



**Reflections on the Utility Regulator's Mid-Term
Review of Corporate Strategy, 2009-14**

September 2011

Introduction

EirGrid welcomes the opportunity to input to the Utility Regulator's Mid Term review of its Corporate Strategy 2009-2014. The Corporate Strategy is an important document in outlining the overall objective function and direction of travel of the work of the Utility Regulator. The first Strategy published in 2009 provided a firm foundation upon which to build and this mid-term review, given so much which has changed in the external environment, is timely. The unique position of the EirGrid Group, as Transmission System Operator in both Ireland and Northern Ireland, as operator of the Single Electricity Market on the island of Ireland and as developer of the East West Interconnector, both in terms of its independence from other interests as well as its more general oversight and visibility of so many parts of the value chain, means it is in an ideal position to contribute to the overall direction both informed and in a position to analyse the issues and without vested interest.

In this response we reflect on:

- The consideration of the External Developments
- An articulation of Outcome in the Context of Conflicting Priorities;
- How to Balance Consumers' Interests;
- The four Utility Regulator Identified Needs; and
- The four questions posed by the Utility Regulator

Consideration of External Developments

There have been a considerable number of external developments since the publication of the original Strategy. While EirGrid largely believes the seven original strands within the Strategy remain valid, and largely always will, we also believe it is important the external developments since the publication of the Strategy are considered and incorporated within it. A couple merit particular mention.

The Changing Financial Environment: There has been considerable change in the underlying financial environment since the publication of the original Strategy document. Capital is now much less easy to come by and, where available, is more expensive in real terms and relative to underlying base rates. This, at the very time when significant investment is required in Northern Ireland's energy and water infrastructure. Utilities within Northern Ireland are subject to varying ownership and financial structures: NIW is a GoCo; Mutual Energy is a mutualised entity; SONI Ltd. and NIE T&D are subsidiaries of Irish government owned companies while others remain privately owned. The restrictions on, and cost of, capital may differ in each case. The Utility Regulator has conducted interesting work on the mutualised model earlier in the year upon which EirGrid has both commented and engaged. The original Strategy suggested that the Utility Regulator would carry out work to assess the implications of the changing financial environment on its regulatory approach. This is something which EirGrid believes should continue to be brought to the fore and further developed in the forthcoming period.

A Changing European Environment: Both the third package in energy (IME3) and the establishment of the new European wide energy regulatory body (ACER) within it have been significant developments since the publication of the original Strategy and will affect the evolution of Northern Ireland's energy industry going forward. Seeking to influence developments at a European level in

relation to energy is one of the Utility Regulator identified needs within the mid-term review. EirGrid believes considerable focus will be required in this area as not one size will fit all. Nonetheless the implementation of the European framework: in independence and certification will be a particular driver in the forthcoming period.

Changes in the Policy Environment: There have also been considerable changes in the policy environment. Most notably and closest to home DETI has published the Strategic Energy Framework which balances the three energy pillars and sets out a 40% renewables target by 2020 for Northern Ireland. In GB, two important developments at least merit reflection in a UR context. The first is the articulation by DBIS of the Principles of Economic Regulation. It would be useful to see these, or at least the Utility Regulator's views of the applicability of these, reflected in the revised Strategy. The second is the DECC review of Ofgem in the context of the balance between the independence from political influence of the economic decisions of regulators with the requirement for democratic accountability within a policy framework; again it would be beneficial to see how UR seeks to reflect this within its Strategy.

Articulation of Outcome in the Context of Conflicting Priorities

Decision making by regulators is sometimes more an art than a science and requires the careful balance of potentially, and sometimes axiomatically, conflicting objectives. Indeed if there is one word which sums up the challenges faced by an independent economic regulator it is most probably 'balance'. However, in achieving that balance, and in particular a consistent balance, it is important, to have a clear articulation of the objectives and the outcomes sought. Much of the focus of the day to day work of the Utility Regulator is on 'inputs' or 'outputs' and with a limited focus on 'outcomes'. EirGrid would like to see a set of desired outcomes articulated and against which the basis of decision making can be measured and assessed. Such an articulation would not only provide a clear understanding of direction of travel but would, in addition, help understand the basis of decision making by the Utility Regulator.

It is important for all stakeholders: investors, utilities, consumers, government and citizens to understand the basis of decision making. EirGrid suggests consideration of Regulatory Impact Assessment as being a worthwhile tool in the context of major decisions. Transparency is not only important for accountability but has a direct financial benefit also as with regulatory certainty, and an understanding of regulatory decision making, comes lower costs and in particular lower cost of capital in financially challenging times. EirGrid would like to see some reflection of this in the revised Strategy Statement.

Balancing Consumers' Interests

The Utility Regulator's primary duty is to protect the interests of consumers in the provision of what are essential services. However, even within this choices must be made and balances struck. Consumers in general must be considered relative to vulnerable consumers in particular. The NISEP and other work of the Utility Regulator looks at this. Consumer needs today must be balanced against the consumer requirements of the future. This will impact the choices made in investing in infrastructure and in the choices we make concerning both the sustainability of, and evolving value chain in, our energy supply. Furthermore the needs of Northern Irish consumers must be balanced against all island consumer interests in the context of altered statutory decision making functions in the context of SEM and CAG.

Energy policy is underpinned by the three pillars: cost competitiveness, sustainability and security of supply. The Utility Regulator has been known to describe these as something of a 'trilemma'. The balance of consumer interests is again a similar such 'trilemma' although again an articulation of the desired outcome can in both cases help indicate the appropriate balance in decision making between the relevant elements.

The Four Utility Regulator Identified Needs

In the paper the Utility Regulator outlines four areas where it believes the Strategy could benefit from further concentration. EirGrid has suggested a number of further issues above but comments below on the identified four.

1. Utilise our Cross Utility work-stream to drive best regulatory practice (e.g. cost reporting and monitoring).

EirGrid comment: Yes, further cross utility working is likely to be beneficial. The focus should be to share and establish experience as to what works best. In particular EirGrid believes that a re-balance of focus between 'costs' and 'prices', or as it has elsewhere been described between a 'bottom up' and 'top down' approach to regulation, would be likely to be beneficial.

2. Mainstream sustainability across all aspects of our work, engaging key stakeholders to support sustainability targets.

EirGrid Comment: EirGrid agrees with this but believes the Strategy Statement would benefit from further articulation as to how it is proposed it be achieved.

3. Strategically set out the future development of Retail Competition

EirGrid Comment: EirGrid agrees with this but (i) given the relatively small impact on final customer bills and (ii) the relatively limited number of viable competitors who are largely price takers in respect of the majority of costs, wonders what level of overall impact this would be likely to have.

4. Seek to Influence Developments at a European level in relation to Energy

EirGrid Comment: As outlined above EirGrid believes this to be very important that the Northern Ireland voice is heard and where possible co-operation between all stakeholders, both in Northern Ireland and in Ireland, in relation to European developments as they affect SEM and the island of Ireland. EirGrid itself, through its membership of ENTSO-E as both EirGrid and SONI is seeking to represent and advance Northern Irish interests in Europe.

The Four Questions posed by the Utility Regulator

Finally we turn our attention to the four questions raised by the Utility Regulator.

1. Have we considered all the Key External Developments that have occurred since 2009?

EirGrid Comment: The key external developments since 2009 have largely been considered. EirGrid believes further reflection on the changing financial environment in line with the intent set out in the original Strategy would be warranted and that further articulation of the impact and any change in direction as a result of the other developments would be beneficial. We have outlined a few suggestions in this regard above.

2. Do you agree with the overall view that the Strategic Direction set out in our Corporate Strategy remains relevant and is the right high level approach?

EirGrid Comment: Yes, EirGrid believes the overall direction remains appropriate but would like to see a further articulation of outcome within the balancing act that the Utility Regulator must manage in the context of the various statutory objectives it faces.

3. Do you agree with the four areas we think we need to evolve?

EirGrid Comment: This is addressed in the previous section. EirGrid has also identified a number of further needs in this response.

4. Is there anything else we need to consider regarding our strategic direction over the period to 2014?

EirGrid Comment: This has been covered above but would include (i) further consideration of a changed financial environment (ii) greater articulation of how to make the most of cross utility working (iii) greater articulation of desired outcome and (iv) further reflection on changes in the external environment and their applicability to the Utility Regulator.

Conclusion

The open consultation on the Utility Regulator mid-term review of Strategy is extremely welcome. EirGrid hopes the comments it has proffered as part of this response and in earlier dialogue, are beneficial to Utility Regulator in finalising its thinking. It is fair to say that from discussions which have taken place between EirGrid and the Utility Regulator we are aware considerable thinking has taken place and work is underway in relation to many of the areas identified in EirGrid's response. Perhaps what has sometimes been lacking is both the visibility of, and early engagement in, some of this thinking.

We face significant changes and ambitious policy targets going forward. Moreover, Northern Ireland will increasingly be affected by external developments (across the island, in the UK and in Europe). It is vital that the Utility Regulator has a strong outward facing focus to represent the interests of the Northern Irish consumer (or all island consumer where appropriate) and to ensure it can punch above its weight. EirGrid is in a position where it is aligned with the objectives of the Utility Regulator in seeking to protect consumers' interests and where, given its position in the industry, it is able to conduct and provide considerable analysis to aid Utility Regulator in its thinking. EirGrid looks forward to ongoing engagement with a view to aiding the Utility Regulator in the delivery of its revised Strategy Statement.