

**Northern Ireland Electricity plc  
Transmission and Distribution  
Fifth Price Control (RP5)**

**Strategy Paper Update  
May 2011**

# 1 Executive Summary

This Information paper is the second in a series of papers which aims to inform stakeholders about the Utility Regulator's RP5 price control review for NIE T&D. The Utility Regulator issued an RP5 strategy paper<sup>1</sup> in July 2010 which welcomed responses to a range of questions focussing on the components of the price control. This Information paper provides a recognition of responses received which have been reviewed by the Utility Regulator.

Since the RP5 strategy paper was issued, a number of developments have occurred. These include Department of Enterprise, Trade and Investment (DETI) consultations on the Strategic Energy Framework<sup>2</sup> (SEF) and the 3<sup>rd</sup> EU Energy package<sup>3</sup> (IME3). Ofgem have also published RIIO<sup>4</sup>, a result of their RPI-X@20 review, all of which are currently being assessed or will be taken into account by the Utility Regulator for RP5. The Utility Regulator has sent a Business, Efficiency and Investment Questionnaire to NIE T&D for completion, and published consultation documents on Connections<sup>5</sup> and Financing Networks<sup>6</sup>. Responses received to these papers will be given regard in the RP5 price control review.

The RP5 strategy paper outlined the objectives for the price control. These will be:

- To ensure value for money for customers;
- To ensure security of supply by maintaining and developing a network which is fit for purpose;
- To facilitate sustainability in the generation and consumption of electricity.

Questions were posed about key issues in the RP5 strategy paper. A summary of the responses to each question is highlighted in this Information paper. Individual responses<sup>7</sup> are on the Utility Regulator website.

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[http://www.uregni.gov.uk/uploads/publications/RP5\\_NIE\\_TD\\_Fifth\\_Price\\_Control\\_Strategy\\_Paper\\_FINAL.pdf](http://www.uregni.gov.uk/uploads/publications/RP5_NIE_TD_Fifth_Price_Control_Strategy_Paper_FINAL.pdf)

<sup>2</sup> [http://www.detini.gov.uk/strategic\\_energy\\_framework\\_\\_sef\\_2010\\_.pdf](http://www.detini.gov.uk/strategic_energy_framework__sef_2010_.pdf)

<sup>3</sup> [http://www.detini.gov.uk/strategic\\_energy\\_framework\\_\\_sef\\_2010\\_.pdf](http://www.detini.gov.uk/strategic_energy_framework__sef_2010_.pdf)

<sup>4</sup> <http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>

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[http://www.uregni.gov.uk/uploads/publications/Consultation\\_on\\_Electricity\\_Connections\\_to\\_the\\_NI\\_Dist\\_System\\_Vfinal.pdf](http://www.uregni.gov.uk/uploads/publications/Consultation_on_Electricity_Connections_to_the_NI_Dist_System_Vfinal.pdf)

<sup>6</sup> [http://www.uregni.gov.uk/uploads/publications/First\\_Economics\\_discussion\\_paper\\_Jan\\_2011.pdf](http://www.uregni.gov.uk/uploads/publications/First_Economics_discussion_paper_Jan_2011.pdf)

<sup>7</sup> Responses were received from the Confederation of British Industry (CBI), Consumer Council Northern Ireland (CCNI), Irish Wind Energy Association (IWEA), Northern Ireland Electricity plc (NIE T&D), Northern Ireland Renewables Industry Group (NIRIG), Smartgrid Ireland (SGI), Scottish and Southern Energy (SSE), and Viridian Power & Energy (VPE).

Among the key issues raised in the RP5 strategy paper was the need to assess legislative and policy developments. The Utility Regulator will have regard to other regulations suggested by respondents and will also ensure that all relevant aspects of SEM are taken into account for RP5.

Questions were asked in the strategy paper about the approach applied to RP4 to see if any aspects are appropriate for RP5. The Utility Regulator is minded to continue with an RPI-X approach for the next price control. The Utility Regulator will continue to evaluate the RP4 approach to Capex and Opex to assess if it is appropriate for RP5 but will develop more incentives. In addition to this, depreciation profiles, WACC and pension treatment will be reviewed. A set of pension principles will be developed by the Utility Regulator which will be consulted on at a later date. The Utility Regulator is minded to have separate 5-year price controls for Transmission and Distribution with the objective of ensuring that full cost reflectivity exists.

Individual responses to the strategy paper will be published on the Utility Regulator website<sup>8</sup>. The most in-depth response received was from NIE T&D and the overall focus of responses was a potential need for increased investment in the network. All respondents highlighted the need to ensure that appropriate incentives are in place to optimise the efficiency of available resources and ensure that potential delays are minimised during RP5.

The Utility Regulator will hold a series of stakeholder events throughout 2011 in order to ensure transparency and understanding of issues which will affect the price control. These stakeholder events will be hosted in conjunction with CCNI. Dates of each event will be advertised on the Utility Regulator website and topics to be discussed include Connections, Network development and Innovation/ Incentivisation. Further areas will be considered at workshops after the publication of the RP5 consultation paper. These will be confirmed at a later date.

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<sup>8</sup> <http://www.uregni.gov.uk/>

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### 3 Introduction

In July 2010, the Utility Regulator published a consultation paper entitled *Northern Ireland Electricity plc Transmission and Distribution Fifth Price Control (RP5) Strategy Paper* (the RP5 strategy paper)<sup>9</sup>. This allowed stakeholders the opportunity to raise concerns which they considered relevant for the next price control and to stimulate debate about issues which the Utility Regulator felt were applicable. Responses were welcomed to help formulate thinking prior to the Utility Regulator forming a view on the structure and content of RP5.

This Information paper follows on from the RP5 strategy paper. It summarises responses received to questions in the RP5 strategy paper and provides feedback to specific issues raised by respondents. The intention of this paper is to promote transparency with stakeholders.

The Utility Regulator received responses from eight organisations. Further meetings were held with a number of respondents by request. The Utility Regulator would like to thank all respondents for their valuable input at the start of this price control review.

Responses were received from:

- The Confederation of British Industry (CBI)
- The Consumer Council Northern Ireland (CCNI)
- The Irish Wind Energy Association (IWEA)
- Northern Ireland Electricity plc (NIE T&D)
- The Northern Ireland Renewables Industry Group (NIRIG)
- Smartgrid Ireland (SGI)
- Scottish and Southern Energy (SSE)
- Viridian Power & Energy (VPE)

Individual responses to the strategy paper will be published on the Utility Regulator website<sup>10</sup>. The most in-depth response received was from NIE T&D and the overall focus of responses was a potential need for increased investment in the network. All respondents highlighted the need to ensure that appropriate incentives are in place to optimise the efficiency of available resources and ensure that potential delays are minimised during RP5.

Further work will continue on the individual components of the RP5 price control during 2011 and these will also be consulted on in due course. The Utility Regulator looks forward to further stakeholder engagement throughout the price control process.

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<sup>9</sup>

[http://www.uregni.gov.uk/uploads/publications/RP5\\_NIE\\_TD\\_Fifth\\_Price\\_Control\\_Strategy\\_Paper\\_FINAL.pdf](http://www.uregni.gov.uk/uploads/publications/RP5_NIE_TD_Fifth_Price_Control_Strategy_Paper_FINAL.pdf)

<sup>10</sup> <http://www.uregni.gov.uk/>

Since the RP5 strategy paper was published in July 2010, a number of policy updates have occurred.

Since the strategy paper was published, a formal Strategic Energy Framework (SEF) 2010 has been issued by the Department of Enterprise, Trade and Investment (DETI)<sup>11</sup>. The Utility Regulator will actively discuss working arrangements with NIE T&D in advance of the price control implementation with regard to DETI's 40% target.

DETI are currently consulting on the implementation of IME3<sup>12</sup>. This involves certification of organisations and a possible re-allocation of responsibilities and asset ownership. The Utility Regulator will continue to keep up to date with any other legislative developments which might have an impact on the next price control.

In July 2010, Ofgem published its proposed new network regulation methodology RIIO, an outcome of its [RPI-X@20](#) review<sup>13</sup>. The RIIO mechanisms are being assessed by a cross-utility working group at the Utility Regulator.

A Business Plan, Investment and Efficiency Questionnaire (BPQ) was issued by the Utility Regulator to NIE T&D in October 2010. This is a key input to the RP5 price control process.

The Utility Regulator have also recently published papers on Connections<sup>14</sup> and Financing Networks<sup>15</sup>. The outcome of these consultations will be considered in the context of RP5.

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<sup>11</sup> [http://www.detini.gov.uk/strategic\\_energy\\_framework\\_\\_sef\\_2010\\_.pdf](http://www.detini.gov.uk/strategic_energy_framework__sef_2010_.pdf)

<sup>12</sup>

[http://www.detini.gov.uk/consultation\\_on\\_the\\_implementation\\_of\\_the\\_eu\\_third\\_internal\\_energy\\_package\\_25\\_october\\_2010](http://www.detini.gov.uk/consultation_on_the_implementation_of_the_eu_third_internal_energy_package_25_october_2010)

<sup>13</sup> <http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>

<http://www.ofgem.gov.uk/Media/FactSheets/Documents1/re-wiringbritainfs.pdf>

<sup>14</sup>

[http://www.uregni.gov.uk/uploads/publications/Consultation\\_on\\_Electricity\\_Connections\\_to\\_the\\_NI\\_Dist\\_System\\_Vfinal.pdf](http://www.uregni.gov.uk/uploads/publications/Consultation_on_Electricity_Connections_to_the_NI_Dist_System_Vfinal.pdf)

<sup>15</sup> [http://www.uregni.gov.uk/uploads/publications/First\\_Economics\\_discussion\\_paper\\_Jan\\_2011.pdf](http://www.uregni.gov.uk/uploads/publications/First_Economics_discussion_paper_Jan_2011.pdf)

## 4 Price control Objectives for RP5

As identified in the RP5 strategy paper, the key objectives for the next NIE T&D price control will be:

- To ensure value for money for customers;
- To ensure security of supply by maintaining and developing a network which is fit for purpose;
- To facilitate sustainability in the generation and consumption of electricity.

Respondents welcomed and agreed with the objectives suggested. IWEA particularly welcomed the recognition that the price control will take legislation into account. NIE T&D suggested that in addition, the following objectives should be priorities when considering the form of the price control:

- an appropriate regulatory regime that does not introduce unnecessary risk to investment;
- appropriate incentive mechanisms to promote value for money outcomes for customers; and
- maintenance of a simple and transparent network modus operandi consistent with the urgent need to execute an extensive transmission capital programme in Northern Ireland.

The Utility Regulator acknowledges NIE T&D's proposed objectives and will consider them where appropriate for RP5.

## 5 Key areas for review

As well as the price control objectives, other key areas suggested in the strategy paper for consideration for RP5 were:

- the effect that new developments in regulatory, governmental and environmental areas would have on the price control;
- an evaluation of the approach for RP4;
- the possibility of split price controls for Transmission and Distribution with differing durations.

### 5.1 Legislative, policy and environmental developments

#### 5.1.1 Strategy paper

The Utility Regulator recognised that the Third European Internal Market Directive (IME3), the Renewable Energy Directive (and Renewable Energy Strategy), and the Strategic Energy Framework for Northern Ireland (SEF) would be given regard during the price control review. The Utility Regulator asked respondents if there any other legislative or policy developments that the Utility Regulator should take into consideration for the RP5 price control.

The Utility Regulator also acknowledged that Single Electricity Market (SEM) arrangements such as policies to encourage demand side participation, transmission connection policy, locational network signals and the promotion of regional integration would need to be taken into account for the next price control. Readers were asked which aspects of the SEM arrangements they believe should be taken into account for the NIE T&D RP5 price control.

#### 5.1.2 Responses

CCNI recognised that RP5 should investigate the impact of the above legislative developments. CCNI also stated that the Utility Regulator should take account of DSD Fuel Poverty Strategy.

NIE T&D considers that as well as the policies and legislation noted above, the Electricity Safety, Quality and Continuity Regulations (ESQCR) and street works legislation should be taken into account.

IWEA responded that the NIE T&D Price Control needs to take into account all SEM arrangements which may influence the future operation and development of the network in Northern Ireland. NIE T&D indicate that demand side management is one aspect of smart technology that it intends to explore in RP5. It also states that 'the policy for charging for connecting wind farms to cluster substations will have a bearing on the proportion of costs to be funded by wind farm developers rather than through the price control, and the 400kV Tyrone-Cavan interconnector is a key element for regional integration'.

SSE believe it would be worthwhile to separate out operation of the retail market from development and operation of networks and that there should be full metering of the T&D boundary, to reduce the subjectivity of demand calculation.



### **5.1.3 Utility Regulator position**

The Utility Regulator will ensure that the impact of DSD Fuel Poverty Strategy and ESQCR are considered within the price control. The Utility Regulator will also have regard to the policies highlighted by NIE T&D.

The Utility Regulator is actively involved in the operation and development of SEM and will ensure that all relevant aspects of the SEM are considered for RP5.

## **5.2 RP4 Price control approach and components**

The Utility Regulator highlighted in the RP5 strategy paper that there would be an assessment of the effectiveness of the price control approach adopted in RP4. The Utility Regulator is currently evaluating the approach and intends to complete this as part of the RP5 process.

### **5.2.1 Strategy paper - Capex**

NIE T&D's Capex entitlement for RP4 was based on actual Capex rather than an ex ante allowance. This is not a common regulatory approach apart from for companies with relatively small capex programmes. However, if there is significant uncertainty about the scope or cost of Capex programmes it is considered a reasonable approach, particularly if supplemented with a rigorous ex post review of the efficiency of the expenditure.

Respondents were asked if there should be an allowance for Capex or if it should be recoverable on an actual (pass-through) basis.

### **5.2.2 Responses**

SSE would support an approach based on an allowed capex for a defined list of projects, with incentives for efficient investment and some form of output measures to ensure that commitments are delivered. NIE T&D responded that the capex arrangements in place for RP4 place relatively weak incentives on the company to develop innovative approaches that could aid the delivery of capex programmes at lower overall cost to customers due to 'the mechanistic approach taken to assessing capex efficiency during RP4'. NIE T&D further their response by suggesting that the implementation of a capex incentive scheme for RP5 under which the company bears a set proportion of any over or under spend relative to the capex allowances would bring capex incentives more in line with the DNOs.

RES suggest that the Utility Regulator takes a long term approach when making decisions for the fifth price control. The Utility Regulator is in agreement with this.

### **5.2.3 Utility Regulator position**

When reviewing this performance in RP4 the Utility Regulator will conduct an analysis of NIE T&D's capitalisation policy and any changes thereto and the reasons for any deferral of capital expenditure.

The Utility Regulator is keen to develop more effective incentives for Capex and will continue to evaluate the application of actual Capex in the RP5 price control.

## **5.3 Opex**

### **5.3.1 Strategy paper - Opex**

For RP4, a five year rolling Opex cap was applied to controllable Opex. Uncontrollable Opex were recoverable on a pass-through basis. The Utility Regulator welcomed views on whether it should continue to use a 'rolling mechanism' for controllable Opex in RP5, or alternatively a bottom-up approach supported by benchmarking. Readers were also asked if they agree with the current classification of rates, wayleaves and licence fees as uncontrollable Opex.

### **5.3.2 Responses**

CCNI support a benchmarking approach as this would be more accurate. Similarly, SSE are in favour of benchmarking, since any assumptions underlying the rolling mechanism cannot be assumed to have enduring validity.

NIE T&D have provided information to show that average annual controllable operating costs in RP4 to date are 32% lower than they were in RP3 (page 7 of their response), due to NIE T&D's customer aligned programme of efficiency measures that was introduced in RP3. NIE T&D believes that it is an efficient organisation and the scope for further savings in RP4 and into RP5 is limited

NIE T&D state that their operating costs during RP5 will be influenced by a combination of factors such as growth of the network, tighter customer standards requiring upgraded IT systems or additional staff, workforce renewal, new legislation, smart networks, smart metering, market services, injurious affection, renewable generation integration and Dt costs.

CCNI asked if it was possible to make uncontrollable opex more controllable. SSE state that wayleaves costs are controllable to an extent, however, NIE T&D feel that there is no reason to change the established treatment.

### **5.3.3 Utility Regulator position**

The Utility Regulator will take into account the effect of legislative and policy developments on projected operating costs as well as assessing if the rolling opex mechanism is appropriate in RP5. As part of RP5, the Utility Regulator will complete a rigorous bottom up analysis of NIE T&D's operating costs and will also discuss

these in detail with the company.

Further analysis of NIE's Business Questionnaire submission will be completed in order to make a decision about what will be classed as uncontrollable Opex for RP5.

## **5.4 WACC**

### **5.4.1 Strategy paper - WACC**

The Utility Regulator asked readers of the RP5 strategy paper their opinions on using Ofgem's WACC as precedent for NIE T&D and also if respondents think the Utility Regulator should continue to do this for RP5.

In addition to this, the Utility Regulator welcomed respondents' opinions on continuing with setting the rate of return on a post-tax basis for the next price control.

### **5.4.2 Responses**

NIE T&D support the continued use of the Ofgem precedent for the WACC conditional upon recognition of Ofgem's new holistic approach in the fifth distribution price control review in GB and think there are practical difficulties in setting a long term WACC. SSE also commented on recent views that Ofgem's WACC has failed to take sufficient notice of turmoil in financial markets and is therefore insufficient to sustain the level of investment needed to support renewable development targets.

NIE T&D want to ensure that the WACC is set at an appropriate level which enables financing for their proposed investment programme to be forthcoming. They feel that a post tax WACC is appropriate for RP5, as do SSE.

### **5.4.3 Utility Regulator position**

The Utility Regulator will take responses into account regarding the WACC for RP5. The Utility Regulator is likely to continue with a post tax WACC.

## **5.5 Pensions**

### **5.5.1 Strategy paper - Pensions**

The Utility Regulator's aim when dealing with pension costs is to ensure that NIE T&D continue to manage their pension costs effectively on customers' behalf. The treatment of pension costs has implications for energy consumers and a number of stakeholder groups. The Utility Regulator is also aware that pension costs and their treatment in price controls are strongly influenced by protections to pension arrangements put in place at privatisation and great uncertainty about the current (and future) levels of liabilities. NIE T&D have firm obligations to the pension scheme they sponsor.

Readers were asked the following questions:

The Utility Regulator welcomes views on the treatment of the proportion of a pension scheme deficit which has arisen due to early retirement deficiency costs. How do respondents think this should be funded?

The Utility Regulator welcomes views on the treatment of a pension scheme deficit as part of the price control. What are respondents' views on the appropriate duration of a deficit recovery plan?

The Utility Regulator also welcomed views on whether the current pension deficit in respect of NIE T&D employees should be treated as part of the company's gearing calculation.

### **5.5.2 Responses**

NIE T&D raise three key issues regarding pension costs:

- The background to the current deficit;
- The appropriate treatment of pension costs incurred in RP4 but not recovered by allowances;
- The appropriate treatment of pension costs that are expected in RP5.

NIE T&D suggest that the under-recovery of pension costs during RP4 should be recovered using a logging-up mechanism at RP5, allowing for a rate of return to be earned on the under-recovery.

In its response, NIE T&D state that none of the pension deficit as at 31 March 2009 is attributable to such costs.

NIE T&D have purported that the current pensions deficit is a result of factors outside of its control, and should be recoverable on a pass-through basis. NIE T&D state that the recovery in full of deficit repair costs is supported by Ofgem precedent. As well as this, the company feel that the recovery of pension costs should be over the same period as agreed with the trustees of the pension scheme.

CCNI state that the inclusion of a pension deficit in the price control is unacceptable. By including the deficit in the price control for customers to bear, this gives NIE T&D no incentive to act to reduce these costs.

NIE T&D does not believe it would be appropriate to reflect the pensions deficit in the gearing calculation because the RAB has been funded through debt and equity, and no portion of it can be seen as having been funded through the pensions deficit. NIE T&D state that since the deficit should be treated as a pass through cost, there is no reason to include it in any gearing calculations, and that including the deficit in gearing would be inconsistent with Ofgem's approach.

SSE are also of the view that the pension scheme deficit should be excluded from NIE T&D's gearing calculation.

### **5.5.3 Utility Regulator position**

The Utility Regulator will work to develop a set of pension 'principles' regarding various important issues. The principles and proposals put forward by the Utility

Regulator will be fully consulted on.

The Utility Regulator has commissioned external consultants to analyse NIE T&D pensions and will assess the results of this analysis as part of its evaluation of the treatment of/ inclusion of pension costs for RP5.

## **5.6 Depreciation**

### **5.6.1 Strategy paper - Depreciation**

In the RP5 strategy paper, the following question was posed:

The Utility Regulator welcomes respondents' views on the depreciation policy and profile used for the current NIE T&D price control. Do respondents agree with the current profile and are there alternatives we should consider?

### **5.6.2 Responses**

NIE T&D state that it may be necessary to consider a faster depreciation rate if NIE T&D is to satisfactorily finance its functions.

SSE's response was that the current depreciation profiles should be retained to ensure that customers do not face higher charges than necessary.

### **5.6.3 Utility Regulator position**

The Utility Regulator intends to review the depreciation profile for NIE T&D assets.

## **5.7 Financeability**

### **5.7.1 Strategy paper - Financeability**

The Utility Regulator's approach is, and will continue to be, underpinned by a statutory duty to ensure that licensees can finance their licensed activities.

The Utility Regulator also highlighted other financing options and the intention to consult regarding financing options for future Transmission projects.

### **5.7.2 Responses**

Due to timing issues with the North-South Interconnector (NSIC), NIE T&D feel there is no need to consider financing options during the RP5 price control.

NIE T&D have stated concern at the Utility Regulator's suggestion that alternative financing models could be applied to new transmission developments. NIE T&D state that advantages of the current equity model include the ability to combine it with incentive arrangements to encourage efficiency and innovative delivery. NIE T&D also states that the alternative financing structures for the new transmission investment mentioned by the Utility Regulator in the strategy paper are

inappropriate, including the mutual model since the specific factors that can contribute to the sustainability of a mutual structure in certain specific cases are not present in NIE T&D.

NIE T&D have stated that the possibility of a mutual model would not work effectively as new transmission developments will be embedded in the existing transmission network and cannot readily be separated from the rest of the system which would be necessary if they were to be owned and managed by a third party.

CBI welcome the commitment to consult further on financing options.

### **5.7.3 Utility Regulator position**

The Utility Regulator engaged economic consultants, First Economics, to produce a discussion paper on the subject. This paper was published in January 2011 and responses to proposals were received on 18 February 2011. A seminar was hosted in early January 2011 by the Utility Regulator and was well received and attended by a range of stakeholders. The Utility Regulator intends to publish a related Information paper when the analysis is complete.

## **5.8 Form**

### **5.8.1 Strategy paper**

The current price control, RP4, is based on an RPI-X revenue cap. A correction factor (K-factor) is included in the licence to recover any over/ under recovery in the previous year.

The price control has a traditional 'building blocks' theme which both NIE T&D and the Utility Regulator feel is appropriate for RP5.

Respondents were asked if they agree on the continued RPI-X approach for the RP5 price control, or if they support developments in incentive regulation such as Totex or Menu regulation. They were also asked if they were aware of any other alternative approaches to incentive regulation, other than RPI-X, Totex or Menu regulation which they feel is appropriate for RP5, taking into account changing circumstances and the integration of renewables

### **5.8.2 Responses**

No other alternatives were offered by respondents. SSE feel that the Utility Regulator should continue with RPI-X regulation, but emphasise that it is important to develop output measures to ensure that delivered outturn is in line with the original commitment and to ensure that benefits are real before they are distributed. NIE T&D believe that Totex regulation is 'neither useful nor informative'. The company wants to strengthen the capex incentive to be more in line with the strength of the opex incentive and feels that Totex is inappropriate as any benchmarking would be done with DNOs in GB. CCNI similarly feel that there has not been enough research on Totex as yet.

NIE T&D have also stated that it does not think it is necessary to replicate the

complexity of the information quality incentive (IQI) as applied by Ofgem in GB, but would seek to discuss with the Utility Regulator how to reproduce the economic effect of this incentive more simply.

### **5.8.3 Utility Regulator position**

The Utility Regulator is minded to continue with an RPI-X approach for the next price control with well defined incentives with measurable and meaningful outputs.

## **5.9 Split price control**

### **5.9.1 Strategy paper - Split price control**

In the strategy paper, the Utility Regulator prompted views on the proposal that two separate price controls could be implemented in 2012 for Transmission and Distribution.

### **5.9.2 Responses**

NIE T&D point out that the separation of the organization would have a negative impact on the response to major incidents and would increase regulatory burden. Viridian Power & Energy is concerned about the proposal to split the transmission and distribution price controls as this would logically seem inefficient and could seriously compromise achievement of renewable energy targets.

In NIE T&D's response, the company says that splitting the integrated business in two would inevitably result in new costs because of the additional transaction arrangements. NIE T&D deem that the current management of the company as an integrated business captures efficiencies and synergies which the Utility Regulator recognizes.

CCNI state their concern in ensuring that the impact on consumers should be taken into account if considering having two separate price controls.

### **5.9.3 Utility Regulator position**

The Utility Regulator objective is to ensure that the price control is cost reflective. The Utility Regulator feel that a joint price control for transmission and distribution is not fully cost reflective and it is important that NIE provide a financial separation of Transmission and Distribution. It is not the intention of the Utility Regulator to reduce any efficiencies which have already been achieved.

The Utility Regulator will assess the impact of IME3 on this price control and take appropriate action.

## **5.10 Duration**

### **5.10.1 Strategy paper - Duration**

The length of the price control period is one factor in determining the strength of incentives for a regulated company to reduce its costs. The length of the price control period is often characterised as a trade-off between 'productive efficiency' and 'allocative efficiency'. Price control duration also has implications for the financing of price regulated industries and it impacts on decisions of investors deploying capital.

In the RP5 strategy paper, the Utility Regulator initiated the following request:

The Utility Regulator welcomes views on changing the duration of the price control to 3 years for Transmission while maintaining a 5 year price control for Distribution. Interested parties who believe the Utility Regulator should maintain the 5 year duration for Transmission are invited to lay out specific reasons in their response as to why we should do so.

### **5.10.2 Responses**

Smartgrid Ireland state that environmental, commercial and regulatory movements 'create a volatile situation that would not support sufficient stability over a five year period. A proposed three year duration would seem more appropriate and beneficial to customers'.

Viridian Power & Energy pronounce that with a three year price control proposed for transmission beginning in 2012 it could effectively mean a (three year) delay in the roll-out of necessary transmission infrastructure to support the 40% target by 2010.

The CBI state that 'it is not clear how shortening the length of the transmission price control to three years would resolve the uncertainty issue'. They also reply that shortening the period of the transmission price control to three years may weaken incentives.

SSE feel that five years is a reasonable compromise between investor and customer interests.

NIE T&D believe that a three year price control for transmission would add costs and introduce investment uncertainty and is strongly opposed to the suggestion. The company does not agree with this due to the uncertainty of transmission investment required. NIE T&D state that the T&D business is operated on an integrated basis to capture efficiencies between transmission and distribution and state that a three year price control would have a number of efficiency defects, including:

- weaker incentive properties than a five year control;
- introduction of further risks of incentive distortion between the businesses;
- an unnecessary increase on the burden of regulation on both the business and the Utility Regulator.

The Utility Regulator proposed in the RP5 strategy paper that the EU third package for gas and electricity (IME3) may have a significant impact on NIE T&D (through



requiring further unbundling).

NIE T&D does not see any good reason why IME3 should be used as an excuse to justify a shorter price control for transmission. They are of the view that unbundling would add transaction costs for customers and would be practically difficult to implement.

### **5.10.3 Utility Regulator position**

The Utility Regulator is minded to have five year price controls for Transmission and Distribution.

## 6 Incentives

NIE T&D are keen that they should be appropriately rewarded for delivering increased and new benefits to customers and the environment if they are able to drive further improvements.

All respondents highlighted the need for having incentives in place during RP5 to ensure that resources available are used efficiently and that potential delays are minimised.

The following was asked in the RP5 strategy paper:

The Utility Regulator welcomes any comments on the current incentive mechanisms in place for RP4. Do respondents think that these incentive mechanisms should continue for RP5?

Another question prompted regarding incentives in the strategy paper was:

Do respondents have any views on any other incentive mechanisms that should be considered for RP5?

### 6.1.1 Responses

SSE believes the current arrangements should be retained and extended but thinks that the Utility Regulator should re-visit the revenue protection scheme incentive. This is to ensure that NIE T&D is not incentivized to make financial settlement agreements with customers without full account being taken of their consequential treatment in the wholesale settlement arrangements.

NIE T&D stated in their response that appropriate incentive-based regulation is required in order to achieve value for money for customers and to ensure security of supply to encourage long term investment in the network. They feel that incentives should play a significantly increased role in RP5 compared to RP4. NIE T&D feel that it will be particularly important to optimise asset utilisation and capex efficiency through suitable incentive mechanisms.

NIE T&D have stated that they will work with the Utility Regulator to agree suitable incentives to produce benefits for customers. The company have suggested further areas where incentives could potentially be developed such as reducing the amount of energy dissipated when electricity is transported through the network (i.e. losses) and improving network performance and customer service.

NIE T&D stated that in order to produce certain new incentives, investment in new IT systems and processes for measurement would be required. NIE T&D also state that an appropriate timeline will be required for the introduction of certain incentives.

NIE T&D suggest that a new or enhanced incentive scheme for the organisation could have desirable benefits in the following principles:

- efficient delivery of the capex programme
- improvements in customer service
- environmental improvements

- encouragement to maintain and where possible improve upon existing levels of excellent performance.

NIE T&D state that targets should be set to ensure that there is an appropriate balance of risk and reward. NIE T&D recognise that it may be necessary to limit the risk of excessive rewards and penalties through the application of caps and collars until the application of new incentives is more mature.

SSE also suggested new incentives as follows:

- quality of service
- reduce network losses
- reduce carbon from network operation
- deliver capacity improvements via extension of scope of the SMART programme
- IQI to encourage better forecasting of Capex required over the price control period.

SGL recommend that there should be consideration of mechanisms for appropriate consumer incentives with flexibility to try different scenarios with a view to define a business model that will help society move from the current delivery and consumption of energy to the desired future sustainable state. Perhaps with an option to evaluate dynamic pricing.

CCNI state that incentives should be in place so that customers pay lower prices e.g. under spend in Capex should be passed on to customers.

### **6.1.2 Utility Regulator position**

The Utility Regulator is keen to develop further incentive mechanisms for RP5. The Utility Regulator believes more accurate information is necessary and is keen for NIE T&D to make this information more publicly available. Any incentives put in place will have well defined and measurable outputs.

In addition, the Utility Regulator intends to develop further annual cost reporting reports which will assist in the measurement of incentives.

## **7 Other suggestions**

### **7.1 Reporter**

Respondents to the strategy paper were asked if they think the introduction of a Reporter role for the NIE T&D RP5 price control would be beneficial.

#### **7.1.1 Responses**

SSE are of the opinion that the introduction of a Reporter for RP5 is a good idea. In contrast to this, NIE T&D feel that the Utility Regulator is in a relatively mature stage in its development, so would not require the use of a reporter. The company does not feel that this concept would be in keeping with an incentive-based price control approach.

#### **7.1.2 Utility Regulator position**

The Utility Regulator will consider this area further. It is being assessed as part of a cross-utility price control group.

### **7.2 Consumer input**

There has been an increasing move to involve stakeholders other than the regulated company in price control reviews, particularly in GB. This has included Ofgem's use of Consumer panels and a Consumer challenge group. The Utility Regulator welcomed views on encouraging additional consumer expertise for RP5.

#### **7.2.1 Responses**

NIE stated that they 'will be pleased to discuss its perspective with the Consumer Council and with any additional consumer representation that might be brought on board'. SSE think that stakeholder engagement is vital to ensure a balanced outcome of price control negotiation.

#### **7.2.2 Utility Regulator position**

The current T&D price control has relatively limited wider stakeholder involvement. Stakeholder engagement should take account of the issues to be considered and the desire of stakeholders to be involved in the price control review. The Utility Regulator's intention for RP5 is to inform stakeholders particularly consumer representatives. It is envisaged that the fifth NIE T&D price control will involve an increased level of stakeholder engagement. The Utility Regulator is encouraged by NIE T&D's willingness to work with stakeholders and has engaged with CCNI. The Utility Regulator plans to hold regular stakeholder workshops in 2011 on key areas. Further information about these will be available on the Utility Regulator website in due course.

## **7.3 Smart grids**

NIE T&D highlighted a need to carry out smart grid trials. They seek support from the Utility Regulator broadly in line with the funding incentives provided by Ofgem for the DNOs since the application of smart technology will call for a greater demand in communications due to increased monitoring and control requirements.

Smartgrid Ireland does not feel that a smart grid rollout can be singly supported by the Utility Regulator and needs wider government and industry participation and support.

### **7.3.1 Utility Regulator position**

The Utility Regulator will consider Smart grid trials proposals as part of RP5.

## **7.4 Smart metering**

Readers were asked if they would support a smart metering roll out as part of RP5.

IWEA and RES welcomed the recognition of the need for revenue for smart metering. NIE T&D say that any deployment and funding of smart meters will need direction from government and the Utility Regulator's approval.

SSE support a smart meter rollout but state that the Utility Regulator needs to ensure it is subject to output measure.

### **7.4.1 Utility Regulator position**

The Utility Regulator is currently carrying out a cost benefit analysis on smart metering. The Utility Regulator is also currently supporting vulnerable customer trials with NIE Energy, NIE T&D, National Energy Action (NEA), Eaga<sup>16</sup>, General Electric and University of Ulster. The Utility Regulator will continue to liaise closely with DETI regarding smart metering proposals as part of RP5.

## **7.5 Low Carbon Network Fund**

The Utility Regulator asked for respondent's views on the possible introduction of a fund similar to Ofgem's Low Carbon Networks Fund as part of RP5 and whether they think this would be beneficial on a Northern Ireland/ all Ireland basis. NIE T&D will be seeking funding arrangements not dissimilar to the Innovation Funding Incentive (IFI) and Low Carbon Networks Fund (LCNF)<sup>17</sup> incentives offered to DNOs by Ofgem.

SSE are encouraged by the idea of a low carbon network fund or similar, but state

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<sup>16</sup> <http://www.eaga.com/>

<sup>17</sup> NIE T&D cannot apply to the LCNF

that it is essential for such a fund to be fully available for third party involvement, and not solely for the network owner/ operators' use. SSE state that competitive access to funding is an important means of promoting innovation, to drive end-customer interests and deliver wider policy objectives.

SGL welcome the proposal. SGL would be interested to how this would fit in the NI/SEM structure from a competition perspective.

#### **7.5.1 Utility Regulator position**

The Utility Regulator will consider innovation as part of RP5. A range of innovative options will be assessed to evaluate if a Low Carbon Networks Fund is the best mechanism.

### **7.6 Electric vehicles**

NIE T&D say it is necessary for government departments, the Utility Regulator and themselves to agree the manner in which NIE T&D should support these wider policy initiatives.

SGL say there is limited information in the strategy paper as to how the expectation re. renewable energy directive (10% of transport energy is to come from renewable sources") would be facilitated or commercially incentivised.

#### **7.6.1 Utility Regulator position**

Electric vehicles are in the very early stage of development but the Utility Regulator will keep a watching brief on this area.

## **8 Conclusion**

The Utility Regulator would like to thank all respondents to the RP5 strategy for their valuable input. Stakeholders are encouraged to continue to respond to all price control consultations and to attend stakeholder events.

The Utility Regulator will continue to review the results of the Business Efficiency and Investment Questionnaire, completed by NIE, in order to aid its assessment of each component of the RP5 price control. All policies and legislation which may affect RP5 will be taken account of.

## **9 Next Steps**

A price control timetable will be published in Quarter 2 of 2011.

The Utility Regulator, in conjunction with CCNI will host a series of workshops to promote stakeholder engagement as part of the RP5 process.

Dates and topics for each workshop are to be confirmed and will be advertised on the Utility Regulator website.