

# Consultation on Overall Approach to NIE Networks 6th Price Controls (RP6)

Response from SONI Ltd.

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4 November 2015



# Introduction

SONI welcomes the opportunity to respond to NIAUR's consultation on its proposed approach to NIE Networks' 6<sup>th</sup> Price Control (RP6). This is the first price control to be fully assessed since NIE Networks' licences were separated to facilitate differences in its responsibilities and activities in distribution and transmission. Since 1 May 2014, as the certified TSO for the NI transmission system, SONI is responsible for the justification of all transmission investments, including those to be made over the RP6 period.

RP6 is therefore an opportunity to establish a framework that will underpin the industry structure to ensure that the benefits of independent planning of the transmission system are captured for consumers.

We present this response across four sections:

- First we summarise our key points;
- Secondly we outline our understanding of the roles of NIE Networks and SONI Ltd. with regard to the planning of the transmission system in NI;
- Thirdly we consider some of the future policy initiatives that may potentially be implemented or considered during RP6;
- Finally we discuss the implications and challenges for RP6 that are posed by the unique industry structure in NI.

SONI's comments focus on the proposed approach to the revenue associated with NIE Networks' transmission licence activities only. This response follows on from our helpful meeting with NIAUR during the consultation period to highlight these issues and we are committed to supporting the transmission aspects of the RP6 process.

# Key Points

SONI would like to raise the following important points with regard to the proposed approach to the review of NIE Networks' transmission revenue entitlement:

- NIE Networks holds separate licences for its distribution and transmission activities. These reflect differences in its statutory role within the industry for these activities. The approach to RP6 should also differ for transmission and distribution to ensure that it respects the separate roles, ensures appropriate incentives are in place and that each set of activities is remunerated adequately.
- While SONI has not considered all of the details, we do not have any significant comments to make on the approach to determining the revenues associated with NIE Networks' distribution activities.
- The European Commission's decision on TSO certification has resulted in an industry structure that is unique to NI. Responsibility for planning the transmission system was transferred to SONI from NIE Networks on 1 May 2014. This means that SONI has a statutory role which needs to be incorporated into the approach to developing RP6.
- The role of the TSO will need to be incorporated within the RP6 arrangements, particularly around the identification and justification of transmission investments, including interaction with the Consumer Engagement Advisory Panel (CEAP)
- While RP6 cannot foresee which future policy initiatives will be realised, it is equally important that it does not frustrate those that have already been signalled. The framework developed for RP6 should therefore keep open the potential for future competitive development of the transmission network.
- SONI would welcome the opportunity to work with both NIAUR and NIE Networks to ensure that RP6 is developed in a manner that embeds the independence of transmission network planning decisions within the enduring industry framework. This should be included within the objectives identified for RP6.

# Responsibilities for Transmission Planning and Operation

## Role and Responsibilities of the TSO – European Framework

Through its three energy legislation packages, the European Commission (EC) has defined and strengthened the role of transmission system operators to ensure that access to the transmission networks across Europe is provided in a transparent and non-discriminatory manner and that investment decisions are only made by parties who are independent of interests in generation and supply. This is to facilitate competition in the generation and supply of electricity, with the aim of reducing prices for consumers and improving security of supply.

The most recent package of legislation (IME3<sup>1</sup>) requires the certification of TSOs as independent of interests in generation and supply. The Northern Ireland arrangements were certified by the EC on 12 April 2013. This was based on an assumption that network planning would be transferred to SONI, which took place on 1 May 2014. As a result, SONI was certified as the TSO for NI, with NIE Networks' corporate structure being assessed as contributing "to a stronger degree of independence" than the reference model and therefore sufficient to allow it to discharge the "transmission asset owner function"

## NI Transmission Licence Framework

Legislation and licences were amended to transpose the IME3 directive into the NI legal framework. The initial tranche of work established the distribution of electricity as a separate licensable activity, and the duties on holders of transmission licences under Article 12 of the Electricity Order were updated<sup>2</sup> to;

"It shall be the duty of the holder of a licence under Article 10(1)(b), as appropriate having regard to the activities authorised by the licence<sup>3</sup>, to—

(a) take such steps as are reasonably practicable to—

(i) ensure the development and maintenance of an efficient, co-ordinated and economical system of electricity transmission which has the long-

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<sup>1</sup> Directive 2009/72/EC

<sup>2</sup> The consultation paper paraphrases Article 12 of the Electricity (Northern Ireland) Order 1992. This was amended to transpose the IME3 Directive. The duties of holders of distribution licences under the Order now differ from those of holders of transmission licences.

<sup>3</sup> Emphasis added

term ability to meet reasonable demands for the transmission of electricity; and

(ii) contribute to security of supply through adequate transmission capacity and system reliability; and

(b) facilitate competition in the supply and generation of electricity”

Currently three parties hold transmission licences in Northern Ireland: NIE Networks; Moyle Interconnector Ltd; and SONI Ltd. SONI’s licence includes the operation of both NIE Networks’ and Moyle Interconnector Ltd.’s assets. SONI and NIE Networks are required to comply with the “Transmission Interface Arrangements” (TIA), whereby the transmission system is to be developed and maintained by NIE Networks and planned and operated by SONI Ltd.

SONI collects any revenue to be paid by customers and generators in NI that is due to NIE Networks for use of the transmission network and also that due to Moyle under its agreements.

## Transfer of Functions to SONI

Responsibility for planning the transmission network was transferred from NIE Networks to SONI on 1 May 2014. The allocation of responsibilities is defined in the respective licences. In summary:

- Transmission licences authorise SONI to plan the transmission network
- SONI is required to have Planning and Security Standards in place. These underpin the case of need for network investment
- NIE Networks is authorised to develop and maintain the transmission network (implicit in this framework is a prohibition on NIE Networks planning the transmission network)
- Outworking of this allocation of the responsibilities is defined in the TIA

Following the reallocation of responsibilities, SONI reviewed and updated the Planning and Security Standards. These were approved by NIAUR on 24 September 2015.

## Description of SONI’s Role in the Approach Paper

As drafted, the paper does not take proper account of SONI’s role and its responsibility for making decisions affecting the transmission network. The paper also infers that decision making is undertaken by NIE Networks for both transmission and distribution. This has the effect of altering the scope of RP6 and avoids the questions posed by the unique industry structure.

## Responsibility for Transmission Investment Plan

Under the revised TIA and Condition 33 of SONI's Transmission Licence, responsibility for the Transmission Investment Plan rests with SONI, consistent with Article 22 of the IME3 Directive. While NIE Networks can request modifications to the plan, the final decision rests with SONI (subject to NIE Networks' right to raise a dispute to be adjudicated by NIAUR).

The approach proposed to RP6 seems to step outside this process, with NIE Networks being required to both submit the investment plan and justify the proposed investments. This would appear to us to infringe on SONI's role. Any exchanges around the plans for the transmission network should pass directly between SONI and NIAUR, to ensure that the certified arrangements are adhered to, and that both NIAUR and SONI can fulfil their obligations around the Transmission Network Development Plan under Article 22. SONI outlined these requirements when we met during the consultation period and found the subsequent discussion helpful.

## SONI's Role in Asset Replacement Decisions

SONI also has the right to request amendments to the Transmission Asset Replacement Plan; including the option of referring a dispute to NIAUR for determination if NIE Networks does not agree to any request. It is therefore important that the funding arrangements determined under RP6 facilitate changes to the volume of asset replacement required without compromising NIE Networks' ability to finance its activities.

SONI is happy to discuss options that would deliver this with both NIAUR and NIE Networks.

## Impact on RP6

NIE Networks' transmission responsibilities were amended during RP5. As stated above, this allocation of responsibilities is unique to NI. For RP6 to deliver its stated objectives, it is essential that the approach to the transmission control reflects the changes in NIE Networks' ability to make decisions affecting the transmission network. Necessarily, this will result in differences between the approach to calculating the revenue entitlement and incentives for transmission and distribution activities.

# Future Policy Initiatives

The development of transmission assets is an area that has been identified by both the Competition Commission (CC) and the European Commission (EC) as being suitable for competitive processes. Two initiatives in particular have been identified:

- **Contestability in Connections:** work has commenced to facilitate connecting customers contesting the development of their connection assets. The RP6 framework should ensure that any incentives are consistent with this workstream;
- **Competition in Transmission Assets:** both the CC and EC highlighted the potential for third parties to compete for the development of the transmission network in NI, with the legal framework already facilitating the financing, ownership and maintenance of the Moyle Interconnector by Mutual Energy.

While RP6 cannot be expected to deliver initiatives such as this, it is essential that the approach to determining revenues for NIE Networks does not prevent opportunities such as these from being explored and potentially implemented, before the start of RP7 in 2024.

# Approach to RP6

## Distribution Revenue Entitlement

SONI has no significant comments on the approach outlined in the consultation paper to the calculation of NIE Networks' distribution revenue entitlement and the associated incentives. The observations made in this section relate to the calculation of NIE Networks' transmission entitlement only.

## Duration and Form

The application of a WACC x RAB price control with incentives is appropriate for an asset heavy utility. The proposed duration is appropriate for the project cycle and to incentivise the revelation of efficiencies. However this longer duration also increases the importance of establishing a framework that accommodates independent planning of transmission network before the period begins.

We welcome the signalling by NIAUR of an NPV neutral approach to adjustments to depreciation profiles, and trust that this will be applied equally to all price controls including the SONI price control that is currently being determined.

While we note the signalling of a change that aligns the price control years with reporting years, we would welcome confirmation in the final approach paper that the tariff year will remain unchanged. As SONI collect the TUoS revenue for NIE Networks, a change in the tariff year would impact on SONI's charging statement and potentially also its financing of payments to NIE Networks.

## Cost Benefit Analyses

We note that the paper signals that NIE Networks should provide cost/benefit justifications for investments. SONI is responsible for these for transmission investments and would expect to provide the relevant information directly to NIAUR as part of its own regulatory engagement. SONI included a description of the processes that it follows to identify and assess investment projects within its own price control submission and remains happy to explore this further with NIAUR. Naturally, SONI will need information from NIE Networks to complete these assessments, as provided for through the approved TIA arrangements.

In this regard, we would welcome the opportunity that RP6 presents to explore the development of network load indices for the transmission network, should this be relevant to the approach adopted. We would also highlight that the other assessments described in paragraph 4.67 are now within SONI's area of responsibility for the transmission network.



## Consumer Engagement Advisory Panel

We welcome the establishment of the Consumer Engagement Advisory Panel (CEAP) for RP6. We do however have some questions around its scope of work. While the scope, as listed in the paper, is appropriate for distribution issues, SONI is now responsible for some of the areas listed within the scope of the CEAP for the transmission network. We therefore request clarification of the role of the CEAP for transmission investments, and should the panel's remit include transmission, we would expect SONI to be represented to ensure that the panel is able to provide input to transmission investment decisions in the manner envisaged in the approach paper.

## Nominated Outputs

Following the recent reallocation, SONI is now responsible for developing projects that deliver an increase in capacity on the transmission network up to the point where all statutory consents are obtained. NIE Networks cannot, and should not, control the delivery of nominated outputs on the transmission system.

It is important to note, that IME3 includes a framework whereby regulatory authorities can intervene if transmission network owners do not invest in a timely manner in the projects that have been included in the transmission development plan.

## Interaction with DS3

The DS3 programme is mentioned a number of times in the approach paper, SONI is happy to meet with the price control team to discuss the DS3 programme and identify any implications that will need to be reflected in the RP6 framework.

## Transmission Innovation

While the framework proposed for innovation appears to SONI to be consistent with the allocation of responsibilities for innovation on the distribution system, it does not address innovation on the transmission network. This was also omitted from the draft determination of SONI's revenue. We would welcome an opportunity for tri-partite engagement to explore how the benefits of innovation on the transmission system can be captured for consumers under the NI industry structure.

## Pensions

While we note NIAUR's desire to align the approach to pensions across companies, it is important to remember that the circumstances surrounding each regulated company's

pension scheme are different. Each decision should therefore be consulted within its own context, given the duty to ensure that each licensee can finance its own activities.

## Financeability

We welcome NIAUR's robust approach to financeability assessment as outlined in the approach paper. We also consider it important that NIE Networks is able to continue to invest in the transmission network under "shock conditions", and consider the use of sensitivity analyses to be an essential part of this assessment.

It is important that NIE Networks is able to finance the necessary investments in transmission. Therefore, while it would be inappropriate to include the Transmission Investment Plan prepared in 2015 within the Nominated Outputs for RP6, the scale of the expected investment should be included within the base case financeability assessments and any subsequent sensitivity analyses.

# Conclusion

SONI is keen to ensure that:

- The approach to RP6 adheres to the arrangements certified by the EC on 12 April 2013;
- Is consistent with SONI's right to request changes to the transmission asset management plan;
- Facilitates SONI's fulfilment of its duties.

We note that the final approach document is due to be published on 18 November (2 weeks after the consultation closes). While this is a short period in which to adapt the approach to the transmission revenue entitlement to incorporate the reallocation of responsibilities, SONI is committed to working with both NIE Networks and NIAUR to ensure that RP6 is developed in a manner that embeds the independence of transmission network planning decisions within the enduring industry framework.