Ofgem appoints and maintains various panels convened to evaluate performance in relation to an incentive mechanism (e.g., for the distribution system operation incentive[4] or the stakeholder engagement and consumer vulnerability incentive[5]).

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[4] Distribution System Operation Performance Panel, Ofgem 2023

[5] Stakeholder Engagement Panel, Ofgem 2021

The appointment process for the panel makes it difficult to see how members will be able to provide unbiased views about NIE Networks' performance which would justify a potential reward. Independent appointment of panel members may also result in a wider range of experience and diversity of panel membership thereby facilitating greater scrutiny of all areas of proposed activity in the interests of end users.

Recommendation

We recommend the UR appoint panel members and guarantees their independence from NIE Networks. However, if the current proposals are retained, the UR should at least require NIE Networks to recruit a list of potential panel members for UR selection and ratification based upon transparent criteria published in advance by the UR. In addition, the UR should ask NIEN to justify its reasons for dismissing or not re-appointing a panel member and must introduce conflict of interest rules (whereby panel members would notify the UR if they became aware of an actual or perceived conflict of interest).

2.3 The calculation of the overall grade is weighted too heavily towards the ambition of the forward plan

The evaluative performance framework awards a penalty or reward based on a grade calculated from the average scores given to the forward plan (which outlines ambitions) and the performance report (which outlines actual delivery). Performance in these two areas is equally weighted. The UR used the figure below to illustrate the maximum reward and penalty NIE Network could have depending on how its forward plan and performance report were graded.

Figure 4 - Maximum reward and penalty for the EPF

		Performance Grade				
		1	2	3	4	5
Forward Plan Grade	1	-£3,000,000	-£2,250,000	-£1,500,000	-£750,000	£0
	2	-£2,250,000	-£1,500,000	-£750,000	£0	£750,000
	3	-£1,500,000	-£750,000	£0	£750,000	£1,500,000
	4	-£750,000	£0	£750,000	£1,500,000	£2,250,000
	5	£0	£750,000	£1,500,000	£2,250,000	£3,000,000

Source: RP7, Draft Determination, Annex M – Incentives

Our views

We are concerned with the fact that the overall grade (and therefore reward or penalty) is calculated from an average of the forward plan grade and the performance report grade. Based on the table shown above, we understand NIE Networks could be rewarded when it delivers an ambitious forward plan (graded four or five) but delivers it just within or below expectations (performance report graded two or three) – see bottom red box in the table. Similarly, it would not be right for NIE Networks to be penalised if it delivered beyond expectations (performance report graded four or five) but had presented a disappointing forward plan (graded one or two) – see top red box.

Consistent with the UR's intention that NIE Networks is only rewarded for delivering beyond expectations (which is equivalent to a grade of three), a grade of three should lead to a neutral outcome, i.e., no reward or penalty. This is not what the table presented by NIE Networks suggests.

Finally, it is important to allow the panel members to define a score to one decimal place rather than full numbers to allow greater sensitivity in the evaluation and accuracy of the reward or penalty.

Recommendations

- To attribute a greater weight to the grade of the performance report than to the grade of the forward plan. We would recommend a weight of 80% for the performance report and 20% for the forward plan;
- To make sure that a score of three leads to a neutral outcome, i.e. no reward or penalty; and
- To allow the panel to set scores to one decimal place rather than full numbers.

3. Consumer measures

3.1 We encourage the UR to propose stretching but realistic targets from year 1 of RP7

NIE Networks has proposed six measures relating to customer contacts (four of which existed previously and two of which are new, but based on Ofgem measures). NIE Networks has proposed targets for each of these, as shown in the table below.

Table 1 – Consumer measures proposed by NIE Networks

Measure	New for RP7?	Proposed target
Enquiries: response within 2 days	No	90%
Enquiries: response within 2 days	No	100%
Complaints to be resolved Day +1 (24 hours)	Yes	80%
Complaints to be resolved Day +31	Yes	95%
All calls answered	No	99%
% calls answered within service level – 20 seconds	No	93%

The UR has proposed eight further measures, shown in Table 2. They have not proposed targets for six of these, but the UR intends to work with the Consumer Engagement Advisory Panel (CEAP) to determine the appropriateness of the measures for the NI context and to develop targets. For example, in the case of Time to Quote and Time to Connect, Ofgem has set targets for GB DNOs at RIIO-ED2 and NIE Networks is already collecting data on performance. Targets for NIE Networks will not be set until they have been agreed with the CEAP.

As a result, the UR only proposed targets for eight of the 14 measures in the Draft Determination:

- The proposed customer contact and customer satisfaction survey metrics were developed based on Ofgem's RIIO-ED2 methodology and NIE Networks' historical performance;
- The customer contact targets were proposed by NIE Networks and accepted without any changes by the UR; and
- The proposed target for supporting vulnerable customers draws on the UR's Best Practice Framework.

Our views

We broadly agree with the UR's proposed consumer measures. Even with a reputational impact, these measures are important to track NIE Networks' performance, provide transparency to stakeholders and incentivise improvements. **We also support the UR's approach of developing consumer measures and targets through collaboration with the CEAP** to ensure that they add value and are appropriate in the context of Northern Ireland.

However, we make the following overall observations:

- **The UR should aim to have targets in place from year one of RP7 or set out a process for determining these targets which is clearly articulated in the Final Determination.** We can see three alternatives. First, as the UR notes, NIE Networks already tracks many of these measures. It is possible that the tracking of these measures is sufficiently robust to allow for this data to be used to set a benchmark. Second, Ofgem has in some instances set a target only from the second year of the price control, to allow the collection of data in the first year. The UR could consider taking this approach in cases where more data is needed to set an appropriate target. A final option is for the UR to build on the performance data of other companies who are subject to similar measures, such as NI Water or GB DNOs. Whatever approach is adopted, **there should be a clear commitment in the Final Determination to set targets for each measure, together with an explicit timeline.**

- **Targets should be stretching but realistic.** As we observed for NI Water's price control (PC21), it is essential that targets are set at a level that is stretching to NIE Networks, while not being unrealistic to achieve. We therefore worry that the UR has accepted the targets proposed by NIE Networks without applying a challenge.

We set our views against each proposed consumer measure in more detail below.

Table 2 – Consumer measures proposed by the UR

Measure	Target proposed by the UR	Consumer Council views
Consumer Vulnerability – BS ISO 22458 Accreditation	BS ISO 22458 certification by the end of the period	Our views are presented in the section below.
Net Promoter Score (NPS)	**No target proposed** due to change from internal data collection to an external organisation undertaking data collection.	While we understand that NIE Networks is switching to an external provider to collect the data, **the UR could use the data collected so far, as a starting point, to set a target for year 1 of the period, potentially with an adjustment based on the target set for NI Water in PC21, if required.** This will make sure that NIE Networks is incentivised to perform from the start of the price control. It will also mitigate the risk that, if targets are set during the price control based on the performance achieved in the first years of the price control, NIE Networks is incentivised to deliver less than optimal performance in the first years of the price control to reduce the targets set. In year 2 of the price control, the target could be adjusted if necessary to reflect the data collected in year 1. In addition, **the UR could consider applying the methodological changes agreed for this measure during NI Water's mid-period review**, specifically to break down this

Measure	Target proposed by the UR	Consumer Council views
		metric into domestic and non-domestic consumers.
First Point of Contact Resolution (FPOCR)	**No target proposed** due to a possible overlap with the new complaints measures. The UR considers that NIE Networks should continue to collect and report on data.	Good customer service means that customers should not have to contact NIE Networks in the first place, and that if they do, their problem is resolved preferably during the first interaction (which FPOCR measures) or quickly after it (which complaints and enquiry metrics measure). We are not convinced there is an overlap between this metric and the complaints and enquiry metric. **We recommend aligning the position with NI Water which has a target set at 84%.**
Customer Satisfaction Surveys (Enhancing Customer Service)	8.2/10	The target for customer satisfaction surveys that has been proposed is **less stretching than the target set by Ofgem at RIIO-ED2, which is 9.01/10.** We note that this may have been an error, since the UR states that they have adopted the same target as the one set at RIIO-ED2.
Communication Channels	**No target proposed** due to the need to develop measures and targets through the CEAP. The UR considers that NIE Networks should start collecting and reporting on a range of data.	We agree with the UR's position. We note that multi-channel communications options are often welcomed. However, voice calls remain a vital service for many consumers.
Time to Connect and Time to Quote	**No target proposed** due to need to develop measures and targets through the CEAP. The UR considers that NIE Networks should continue to collect and report on data.	NIE Networks' commitment to "maintain" their performance on these metrics is not stretching. **In line with Ofgem, the UR should set targets for this metric.** NIE Networks already collects and reports data on these metrics and there are comparable measures in

Measure	Target proposed by the UR	Consumer Council views
		Great Britain. **We see good reason to set targets for these metrics.**
Customer Satisfaction Surveys (Enhancing Connection Services & Supporting Competition in Connections)	**No target proposed** due to need to develop measures and targets through the CEAP. The UR advises that NIE Networks continue to collect and report on data.	We welcome further engagement through the CEAP to confirm appropriateness of these targets. However, we are keen to see confirmation in the Final Determination of a date for commencement of CEAP agreed targets.
Customer Satisfaction Surveys (Supporting Customers with Energy Transition)	**No target proposed** due to the need to develop measures and targets through the CEAP, and with a view to potentially include some aspects of this measure in the customer service satisfaction survey.	We agree with the UR's position and welcome further engagement through the CEAP. However, we are keen to see confirmation in the Final Determination of a date or milestone (such as establishment of the DfE One Stop Shop) for commencement of CEAP agreed targets.

Recommendations

- To set clear targets in the Final Determination.
- Where setting targets is not yet possible, to make a clear commitment to set targets in the Final Determination, with an explicit timeline for commencement of their application.
- To use the data collected by NIE Networks and NI Water to set a target for the Net Promoter score for the first year of the price control, which could then be re-adjusted in light of data collected during the first year of price control.
- To introduce a target for FPOCR, for example at the same level as NI Water's in PC21 – 84%.
- To set the target for the customer satisfaction survey at 9.01/10, in line with RIIO-ED2.

- To set targets for time to connect and time to quote, using historical data from NIE Networks and performance in Great Britain as a benchmark.
- To confirm explicit dates or milestones in the Final Determination for application of Customer Satisfaction Surveys relating to Enhancing Connection Services, Supporting Competition in Connections and Supporting Customers with Energy Transition.

3.2 The UR could go further to encourage NIE Networks to develop its support for vulnerable consumers

In line with its Best Practice Framework, the UR proposed that NIE Networks obtains the BS ISO 22458 accreditation during the period control period. The accreditation sets specific requirements and gives guidance to organisations on how to provide an inclusive service at all stages of service delivery, helping them to identify and support consumers in vulnerable situations.

Our views

We support the proposal that NIE Networks gains the ISO accreditation, which would bring NIE Networks in line with other major actors in the sector (such as PowerNI and the Consumer Council) and give weight to the UR's Best Practice Framework. We note that the UR had stated in 2022 its intention to require companies to achieve the accreditation.[6]

We are concerned that a target to obtain certification by the end of RP7 could delay efforts to bring NIE Networks up to the standard of the proposed ISO certification. There is a risk that the scale of improvements required could be underestimated if progress towards certification is not reported upon over the course of RP7. We would therefore recommend **requiring NIE Networks to at least**

[6] Best Practice Framework programme, Utility Regulator, 2022.

demonstrate a clear programme of work to achieve the accreditation and to regularly report on its progress during the price control.

Furthermore, we think the UR could go further to encourage NIE Networks to step up its support for vulnerable consumers. The UR could introduce measures targeted at vulnerable consumers, for example, to maintain an appropriate number of households on the customer care register, to promote consumers' awareness of the register, and to increase the satisfaction of those consumers on the register. There should also be a requirement for NIE Networks to review the contents and requirements of the customer care register in line with the UR's Best Practice Framework.

Finally, the development of RP7 is an opportunity to develop a shared care register across gas, electricity, and water in Northern Ireland, which NIE Networks could lead on. These propositions would encourage NIE Networks to better support consumers who need it the most and promote the achievement of the UR's Best Practice Framework, particularly the proposed measures 3.3 and 3.4.

Recommendations

- To require NIE Networks to have a clear work programme to achieve the ISO certification and to report regularly on the progress being made;
- To consider seizing the opportunity to develop a shared customer care register across gas, electricity and water, potentially asking NIE Networks to lead on this process.
- To introduce the following additional measures:
    - A benchmarked target to increase awareness of the customer care register.
    - A customer satisfaction survey specific to the quality of service provided to customers on the care register.

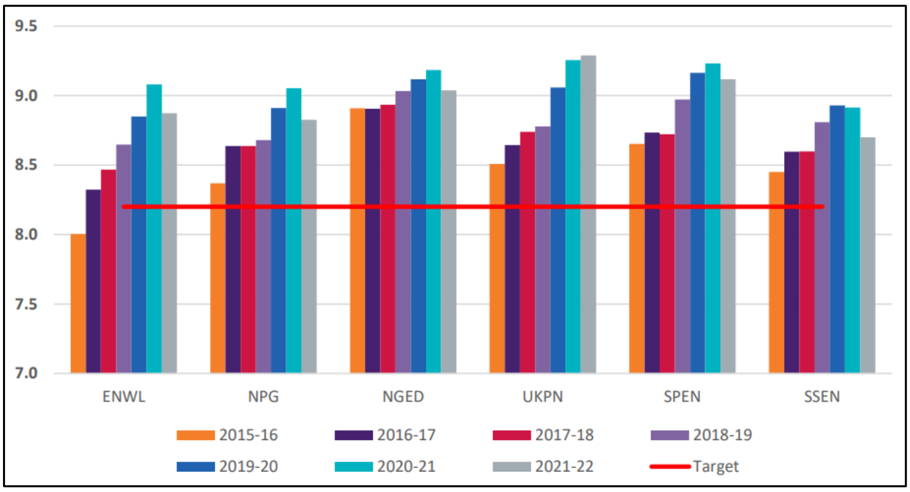
3.3 We would encourage the UR to consider attaching financial incentives to some measures, particularly customer satisfaction

The UR only uses the network reliability incentive (CML) and the new evaluative performance framework to incentivise performance. In contrast, in RIIO-ED2, Ofgem uses no less than seven common incentives, in addition to bespoke incentives. These incentives cover, for example, customer satisfaction, support to vulnerable consumers, network reliability, and connection services.

As the UR has experienced with CML, financial incentives can have a powerful impact on performance and deliver fast, tangible improvements for customers.

The use of financial incentives to improve customer satisfaction is well established. The customer satisfaction incentive has driven very significant improvements in GB so that all network companies but one perform above 9/10.

Table 3 - Average customer satisfaction score by DNO group



Source: RIIO-ED1 Network Performance Summary 2021-22

We think there are strong arguments for introducing a financial incentive which is liked to NIE Networks' customer satisfaction survey. Assessing customer service through the Evaluative Performance Framework would be relatively more intensive as it would require engagement from the UR, NIE Networks and the Panel to inform a qualitative assessment. Customer service could be excluded from the

Evaluative Performance Framework and assessed through a mechanistic incentive which would be relatively simple to design and operate.

The UR should also consider introducing a reward-only incentive on customer satisfaction, with a requirement that any reward earned is allocated to supporting vulnerable customers. This mechanism supports the delivery of good performance as it could have a positive impact on NIE Networks' staff engagement and senior management attention. It would fund improvements for customers who need it most.

4. Uncertainty mechanisms

The UR is proposing an increasing use of uncertainty mechanisms, has created new re-openers, volume drivers and pass-throughs and has rejected some proposals for new mechanisms made by NIE Networks.

Our views

We are broadly supportive of the UR's approach and have not identified strong areas of concern. Nonetheless, the increased reliance on uncertainty mechanisms means that a greater proportion of allowances is provided through these mechanisms, increasing the risk that consumers face bills which are higher than they anticipated. Therefore, when uncertainty mechanisms are applied appropriate controls and calibrations must be in place to ensure consumers do not pay more than they should for an output.

We are particularly supportive of the following proposals that the UR has made:

- **Primary network – forward power flow and reverse power flow**: We agree with the introduction of these mechanisms and support the UR's decision to conduct a review of the allowance at the end of the price control if the expenditure was less than 80% of the ex-ante allowance.
- **Low rated cut-outs**: We agree with the introduction of a volume driver for low rated cut-outs. We recommend the UR clarify the scope of the volume driver, in particular if it would include replacements due to the smart meter roll-out rather than LCT uptake. We would welcome further evidence and justification of the proposed unit cost. The UR should also consider if control measures should be implemented to ensure the spend was justified. A cap on total expenditure could be introduced and could be reviewed within the control period, if necessary.
- **Non recoverable alterations**: We agree with the UR's proposal to reject NIE Networks' suggestion that non recoverable alterations should be covered by a pass-through. We agree with the general principle that pass-through mechanisms

should be used exceptionally and that using one for non-recoverable alterations is not justified. We support the rationale that the low variance between RP5 and RP6 costs provides reassurance that costs for RP7 can be forecast reliably based on historical spending, and the 50:50 cost sharing mechanism reduces the risk to NIE Networks.

- **Large scale asset replacement programmes**: We support the UR's decision not to accept NIE Networks' proposal to include large scale asset replacement programmes within the D5 mechanism. We agree with the UR that "while there was a case for determining allowances at a later date under the uncertainty mechanisms where the scope and/or cost are not well defined, this should not be viewed as the norm. It is for the company to plan development work on this type of project to ensure that, where possible, ex-ante allowances can be included in the Price Control determination rather than delayed to a later date".[7]
- **Severe weather**: We agree with the UR's proposal not to treat severe weather costs as a pass-through. This would have removed all incentives on NIE Networks to be cost efficient to manage the impact of these events, which are likely to increase in likelihood and magnitude.

That said, we are concerned about the use of volume drivers and the determination of their unit costs, specifically:

- **We are concerned that NIE Networks and the UR have provided little evidence to justify the unit costs proposed**. One example is the secondary network volume driver which is intended to fund additional load-related investments on the secondary network. As shown in the table below, some of the unit costs proposed appear to be higher than in GB. We are unsure why this is the case. We would encourage the UR to explain how the proposed unit costs have been scrutinised and why they are considered to be set at an appropriate level.

[7] RP7 Draft Determination. 2023, Annex S, p.53.

- In addition, as volume drivers allow automatic adjustments to allowances, there should be **appropriate protections for consumers, for example caps, clawback mechanisms and a requirement on NIE Networks to report on the use of the mechanisms.** Caps on uncertainty mechanisms act as a backstop to prevent funding from going above a reasonable value. Clawback mechanisms would allow the UR to review spending ex-post and, if the UR determined that the spending was unjustified, to order the company to pay back this spending to consumers. Reporting on spending under uncertainty mechanisms provides a mechanism to make companies more accountable for that spending.

We have further comments on specific mechanisms which we set out in the table overpage.

Table 4 – Consumer Council views on uncertainty mechanisms proposed

<table>
<tr><td>UM Name</td><td>Observations</td></tr>
<tr><td>Secondary network volume driver</td><td>As stated above, it is crucial that unit costs are well calibrated to ensure that consumers pay for efficient costs. We think NIE Networks and the UR should provide more evidence to justify the proposed unit costs. We also note the unit costs proposed for ground mounted substation and HV OHL are significantly different to their equivalents in RIIO-ED2, as shown in the table below.

Table 5 – Comparison of unit costs for secondary network volume drivers in RP7 and RIIO-ED2

<table>
<tr><td>Asset class</td><td>UR proposal</td><td>RIIO-ED2</td></tr>
<tr><td>Pole Mounted substation</td><td>£85.7/Total Activity Volume (MVA)</td><td>£89.5/MVA</td></tr>
<tr><td>Ground mounted substation</td><td>£80.2/MVA</td><td>£63.3k/MVA</td></tr>
<tr><td>HV cable</td><td>£95.9/km</td><td>£127.3k/km</td></tr>
<tr><td>HV OHL</td><td>£57.0/km</td><td>£39.6k/km</td></tr>
<tr><td>LV cable</td><td>£101.7/km</td><td>£141.3k/km</td></tr>
</table>
Source: Consumer Council analysis</td></tr>
</table>

UM Name	Observations
	Furthermore, **we would encourage the UR to consider introducing a cap** on the expenditure that can be incurred under this mechanism given the lower level of scrutiny applied to these costs. **A cap would increase the necessity for NIE Networks to carefully consider the priority of secondary network reinforcement and would encourage the use of flexibility as an alternative where appropriate**. If the investment needed were to exceed the cap, the UR could scrutinise a request from NIE Networks for further expenditure. This would also be in line with Ofgem's approach. Finally, we note the UR proposed a lump sum allowance of £1.1m to ensure NIE Networks is not disincentivised from procuring flexibility. It is not clear why the UR considered this amount was appropriate, and we note the allowance is extremely small. We consider it unlikely that this allowance will incentivise NIE Networks to consider flexibility options. **We recommend the UR include flexibility procurement within the volume driver, as did Ofgem in RIIO-ED2.**
Low rated cut outs	We recommend the UR **clarify the scope of the volume driver**, in particular if it would include replacements due to the smart meter roll-out rather than LCT uptake. We would also welcome **further evidence and justification of the proposed unit cost.** The UR should also consider if control measures should be implemented to ensure the spend was justified. **A cap on total expenditure** could be introduced as a backstop to protect customers from unforeseen levels of expenditure.

Recommendations

- To explain how proposed unit costs for volume drivers were scrutinised and why they are considered to be efficient;
- To include the procurement of flexibility within the secondary network volume driver to ensure NIE Networks is not disincentivised from securing flexibility to manage network constraints; and
- To consider how consumers can best be protected when allowances are granted through uncertainty mechanisms, particularly with volume drivers. We think all volume drivers should have caps, the UR should rely on some form of reporting to check the spend was reasonable given the conditions, and the UR should consider whether a clawback mechanism should be introduced.

5. Cost of capital

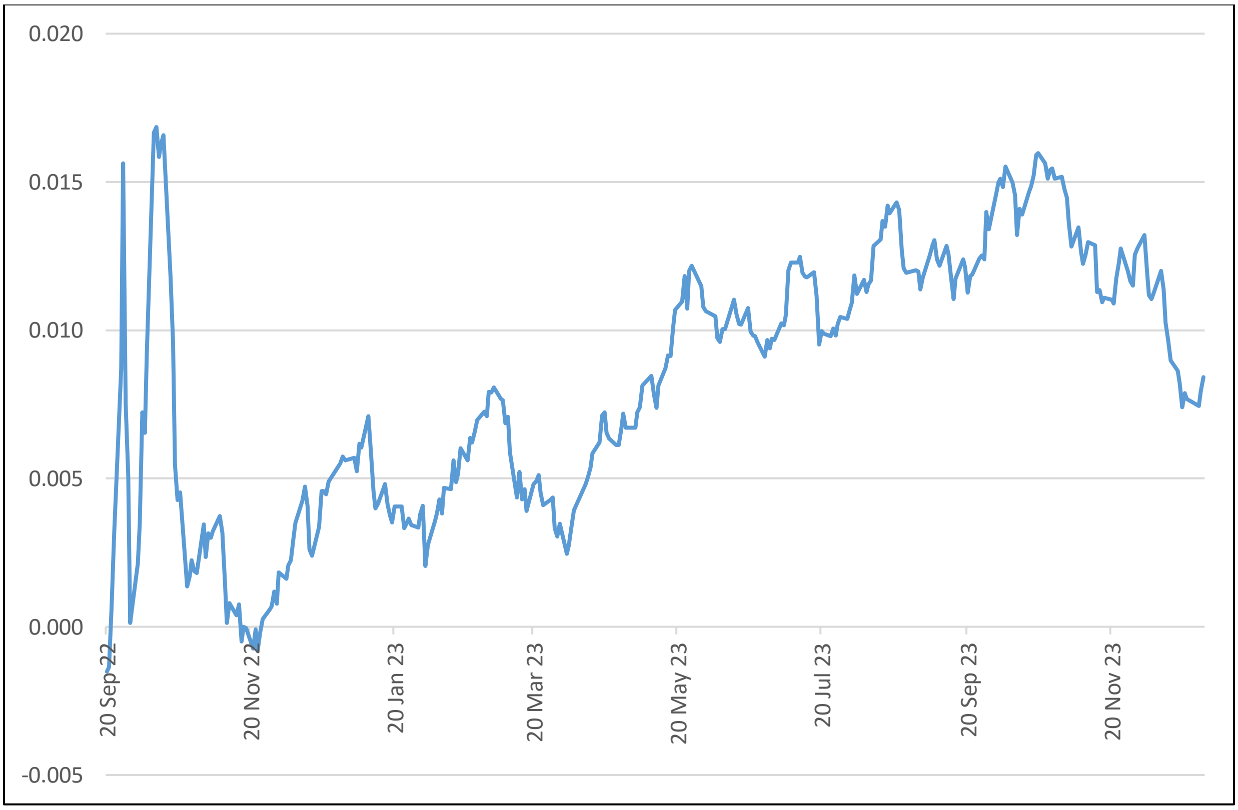
5.1 Up-to-date data on index-linked gilts (ILGs) should be used to estimate the risk-free rate

The data that the UR used to estimate the risk-free rate had a cut-off date of 30 September 2023. As a consequence, the recent volatility in the yield of ILGs was not captured in estimates of the risk-free rate.

Our views

It is best practice to use the most recent market information to determine the risk-free rate. For example, as the figure below illustrates, the yield on ILGs has varied significantly since the UR's cut-off.

Figure 5 – 20-year index-linked gilts yields



Source: Bank of England

Recommendation

The UR should use the latest available market information, including on ILGs to estimate the risk-free rate (and consider using an average given recent volatility on ILGs) and on inflation.

5.2 Unlike recently established regulatory practice, the UR relied on both ILGs and AAA-rated corporate bonds to estimate the risk-free rate

The UR derived the risk-free rate from a 50:25:25 weighted average of index-linked gilts (ILGs) and two AAA-rated corporate bond indices, respectively. The use of AAA-rated corporate bonds as a proxy for the risk-free rate is no longer considered best practice.

Our views

It is generally accepted that AAA-rate corporate bonds are not a good proxy for the risk-free rate. In recent decisions, regulators have relied on ILGs as the primary source of information on the risk-free rate.

The UK Regulators' Network (UKRN) guidance on determining the cost of capital highlights that AAA-rated corporate bonds "contain risk premia that would not feature in the true risk-free rate".[8] The guidance explains that AAA-rated corporate bond indices are comprised of a limited number of constituents and have tenors significantly longer than the investment horizon common to regulatory determinations. Placing weight on instruments which are illiquid and have materially longer tenors makes for a less relevant risk-free rate proxy. UKRN advises that regulators should use "ILGs at the assumed investment horizon in their sector as their risk-free proxy".[9] In comparison to AAA-rated corporate bonds, ILGs have many characteristics that qualify them as a

[8] Guidance for regulators on the methodology for setting the cost of capital, UKRN, 2023, p. 14.
[9] *Ibid*, p. 4.

good proxy for the true risk-free rate including the "combination of inflation protection, low default risk and low liquidity risk".[10]

For these reasons, Ofgem and Ofwat have discarded AAA-rated corporate bonds to set the risk-free rate in recent price controls. For example:

- Ofgem's RIIO-ED2 Final Determination used ILGs alone to estimate the risk-free rate. Ofgem explained "the overwhelming weight of academic theory and of suggested practice, regarding risk-free rate estimation, supports the use of ILGs".[11]
- Ofwat's PR24 Final Methodology also used ILGs as the primary instrument for estimating the RFR. Ofwat stated that "AAA-rated corporate bond indices do not constitute an appropriate proxy for the risk-free rate".[12]

Recommendation

We recommend that the UR adopts the UKRN guidance and aligns with precedents from other regulated sectors by relying solely on ILGs to estimate the risk-free rate.

5.3 In line with the CMA's determination for Heathrow, the UR should confirm the impact of Covid-19 has not led to a bias in the way it has estimated beta and should present its analysis and conclusions in the Final Determination

The UR calculated NIE Networks' proposed asset beta by reference to beta estimates for comparator companies averaged over the past five years, as well as beta estimates made by regulators in recent reviews. The UR only presents a summary table of values for company beta, and does not demonstrate how it has considered historical patterns and particularly how the impact Covid-19 impacted the comparator betas. We note that the UR has used National Grid, Pennon Group, Severn Trent and United Utilities as proxies for the estimated beta.

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[10] *Ibid.*
[11] RIIO-ED2 Final Determination, Finance Annex, Ofgem, 2022 p. 28
[12] PR24 Final Methodology, Appendix 11 – Allowed return on capital, Ofwat, 2022, p. 12

Our views

We are concerned the Draft Determination does not provide evidence the UR considered the impact Covid-19 had on the beta of these companies from 2020.

Covid-19 has affected the observed betas since around the beginning of 2020. The effects of Covid-19 will remain apparent in observed five-year betas until the end of 2026 and were apparent within two-year betas through to the end of 2023.

Thus, around 50% of the beta data that underpinned the First Economics recommendations (based on five-year averages of observed beta values) is affected by share price behaviours and risks that manifested during the Covid-19 pandemic. If the betas observed during Covid-19 were not reflective of forward-looking risks now faced by investors, this is problematic.

As part of an appeal to the Civil Aviation Authority (CAA)'s latest determination for Heathrow, the CMA investigated the impact of Covid-19 on betas. It found that Covid-19 created a spike in companies' betas that did not reflect forward looking risks and were therefore not appropriate for setting Heathrow's price control. The CMA agreed with the CAA's approach which "weighted down" the data during the period of the pandemic to correct this effect.[13]

While the effects in the aviation industry during Covid-19 may have been extreme, the effects on observed betas (up and down) can be seen across a number of sectors. To evaluate the potential impact, we have undertaken a simplified version of the analysis performed by the CAA and applied it to National Grid, which may be considered to be a good proxy for NIE Networks. The graphs below show unweighted betas (observed data) as well as weighted beta (where we have "weighted down" the impact of Covid-

[13] H7 Heathrow Airport Licence Modification Appeals - Final Determination., CMA, 2023

19, using approximately the same method as the CAA and CMA). The graphs indicate that Covid-19 materially inflated the observed beta of National Grid.

Figure 6 - Estimated beta for National Grid using weighted and unweighted data for the Covid-19 affected period using 2-year betas

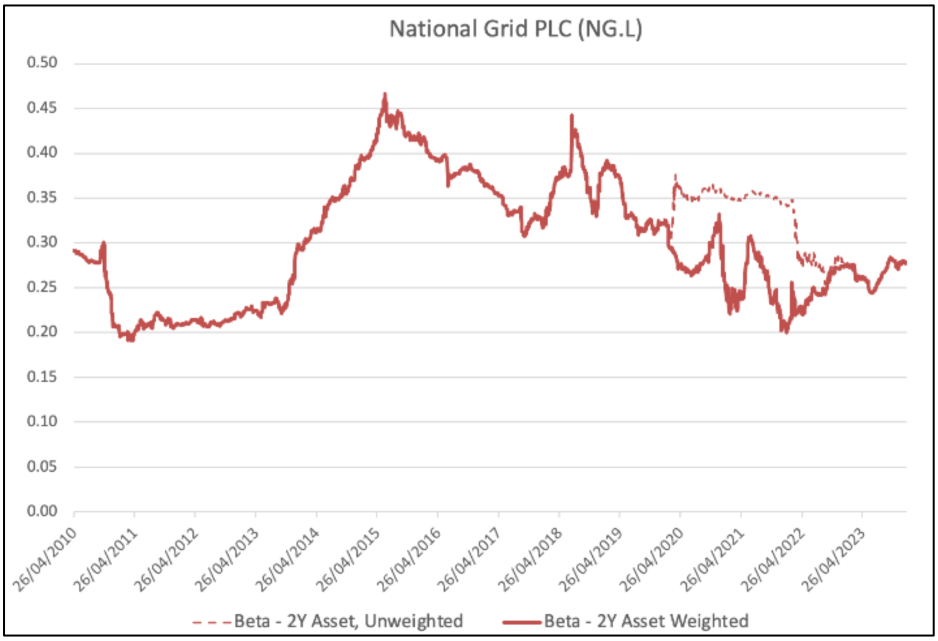
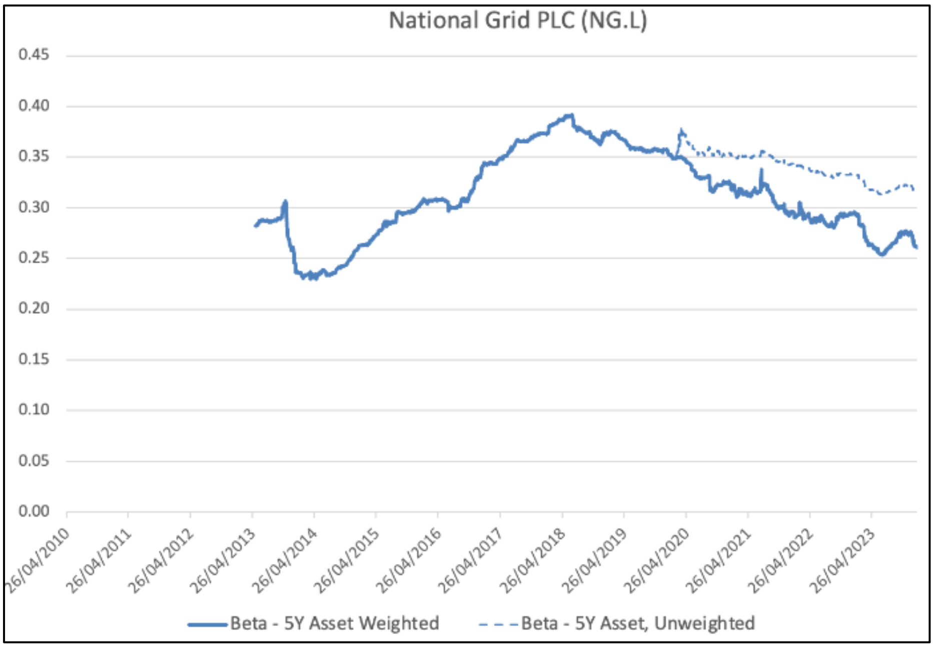


Figure 7 - Estimated beta for National Grid using weighted and unweighted data for the Covid-19 affected period using 5-year betas



It is not clear from the Draft Determination whether the UR has made a similar adjustment. However, our analysis suggests that, if an adjustment has not been made, it might be significant.

For reasons of statistical confidence, we draw our views mainly from the five-year beta values. If an appropriate adjustment has not been already made, **our analysis would justify a downward adjustment of approximately 0.05 to the beta estimated by First Economics, which would result in a c.0.2 percentage point reduction in the WACC holding other parameters constant.** This is summarised in the table below.

Table 5 - Cost of equity calculations with original and revised parameters

Parameter	First Economics Assumptions	Consumer Council assumptions (asset beta reduced by 0.05)
Gearing	55%	55%
Cost of debt	4.49	4.49
Risk free rate	2.2	2.2
Market return	6.5	6.5
Equity market premium	4.30	4.30
Asset beta	**0.35**	**0.30**
Debt beta	0.075	0.075
Equity beta	**0.69**	**0.57**
Vanilla WACC	**4.79**	**4.57**

In light of the approach adopted by the CMA and the potential material impact we have estimated on WACC, we would encourage the UR and First Economics to confirm how they have adjusted for the impact of Covid-19.

Recommendation

We suggest the UR and First Economics consider the impact of Covid-19 on comparator betas and whether adjustments are needed to the data, in line with the CAA/CMA approach and as indicated by our analysis of National Grid's average beta and presents their results and conclusions in the Final Determination.

6. Environmental Action Plan

6.1 We would welcome a requirement for NIE Networks to publish an annual environmental report

NIE Networks' stakeholder engagement illustrated that environmental protection is an important issue for consumers and stakeholders. As a result, the company submitted an Environmental Action Plan (EAP) as part of its business plan submission. The EAP outlined 16 commitments reflecting the company's ambitions to achieve best practice and meet the net zero and environmental expectations of stakeholders.

NIE Networks already provide data on network losses, SF6 emissions and oil leakages through annual regulatory instructions and guidance submissions (RIGs). The UR propose to expand this annual data reporting to include business carbon footprint data.

The UR does not propose to introduce any further incentives, reporting requirements or licence conditions related to NIE Networks' EAP commitments but asks stakeholders if they would support the introduction of a requirement for NIE Networks to publish an annual environmental report, like DNOs in GB.

Our views

We support NIE Networks' submission of an EAP, including its engagement with stakeholders as part of its development. We agree with NIE Networks that environmental commitments form part of consumers' expectations for networks.

We would support the introduction of an annual environmental report. As the UR notes, in GB, it is now standard practice for network companies to report the progress made against their EAPs through an annual environmental report.[14] Ofgem consider the annual report an "effective safeguard against the risk that a licensee does not

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[14] RIIO-ED2 Final Determinations Core Methodology Document, Ofgem, 2022, p. 46.

deliver on commitments, as it is a public facing report that will be visible to stakeholders keen to see progress".[15] The report provides a view of key activities undertaken and progress made against the commitments. It holds companies to account and provides transparency to stakeholders.

Requiring companies to develop an EAP has encouraged them to improve their understanding of their environmental impact, identify a strategy and action plan to reduce their emissions, and provides a means to hold them to account for the progress they make. As a result, network companies have delivered significant improvements.[16] We think there is a strong rationale to adopt a similar approach in Northern Ireland.

Table 6 - Key performance improvements delivered by DNOs through their EAPs

Areas of environmental priority	**Average reduction in 2022/23 (compared to 2014/15 baseline)**
Business carbon footprint	-65.3%
Operational transport emissions	-59.6%
Network losses	-67.4%
SF6 emissions	+2.9%

Note: Estimates have been calculated using reported performance data from GB DNOs including UK Power Networks, National Grid Electricity Distribution, Electricity North West, SP Energy Networks and Northern Power Grid. SSE has been excluded due to data being drastically different to the industry trend.

Recommendation

We suggest the UR requires NIE Networks to publish an environmental action report, based on the model used by DNOs in GB.

[15] *Ibid*.
[16] RP7 Business Plan - Stakeholder Report, NIE Networks, 2023, p. 21.

6.2 The UR should clarify its intention with regard to an EAP assessment through the Evaluative Performance Framework

The UR suggest that NIE Networks' performance against its EAP commitments could be rewarded through the evaluative performance framework, if "they aim and evidence Best in Class in this area".[17]

We suggest the UR clarifies its intention regarding an assessment through the Evaluative Performance Framework, in particular:

- Whether this would be in addition to the publication of an annual environmental report or an alternative to it; and
- That performance will be assessed regardless of whether NIE Networks has delivered positive or negative results. The statement that the EAP would be assessed if NIE Networks "aim and evidence Best in Class in this area" could suggest that the progress against the EAP would only be evaluated if there is a sense that NIE Networks has performed well. We do not think this would be appropriate and we invite the UR to clarify its wording.

[17] RP7, Draft Determination, Main document, Utility Regulator, page 59.

CONTACT INFORMATION

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The Consumer Council consents to this response being published.

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