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Response to NIAUR Consultation

SONI Price Control for 2010 - 2015

on behalf of

AES Kilroot Power Ltd and AES Ballylumford Ltd

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Submitted by

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Introduction

AES Kilroot Power Limited and AES Ballylumford Limited (collectively "AES") welcome the opportunity to comment on the SONI Price Control 2010 – 2015 Consultation Paper ("the Consultation Paper").

Summary

AES welcomes the enhanced level of detail provided in the Consultation Paper and the bottom up review adopted by the Utility Regulator. Despite the enhanced level of detail provided it is not possible for AES to comment on the absolute values of the costs that should be permitted. AES can therefore only provide general comments or observations. AES also welcomes the introduction of incentives in the price control.

It is important that SONI has the appropriate level of resource to continue with its high standard of service provision and to enable it to meet its objectives efficiently and effectively. SONI must therefore be fit for purpose and incentivised to seek efficiencies and look for innovative ways of carrying out its functions. It is also important to consider the challenges that SONI faces particularly dealing with the high level of wind connecting to the grid and to ensure that these are dealt with effectively so that costs are minimised for customers.

Comments

Question 1: Do Respondents agree with the proposed approach for the SONI Price Control?

In the Consultation Paper the Utility Regulator outlines that the objective of the price control is to ensure that SONI can continue to operate the transmission system in Northern Ireland securely and efficiently and at a reasonable cost to consumers. In order to achieve this the Utility Regulator proposes to continue with the use of an RPI-X price control for Opex with a revenue cap and also agree an allowance for Capex with any unforeseen or outside the normal course of business costs treated as pass through under DTSOt. AES agrees with this approach.

SONI plays a crucial role is the smooth and efficient operation of the SEM and it is essential that the right balance is struck between cost containment and investment and between incentives and penalties as its operation can have significant cost implications for customers.

Question 2: What Duration to respondents deem appropriate for the SONI Price Control: Five-and-a-half years from 1 April 2010 to 30 September 2015 or three-and-a-half years 1 April 2010 to 30 September 2013?

A longer price control period is generally preferable in that it provides stability to both investors in terms of tariffs and also for SONI to enable longer-term planning. The fact that the first year of the price control period has virtually been completed would tend to support the five-and-a-half period in preference to the three-an-a half year period. The longer period would also provide better opportunity for the new incentives take effect.

As AES is not privy to the detail of SONI's price control submission it is difficult to tell whether the reduction in detail for the latter two years is concerning enough to warrant the selection of the shorter price control period. The Consultation Paper does not give the impression that it is, other than for Capex and the Utility Regulator deals with this separately. On this basis AES therefore supports a term of five-and-a-half years for the price control.

Question 3: Do Respondents agree with the proposed headcount and payroll allowance for the SONI Price Control?

AES recognises that SONI faces a number of challenges over the next few years, particularly with the implementation of the EU Third package and the connection and operation of large quantities of wind on the system. and that these will have resource implications, however the increase in staff numbers by almost 50% seems excessive.

AES believes that SONI must have adequate resources to deliver its objectives and to maintain its high quality of service however it is unable to comment on the appropriateness of the specific headcount or payroll allowance. The Utility Regulator appears to consider that, on the basis of its analysis, salary rates are reasonable and AES sees no reason to dispute this. The number of staff should therefore be reviewed following receipt of the external benchmarking study.

AES commends the Utility Regular on the rigour which it is applying to this key area of SONI's price control, the benchmarking of payroll costs and the commissioning of a study to benchmark the structure and headcount of SONI.

Question 4: Do Respondents agree with the proposed IT & Comms allowance for the SONI Price Control?

The provision of high quality, timely information is critical to the achievement of SONI's objectives. On the basis of the information available it appears that the Utility Regulator has accepted all of the costs proposed by SONI other than the challenge of 15% on static support costs in year 4. AES considers such a challenge to be reasonable and should be achievable through retendering/restructuring.

Question 5: Do Respondents agree with the proposed pension allowance for the SONI Price Control?

AES agrees that the pension allowance should reflect the number of staff approved in the price control.

Regarding the level of employer contributions, the Consultation Paper states that the Utility Regulator considers SONI's proposal to be high when compared to benchmarked information. Since the level of employer contributions is generally reviewed by the employer and pension scheme trustees after each formal actuarial valuation AES considers that the price control should reflect any change in the employer contributions following this review.

Question 6: Do Respondents agree with the proposed pension deficit recovery period and treatment for the SONI Price Control?

The Utility Regulator is proposing to allow 100% of the pension deficit recovery over a 15 year period and the pension deficit is currently estimated at £1.6m, although this will be confirmed when the actuarial valuation report is received. AES supports the proposal to allow full recovery of the pension deficit since the Utility Regulator agreed that SONI should retain the deficit at the time of the purchase by EirGrid.

While AES understands the logic of following the 15 year funding period determined by the Competition Commission last year in the case of Bristol Water, given that SONI is likely to have to make the payments in a period of 10 years or less and therefore finance any timing difference, and given the relatively small impact on the price control, AES believes that the payment period should be 10 years as per the SONI submission.

Question 7: Do Respondents agree with the proposed Other Opex allowance for the SONI Price Control?

The Consultation Paper states that the only reduction the Utility Regulator proposes to make to Other Opex is to align the Facilities costs with the proposed headcount and reduce Insurance costs in line with proposed Capex. AES would agree that any of the Facilities costs which are variable and directly proportional to the number of staff should be reduced in line with headcount. Similarly AES would agree that to the extent that Insurance costs are proportional to Capex a corresponding reduction should take place.

Question 8: Do Respondents agree with the proposed Capex allowance for the SONI Price Control?

As a general comment it is important that SONI maintains and invests in its business to ensure that it is efficient and fit for purpose. It is also important to ensure that assets are maintained on an ongoing basis so that problems are simply not stored up for future periods, or that opportunities for the implementation of efficiencies or enhanced service provision lost, provided that Capex is only incurred if the benefit clearly justifies the cost.

AES recognises the difficulty in identifying and providing detailed Capex justifications the further out the time period and is therefore sympathetic to the positions of both SONI and the Utility Regulator. AES fully supports the Utility Regulator's position that it cannot approve Capex at this stage which either has not been identified or has not been fully justified. However it is important to ensure that a mechanism exists for SONI bring forward critical or beneficial Capex proposals during the price control period so that important investment is not delayed unnecessarily until the next price control period. This appears to be accepted as the Consultation Paper states that the Utility Regulator will consider any innovation ideas with a full CBA during the price control period.

It is difficult for AES to comment on the specific elements of Capex outlined in the Consultation Paper and the approach adopted by the Utility Regulator however it is worth commenting on the SONI website. The internet is an extremely powerful communication tool for market participants and other interested parties and it is critical that SONI's website is upgraded as a matter of urgency as it is not fit for purpose. While AES cannot comment on the magnitude of the costs it is important that the right level of investment is made. Given the apparent divergence in views between SONI and the Utility Regulator AES would therefore urge SONI and the Utility Regulator to discuss the matter further and clearly establish the scope and costs of an appropriate upgrade.

Question 9: What opinions do Respondents have regarding the future building requirements for SONI?

AES recognises that buildings require upgrading, particularly to comply with legislation and for health and safety reasons. It also recognises the benefits of having all staff located at a single location however the cost of this must be proportionate to the benefit received. AES therefore believes that a detailed cost benefit analysis should be carried out on the lifecycle costs of the various accommodation options before a decision is made.

Question 10: Do Respondents agree with the proposed WACC for the SONI Price Control?

AES agrees with the continued use of the Capital Asset Pricing Model in the calculation of WACC as this mechanism is well established and maintains consistency with the existing price control. It is also helpful that an independent assessment was obtained.

Again it is difficult for AES to comment on the absolute values of the various components however it would appear that the values for asset and equity beta may warrant a further review in view of the relatively large ranges provided by First Economics and the fact that the Utility Regulator has selected the low value in each of these cases.

AES would agree that if the tax rate changes during the price control period the impact on the WACC should be reviewed.

Question 11: Do Respondents agree with the proposed Depreciation period of 10 years (straight line) should be used for the price control period?

AES agrees with the continued use of a 10 year depreciation period on the grounds of consistency.