

CBI response to Utility Regulator's NIE Transmission and Distribution Price Control 2012- 17 (RP5)

Introduction

- 1 CBI Northern Ireland welcomes the opportunity to comment on the Utility Regular's Draft Determination of Price Control proposals for Northern Ireland Electricity for the period 2012-2017. The CBI is the UK's leading business organisation, speaking for some 240,000 businesses which together employ around a third of the private sector workforce.

- 2 The environment within which the price determination is being made is an exceptionally challenging one. The cost pressures on business in the current economic climate are unprecedented, yet against this the price determination needs to balance the short term price control with the need to invest, both for long term supply security and for the transition to renewables generation. The provision of a high quality, reliable and cost effective transmission and distribution network is a critical part of the infrastructure required to support a modern and prosperous economy. All sectors, including the agri-food, electronics/ engineering, chemicals, health technologies and increasingly the IT sector are dependent on a cost effective, high quality and reliable electricity supply. A CBI/KPMG survey in 2011 revealed that 80% of investors identified the provision of a reliable and quality energy supply as a significant or very significant consideration in their investment decisions.

- 3 In terms of priorities for the regulatory period the CBI is keen to see the following key outcomes:
 - Continued improved efficiencies in the cost of delivery of services to ensure the delivery of competitively priced tariffs
 - High quality customer service and standards, within a responsive, customer focused organisation
 - Continued investment in capital assets and people to ensure the assets are being appropriately maintained (and replaced where necessary in a timely manner) and security and quality of supply performance is at least maintained
 - Predictability and 'smoothness' regarding tariffs to assist companies with their forward planning and investment decisions

The business community needs to have confidence that these outcomes will be delivered. It is essential that the outcome of RP5 delivers confidence to consumers that the proposed outcomes are achievable. It is important that there is continuity between price control periods and that investment in network infrastructure is smooth and progressive.



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- 4 The regulatory review is clearly a complex and detailed process involving a wide range of information and data gathered over several months. We are not in a position to comment in detail on many aspects of the RP5, nor do we believe that is the role for us. This response, following briefings with the Utility Regulator and NIE, together with consultation with our members focuses in on a number of key issues which are a key part of the RP5 determination.
- 5 It is our understanding that NIE's Transmission and Distribution network charges (which is the prime focus of the RP5) represent around 20% of end-users bills, and less for larger energy users – this is broadly in line with GB electricity utilities. CBI members are keen to ensure that T&D costs remain competitive with comparable GB utilities, and that we should seek to keep any increases in network costs and prices at a lower rate than in the price controls agreed by OFGEM in Great Britain. At the same time CBI members are keen to see all the key components of the final electricity bill benchmarked against GB.

Specific comments on NIAUR Draft Determination

- 6 CBI members expect to see a robust regulatory review take place which is both fair to consumers and to NIE. One that can provide the necessary clarity and confidence to business in planning future investment strategies, to NIE in order to facilitate the future investment in the Transmission and Distribution network across Northern Ireland and one that provides the necessary reassurance to customers regarding security and quality of supply, and the provision of competitively priced transmission and distribution charges. Our analysis of the Utility Regulator's Draft Determination against NIE's proposals (and the resulting very large discrepancy in investment proposals) leads to significant concerns, which we have highlighted below, about the outcomes and the nature of the regulatory process, relative to that which is undertaken with other similar utilities in Great Britain. The draft determination has resulted in a Utility Regulator Capex programme, rather than an NIE one, and hence NIE will have little if any 'ownership'.
- 7 A key issue is the nature of the regulatory process in arriving at the draft determination. CBI members believe this should follow best practice, as established with Regulatory bodies in Great Britain, and now reflected in many other countries. The regulatory process in Northern Ireland appears to have taken the form of extensive information requests (with the use of various consultants) but with an **apparent lack of sufficient engagement and interaction** to fully understand the dynamics and issues being addressed – this is in sharp contrast to the process which has taken place in Great Britain. Furthermore the element of retrospective regulation covering previous price review periods also does not appear to be in line with best regulatory practice as we understand it. Members have raised surprise that a more 'engaging' and 'informed' process has not taken place, similar to what normally occurs across similar regulated organisations in Great Britain – the fact that an apparently 'arms length' process has been applied in Northern Ireland in our view has led to the extreme divergence in views of the investments required.
- 8 NIE has raised a number of issues with our members which clearly need to be addressed in the final determination, including:
 - The regulatory process and assessments appear to be largely desk based – with no site visits – it is hard to understand how decisions on the quality of assets and the need for their replacement can be taken without such visits

(particularly when there is such a major difference of views on the level of asset replacement required)

- A number of inaccuracies have been highlighted to our members, including
 - o disallowances for load related investments where NIE have shown that plant is already under strain eg in Cookstown, Limavady, Armagh and Castleterragh
 - o basic errors in NIAUR's benchmarking of NIE costs versus GB peers – we understand these have been confirmed by external economic consultants; and
 - o In Section 8 NIAUR states that 'average salaries at NIE Powerteam Ltd are above the Northern Ireland average' – yet evidence has been given that the majority of NIE staff are specialist (largely in engineering, professional, craft and technical roles) are on salaries below the NI average, when compared with the appropriate job categories. NIE are of the view that they are in danger of losing large numbers of key staff to competitors due to the skills shortage in the sector and in engineering generally (see also Para 12). It should be noted that NIE's views would echo the concerns also held by many of our members in relation to their own businesses
- The draft determination has taken a very harsh view on the need for replacement of key aged infrastructure even where there is a risk of catastrophic failure and where replacement lead in times are extremely lengthy. For example a third of the proposed replacement of aged power transformers have been disallowed despite them being demonstrably in poor condition

We are not in a position to comment on the specifics of these issues but it is essential that the Utility Regulator addresses these concerns satisfactorily before reaching its final determination and it is clear in its own evidence about why they have been disallowed.

9 A key issue which reflects on the apparent dysfunctional process outlined above is in regard to the proposed **Capital Expenditure** proposals. CBI members are very surprised at the size of the discrepancy between NIE proposals (for an investment of £776m over the five year regulatory period) and Utility Regulator's proposals (for an investment of £315m) – by any measure (and compared with GB experience) this is an extraordinary difference to emerge within a draft determination. We recognise that the current Capex proposals from NIE are in excess of historic outturns, though we also note that much of the network is approaching the end of its expected life. The size of the gap emerging does however raise issues of confidence about the regulatory process which has taken place. In Great Britain the 'gap' between utility proposals (which have included significant replacement Capex) and OFGEM's draft determinations have been significantly narrower¹.

10 We also understand that the Utility Regulator's Draft Determination was presented to NIE and immediately published, yet the scale of the discrepancy in investment proposals would have suggested that a particularly high level of engagement was necessary before publication of this determination.

11 On the face of it a strong case has been made by NIE for increasing investment to replace assets built in the 1950s and 1960s – similar asset replacement programmes have been accepted across in Great Britain by OFGEM, albeit that the regulatory

¹ OFGEM Electricity Distribution Price Control Review Initial Proposals 92/09 – the equivalent variances of the 14 Distribution Network Operators in GB and OFGEM proposals ranged between 8% and 21% (August 2009)

process has become more sophisticated, with a shift to a 'conditional based approach'. The CBI is not in a position to comment on what the scale and scope of such a replacement programme should be, and we are clearly conscious that we need to avoid replacing assets which have not come to the end of their useful lives. Without appropriate and planned asset replacements the risks of outages in the network are likely to increase. Clearly there is some trade-off between maintaining a high security of supply and delaying replacement investment of assets now approaching, and in some cases exceeding, 50 years of age. Businesses will make their own judgements on the 'reasonableness' of the risk assessment which has been undertaken, and how these may impact on their own businesses continuity plans. However CBI members would wish to seek assurances from the Regulator that the final determination will not result in the deferral and build-up of a 'cliff-face' of assets that will need replacement and creating an even greater increase in T&D charges in the future.

12 There are concerns that without appropriate replacement investment being undertaken:

- Customer service standards, including the likelihood of unpredicted interruptions/outages will increase
- Delaying investment may mean an even an even larger increase in investment in the future. For example the draft determination excludes any asset replacement in the 11Kv network conductor category (NIE are proposing an investment of £127m) – even though the age of a significant percentage of these assets exceeds 40 years and where it is recognised that failures in this part of the network due to the conductor age, condition and size can have a large impact on customers especially during weather related events – if this programme is not started in RP5 what will be allowed in RP6?
- Indeed what is NIAUR's view of the Capex requirement in RP6 under the current approach (including for renewables)?

Consumers need to have confidence that the final determination will ensure that network performance is at least maintained.

13 It would seem sensible both from NIE's planning and from a customer predictability perspective that there may be some guidelines/benchmarking with regards replacement/renewal expenditure versus the Estimated Replacement Value – we would expect this to reflect the nature of these long term assets typically with a life of around 40 years. We would propose that consideration be given to a long-term asset replacement strategy (commensurate with the life of the asset) which allocated sufficient capital for NIE to then prioritise investment through a risk based approach in terms of prioritisation and scheduling. Such an approach would lead to some flattening of the replacement investment cycle which would aid workload and staffing planning. Does the Utility Regulator have a view of such a replacement programme?

14 There is strong evidence to indicate that storms and severe weather events are becoming more frequent and we would expect that strategically the electricity transmission and distribution network would be appropriately strengthened rather than weakened – as highlighted above the test of this is that consumers will expect network performance to improve and not to reduce.

15 A number of other issues are raised within the Draft Determination which we wish to comment on briefly:

- With regard the proposed investment in **renewables and interconnection** (of £306m) the approach appears sensible due to the uncertainty regarding timing

(much relating to planning issues) though it also raises concerns about the ability of the network to facilitate the delivery of the Executive's goal of 40% renewables by 2020. It is essential that we avoid a situation of the Regulator micro-managing the necessary investment or having long drawn-out bureaucratic processes introduced to facilitate the required investments which could lead to delays in investment in renewables and interconnection (which must be a priority in order to reduce constraint costs on consumers) – we understand that many projects are already facing grid connection delays. In this area, and indeed with the wider investment programme the level of Regulator involvement in day to day decision making should be left to incentivising management. Investors in energy generation need confidence that appropriate infrastructure will be developed in a timely manner – with this approach an explicit performance target for the Utility Regulator for regulatory approvals needs to be considered

- **Investment in training** – we are informed by NIE that the draft determination has made no allowance for training expenditure over the regulatory period – a cost of c £5m has been identified by NIE. Our members are extremely surprised at this decision. Investment in people, particularly in apprenticeships and graduates, in an organisation with an aging workforce, and in a sector which is experiencing skills shortages, is essential. Indeed some of our members have argued that government should be encouraging larger companies such as NIE(which has the necessary HR infrastructure to develop apprenticeships to 'overtrain' as the benefits will flow to the wider economy) - such 'overtraining' should not form part of the RP5 but is something for other government departments to consider supporting. The approach in Northern Ireland is totally at variance with what has taken place in GB where utilities have informed us that they have been 'encouraged to increase their investment in training' with a special allowance allocated
- **Return on investment** - NIE's return on investment should be similar to that of equivalent GB companies – this is essential if NIE is to secure the necessary funding (at competitive costs) to allow it to continue to invest
- **Retrospective regulation** – while we understand a price review will inevitably entail a review of past expenditure during the current regulatory period (RP4) it is not, as we understand it, best regulatory practice to undertake retrospective regulation of previous 'closed' regulatory price controls periods prior to the existing one (where it is essential that true run rates and base line expenditure can be established)

16 In conclusion the interests of CBI members and the wider community are best served by delivering sustainable reliable services at an efficient cost, rigorously benchmarked against comparable service providers in Great Britain. The final price determination should:

- Be affordable to all – and seek to keep any increases in network costs and prices at a lower rate than in the price controls agreed by OFGEM
- be designed around best regulatory practice and must be robust, yet fair
- demonstrate a high level of engagement
- set out regulatory outcomes which focus on value and not just cost, which deliver realistic efficiency savings and appropriate investment (which can be financed at low cost) in which consumers can have confidence
- ensure that network performance is at least maintained, if not improved