

22 March 2024

Alan Craig  
Finance and Network Assets  
Utility Regulator  
Queens House  
14 Queen Street  
Belfast  
BT1 6ED

Dear Alan

firmus energy welcomes the opportunity to respond to the Utility Regulator's consultation on its Draft Determination for the RP7 price control for NIE Networks ("NIE").

The RP7 price control will form a pivotal role in creating the foundation for Northern Ireland's journey towards net zero. The investments made during this price control period will shape the ability of Northern Ireland to deliver the Northern Ireland Executive's Energy Strategy and the Climate Change (Northern Ireland) Act 2022.

firmus energy operates as both a gas distribution network operator and a gas supplier in Northern Ireland and whilst we are not directly involved in the electricity sector, the consequences of the investment decisions made by NIE during the RP7 price control period will have a direct impact on electricity and gas consumption in the future.

We have focussed our response on those matters where we can draw on our experiences from the GD23 price control process and also some of the areas which will have a knock-on impact for gas distribution and supply.

#### The impact of RP7 on energy bills

The RP7 draft determination notes that 'substantial investment is required to achieve the Northern Ireland Executive's Energy Strategy's target of net zero greenhouse gas emissions by 2050' and that 'this additional investment will increase the amount of money NIE Networks can charge consumers through the network cost element of electricity tariffs.'

However, the draft determination then notes that 'domestic tariffs will not increase due to the additional network costs for RP7'.

The Utility Regulator's estimates for RP7 show that small businesses will see a 3%-9% increase whilst large energy users will see an 11%-19% increase. This suggests that commercial customers are 'footing the bill' for decarbonisation.

The introduction to the executive summary for the RP7 draft determination concludes that "Whilst this additional investment will increase the network cost for electricity consumers, we will ensure that the transition is affordable, fair, and inclusive for all.'

It is not readily transparent how increases for commercial users but no increase for domestic users can be described as ‘affordable, fair, and inclusive for all’.

With this in mind, it is also important that revenue and cost modelling is reviewed and updated to allow tariffs to provide cost reflectivity. If the allocation of costs or revenues is seen as a policy decision, then this should be carefully considered by the Utility Regulator, in conjunction with the Northern Ireland Executive.

This draft determination currently seems to send a confusing message to domestic consumers. Domestic consumers need to recognise that the energy transition does have a cost, and everyone has to contribute to ensure we move towards a greener economy. Domestic consumers must recognise how critical NIE’s infrastructure investment during RP7 is for Northern Ireland and the positive impacts it will have.

### Rate of Return

firmus energy welcomes the approach, consistent with GD23, taken by the Utility Regulator in relation to the new rate of return adjustment mechanism.

We do, however, note a difference in the application of the adjustment to the cost of debt mechanism to correct for the forecasting error in inflation. Whilst the GD23 mechanism applies the inflation adjustment for each individual year with a true-up at the end of the price control period, the RP7 mechanism calculates an average inflation adjustment for the period, with tariffs being adjusted annually to reflect changes to the rate of return. firmus energy would be keen to understand the Utility Regulator’s rationale behind this difference in application.

In relation to the cost of debt adjustment mechanism, whilst this is in line with the GD23 final determination, we would like to highlight one particular challenge within the mechanism.

The replacement debt (iBoxx) figure will be calculated using the average reported yield on the relevant series over the whole of the calendar month in which NIE carry out its refinancing exercise. Historical movements in iBoxx rates show that there can be material movements of the rate within a month, leading to a risk of fixing at a rate that is in excess of the average for the month. Utilising the rate for the actual date of refinancing would provide more surety for the company and provide a more representative benchmark for the cost of debt that has been raised.

We note that in making its assessment of the rate of return for NIE, the Utility Regulator has relied upon the recommendations from its consultant, First Economics. The Utility Regulator has utilised this consultant for the majority of its price control decisions and whilst this leads to a level of consistency across determinations, it could lead to a limitation of perspective regarding regulatory precedents, loss of a fresh approach or ideas and the risk of confirmation bias when comparing outcomes.

In its analysis of benchmarking of the NIE beta, First Economics sets out the four main determinants of the (systematic) risk that shareholders bear. A focus is given to cost/revenue structure, looking at exposure to demand risk, cost risk and operational gearing. Whilst the conclusion drawn by First Economics is that these risks are all low or very low for regulated companies, we would note that in the last 2-3 years firmus energy has faced unprecedented levels of inflation, construction, and material cost price increases considerably in excess of inflation and a year in which we achieved less than 75%

of our determined revenues. Whilst regulation mitigates against some risks, the above challenges highlight that regulated Northern Ireland network companies can and have been exposed to both demand and cost risks.

### SMART metering

An important area to consider in advance of any roll-out of SMART metering is the funding of that roll-out.

Table 13.10 in the draft determination (see below) outlines that despite the increased levels of capital investment and costs associated with the energy transition, domestic tariffs are proposed to come down.

Customer Group	Typical MWh/a	UR Draft determination – increase in tariff			
		D	T	T&D	(%)
Domestic	3.4	-10	7	-3	-2%
Small Business	16.4	-10	34	24	3%
SME, LV	275	82	575	657	6%
SME, HV	1,593	337	3057	3394	9%
LEU, HV	5,457	389	10472	10861	11%
LEU, 33kV	31,075	-1697	58932	57235	19%

**Table 13.10: UR impact on customer bills for a typical customer by transmission and distribution**

In paragraph 13.76 of the draft determination, the Utility Regulator notes, ‘These relative change of charges to different types of consumers are indicative of a need to carefully consider the allocation of charges in a changing environment. For example, further work on tariff structures will be required as part of the development of SMART metering. This might further impact on the distribution of network revenues and how this affects individual consumers and groups of consumers.’

There will be an unavoidable large initial capital outlay for the meters and technology/systems to support those meters. How will these necessary costs be recovered from consumers? If the electricity SMART metering programme is definitively happening, then should costs start to be recovered now to smooth their recovery and avoid large future tariff increases for domestic consumers? Including ringfenced allowances within RP7 could allow for this recovery, commencing from April 2025.

### Low carbon technology connections

As the Utility Regulator notes in paragraph 1.6 of the draft determination, the rate of development and distribution of new renewable generation and the uptake of electric vehicles (EVs) and renewable heat will have a major impact on demand.

NIE Networks has developed its plans for RP7 within this evolving strategic framework and it has based its central estimate of new demand on the connection of 300,000 electric vehicles and 120,000 heat pumps by 2030.

The government's ban on the sale of new petrol and diesel cars will come into effect from 2035, pushed back from the original target of 2030 and any estimates of electric vehicle uptake in Northern Ireland should take account of this extension to the timelines for the ban.

The move toward electric vehicles is however relatively certain and, as such, investment in these connections and the infrastructure to support them should be encouraged and even incentivised. Whilst a target of 300,000 electric vehicles by 2030 may be optimistic, having the infrastructure to allow for this level would help facilitate the promotion of uptake.

By contrast, the roll out of heat pumps is not presently supported by government policy. Installing a domestic heat pump requires a large upfront capital outlay and may not be suitable for a significant proportion of Northern Ireland's housing stock that are older houses with poor insulation.

firmus energy, together with the other gas distribution network operators, would see Hybrid heat pumps playing a significant role in any decarbonisation scenario due to their ability to improve the affordability of heat pump installation for users and offer consumers the opportunity to utilise cost-optimal heating – switching between gas and electricity whenever it best suits them.

More than two-thirds of Northern Ireland households use oil boilers as their main source of heating. Heat pumps can provide a greener solution for those consumers currently off-grid, i.e. not passed by the gas network but for those consumers who do have access to the gas network, moving from oil to gas can provide an immediate carbon emission saving of 50% and is a more cost-effective alternative compared to installing a heat pump.

With the injection of renewable gases into the Northern Ireland gas network, even further carbon savings can be achieved.

Ultimately, a full review of a heat strategy for Northern Ireland needs to be carried out to ensure the best solution is delivered for consumers; a solution that is cost-effective, takes account of any infrastructure investment to date and delivers the carbon savings required to achieve the net zero targets.

\*\*\*\*\*

We trust that you find these comments useful and if there are any aspects to this response that you would like to discuss further, please do not hesitate to contact me.

Kindest regards,

A handwritten signature in blue ink, appearing to read 'Mark W. Stevenson', with a stylized flourish at the end.

Mark Stevenson  
Director of Regulation