

Price Control for Northern Ireland TSO 2020-2025

UR Approach Consultation

Power NI Response

28 January 2019

Introduction

Power NI welcomes the opportunity to respond to the Utility Regulator's (UR's) Consultation Paper in relation to the approach the UR will adopt in setting SONI's Price Control for the period of 2020 to 2025. SONI acting as Transmission System Operator (TSO) in Northern Ireland, play a vital role in the development and operation of the electricity system. SONI also have an important role in the outcomes of the wholesale market.

As a monopoly business, having a price control in place ensures that costs, ultimately paid by consumers, are reasonable and efficiently incurred. Unlike the majority of price controlled businesses however SONI are not an asset heavy network business. It is therefore important that the UR recognises SONI's asset-light nature in considering the risk, margins and contingent capital requirements placed on the business. It is also important that the UR carefully considers how it provides the necessary incentives to SONI to ensure that its influence is brought to bear to deliver better customer and consumer outcomes.

Power NI recognises that this is a difficult task and one that cannot be delivered by prescriptive traditional price control formula. Power NI would encourage the UR to consider issues such as innovation and influence more broadly and provide controlled latitude for SONI to work to deliver in the interests of the end consumer. A price control determination should deliver a balanced, proportionate and reasonable outcome which both recognises the burden and risk placed on the business while ensuring that costs are reasonably and efficiently incurred.

Specific Questions

The UR posed a number of specific questions within the Consultation Paper and Power NI has sought to deal with each in turn.

1. Do you agree with the proposed form, scope and duration of the control?

Power NI response:

Power NI notes that the scope of the price control remains to be set and will be determined following the UR's assessment of the SONI business plan. In relation to the form and duration of the control Power NI supports the single revenue cap approach and a five-year duration would appear appropriate and gives certainty to the SONI business.

2. Do you agree with the way SONI's roles, services and activities have been defined (as set out on page 17 and Appendix C)?

Power NI response:

The summation provided on page 17 and within Appendix C of the UR's Consultation Paper provides a reasonable definition of the roles, services and activities SONI provide.

Power NI would however welcome the area of system balancing being highlighted from both a system operation and a market operation perspective. The implementation of the new wholesale arrangements making the SEM compatible with the European Target Model, increases the level of influence SONI has on market outcomes. Dispatch decisions set the price within the Balancing Market and send trading decision signals to participants. This significantly increases SONI's influence in this area beyond system security and into economic and market trading decisions. This increased influence and the impact dispatch instructions have on balancing market prices and volatility are critical to market participants. This role and responsibility assumed by SONI should not be underestimated.

3. Do you agree with our expectations as part of our test area on delivering value for money?

Power NI response:

A test area of delivering value for money at a headline level is one that all participants, customers and consumers would support. Beyond efficiently incurred operating costs for the completion of core activities, this test becomes more opaque. SONI have significant influence both on system and market outcomes. This is inherently difficult to measure. Power NI would welcome the UR carefully considering this aspect of the 'value for money' considerations. As has been described by the UR, the electricity system and market is evolving at a rapid rate. SONI have a significant facilitating and enabling role to play in this development. It would be contrary to the interests of both customers and consumers if SONI were unable to fulfil the role as facilitator or enabler simply because they have price controlled enabled remit or allowance to do so.

4. Do you agree with our framework approach and expectations as part of our test area on delivering services and outcomes (including our proposed framework for service quality and performance)?

Power NI response:

Power NI believes that the delivery of service and the development of the electricity system and market are the key SONI deliverables. It will be difficult and in many ways counterproductive to stringently tie SONI to a prescriptive set of deliverables for a period

which stretches to 2025. The UR must carefully consider both the base set of deliverables alongside an aspirational, flexible set of developmental deliverables. As has been highlighted in the UR's Consultation Paper, this response and at the consultative workshops, SONI has significant influence. This is difficult to measure, define and track however should be reasonably facilitated within the regulatory structure.

5. Do you have any initial views on how the service quality and performance framework could be implemented as part of our test area on delivering services and outcomes?

Power NI response:

Within the Consultation Paper the UR highlights financial incentives, warns about unintended consequences, acknowledges the need for innovation and describes a TSO framework which is in its infancy in Northern Ireland. Power NI recognises this as the challenge when determining a price control for an organisation such as SONI.

Appropriate incentives both financial and non-financial form an important part of the price control determination. It is also important to ensure that the UR does not create a regulatory framework which is excessively burdensome. Such an outcome would be counterproductive and clear unintended consequence which would damage the relationship between the UR and SONI while undoubtedly resulting in avoidable costs ultimately paid by consumers.

Power NI believes there is a basis to proceed within the paper. SONI carry out a number of core activities which are known and understood. For such activities traditional incentive based regulation i.e. a cost allowance and efficiency sharing if delivered for less than allowances, remains appropriate. For the activities which are more difficult to define e.g. influence and innovation the UR has described assessment of outcomes and description of deliverables. This area is clearly much more difficult to incentivise and discretion will form an important part of any solution. Discretion however does need a transparent and constructive relationship to exist between SONI and the UR. Such a relationship must be in place to ensure that the business is incentivised appropriately and with the knowledge that reasonably incurred will be allowed. Equally important the UR needs to ensure that it has sufficient transparency of SONI's delivery and costs.

6. Do you agree with our framework approach and expectations as part of our test area on securing cost efficiency and managing uncertainty?

Power NI response:

Power NI understands and supports the UR's goal of providing a clear framework for assessing cost efficiency and for the traditional and well understood service delivery SONI provides this should be achievable. Power NI would however caution being overly

prescriptive in the area of innovation and managing uncertainty. Restricting SONI's ability to respond to developments, particularly over such a long timeframe which this price control covers, has the potential to deliver the unintended consequence of a lack of flexibility. The UR should be mindful of this and explicitly allow for some discretion within the assessment and allowances. This could be in the form of provisions for SONI to come back to the UR at any time to request funding for a particular development or even research into a particular area.

7. Do you support the overall approach and expectations to financeability set out above, and elaborated on in the Reckon working paper, for the SONI TSO control?

Power NI response:

The question of the approach to financeability is difficult for a party other than the UR or SONI to appropriately comment on. The CMA determination clearly is an important factor in the UR's final determination as is a detailed understanding of SONI's own financing arrangements. At this stage and mindful of those factors, Power NI is limiting its comments to the high level principle that SONI should be financeable, receive a reasonable return for the services it provides and the methodology should recognise that it is an asset-light business.

8. Do you support our approach and expectations for remuneration of the SONI's equity capital and debt finance set out above, and elaborated on in the Reckon working paper, for the SONI TSO control (including whether we move to CPI or to CPIH indexation as part for the 2020-25 SONI price control)?

Power NI response:

Consistent with Question 7, Power NI has no further comments in relation to SONI's return on equity other than to again highlight that it is asset-light and given its processing of funds within the market (TUoS, SSS and CAIRt) will have to have significant contingent capital available and therefore paid for.

9. Do you agree with our expectations as part of our test area for engaging customers, consumers and other stakeholders?

Power NI response:

Power NI believes it is reasonable for the UR to expect that SONI undertakes a broad range of engagement given its role and influence over the electricity system and market.

10. Do you agree with our expectations as part of our test area on resilience and governance?

Power NI response:

Resilience and good governance should be expected from an organisation such as SONI. Power NI would suggest that the UR should only require light touch assurance in this area and detailed testing and evidence is overly burdensome and unnecessary.

11. Do you agree with our expectations as part of our test area on accounting for past delivery?

Power NI response:

A test area of accounting for past delivery is in essence a 'lessons learnt' exercise for SONI. Power NI would assume that an organisation with roles, responsibilities and governance of SONI would undertake such exercises on a regular basis, taking learning from all facets of their business. Similar to the area of governance, Power NI does not believe that it is beneficial for the UR's price control process to spend any significant time on this area. The SONI business should be allowed to manage their own affairs as they see fit and with what is determined to be reasonably allowed efficient cost levels for doing so. Power NI considers these types of tests as straying in to the overly burdensome category.

12. Do you agree with our framework approach proposals and expectation as part of our test area on securing confidence and assurance?

Power NI response:

The UR should set a framework it feels necessary to provide it with a reasonable level of assurance. This will be difficult to fully define especially given SONI's particular role. Power NI would encourage the UR not to be overly prescriptive or burdensome in its assurance requirement. For any ex post project type project expenditure an approval audit of reasonably incurred cost would be expected.

13. Do you agree with our framework approach to setting clear regulatory expectations for SONI as part of its business plan and for assessing SONI's business plan, (including test area guidance and questions, categories and incentives to motivate SONI to produce a high quality business plan)?

Power NI response:

As stated above, Power NI understands that the UR is attempting to provide absolute clarity in terms of the UR's expectations of the SONI business plan and ultimate deliverable. While clarity and structure is helpful the UR should also be mindful of not creating an unnecessary regulatory burden.

At a high level, stakeholders have an expectation of what SONI will deliver, the price control should provide a reasonable allowance for that delivery and the UR requires the necessary assurance and transparency of that delivery. Power NI believes that in the price control process it is for SONI to convince the UR that they can and should delivery certain services and make a cost assessment of that delivery. It is then for the UR to make a determination based upon all the information and feedback available. To be overly prescriptive at the business plan phase risks derailing the process.

14. Do you agree that we have identified the right test areas and that these are structured in the right way?

Power NI response:

Power NI does agree with the UR's test areas as the key review points of the SONI business plan.

Conclusion

Power NI welcomes the process which the UR has undertaken in relation to the SONI price control and remains committed to contributing via the Stakeholder Expert Challenge Group. Setting the SONI price control is a challenging activity. The UR has to be mindful that much of SONI's deliverable is centred on influence and market signals. While a number of the core traditional services should be able to be determined relatively quickly, the incentivisation the price control provides is an important and difficult aspect.

Power NI would encourage the UR to focus on how effective incentives can be and what outcomes they might deliver in the interests of both customers and consumers. Power NI would also encourage the UR to not be overly burdensome in the business planning assessment stage.