

Response of Bord Gáis Energy Supply

to

The Northern Ireland Authority for Energy Regulation

On the consultation paper entitled

Northern Ireland Electricity – T&D Price Controls 2007 – 2012

Bord Gáis Energy Supply (BGES) welcomes the opportunity to comment on the consultation paper referred to above, issued by the Northern Ireland Authority for Energy Regulation (NIAER) on 14th December 2005. BGES has considered the paper and requests that the NIAER take this response into account when considering the issue further. Views expressed herein represent those of BGES only.

Introduction & Approach

1. BGES is surprised that a paper representing such an important issue would amount to no more than a 20-page consultation paper. We are of the opinion that all Northern Ireland electricity industry participants should have access to substantially more detail on the underlying principles and approach to the area of determining the price controls and allowable revenues which Northern Ireland Electricity Transmission and Distribution Business (NIE T&D) are entitled to recover from Northern Ireland electricity customers. The level of allowable charges has an extremely significant impact on the costs of all industry participants.
2. While we understand NIAER's position that a collaborative approach may reach a satisfactory outcome, BGES is concerned that without full information made available to all interested parties, particularly in relation to costs, a satisfactory outcome for all concerned may not be achieved. It is difficult for market participants to have confidence in the process and the revenue levels set without a detailed presentation of the analysis.
3. BGES is also concerned that NIAER has rejected a thorough approach because it is "time consuming and resource intensive". BGES has real concerns that the approach adopted will result in consumers and suppliers incurring higher costs than necessary.
4. The previous Price Control consultation paper for the third Regulatory Period (RP3) covering the years 2002 – 2007 was a far more comprehensive document. It

would be normal to assume that further consultation documents would, at least, be of a similar nature.

Furthermore, an analysis or review of RP3 should be contained within or prior to the release of an RP4 consultation paper.

Price Control Duration

1. BGES believes there are real advantages to aligning price control periods in other jurisdictions. We believe this will have advantages of improving NIAER efficiency and increase perceived transparency.
2. Therefore, in principle a 5 year review could be considered appropriate for NIE T&D. However, what is more important is the basis on which the review is made. The current consultation paper is not transparent, does not go into any detail on costs, allowable or otherwise and contains no reasonable element of benchmarking or any other such performance measure. The starting point for allowable costs is deemed to be the actual costs for year 1 of RP3. This therefore does not take into account any of the previous 5 years efficiency improvements.

Operational Expenditure (Opex)

1. As NIE T&D are incentivised to spend less on Opex than that allowed by NIAER, it is imperative that a full consultative process takes place with regard to what costs are allowed and why. Table 1 as presented in the consultation paper does not provide this information. Therefore, it is impossible to make reasonable comment on the actual numbers except for the following broad comment on what has been referred to in the consultation paper.
2. BGES believes that external analysis of the cost base with the aid of appropriate benchmarking should be undertaken. Professional and independent external analysis, carried out with reasonable and clearly defined objectives, provides market participants, and consequently customers, with a certain reassurance that adequate, necessary costs only have been allowed.

Controllable:

3. The actual process described appears to be reasonably fair, however BGES has a number of concerns:
 - (a) The start point, year 1 of RP4 is based on the actual costs for year 1 of RP3 (as referred to above, this does not take account of any efficiencies gained over the 5 year period).
 - (b) We note that there is a downward adjustment of £4.2m, however there is no basis as to how this number was ascertained.
 - (c) The proposed approach states that NIE T&D are still incentivised to reduce costs with the savings automatically being passed back to customers in due course. There is no detail as to the level of savings that will be passed back

to customers. It would appear that in order to incentivise the company to reduce costs, the customer will not have all savings passed onto them

Non-Controllable:

4. Details on what non-controllable costs will actually include is incomplete – reference made only to wayleaves, payments and licence fees.

Capital Expenditure (Capex)

1. The proposal that actual, rather the previous allowable Capex, will be the regulated entitlement NIE T&D is allowed to recover is a fundamental change that merits debate with market participants on the precise nature of the new arrangements. Will the requirement on NIE (T&D) to report annually on its investment include a public consultation process to allow consumers, and market participants, the right to comment on costs that are being recovered directly from them?
2. Can NIAER confirm that any costs resulting from delays in market opening projects will not be recoverable from customers? This would be a fundamental flaw to enabling the market opening process and is simply not acceptable.
3. The figures provided in the consultation paper cannot be reasonably commented on i.e. NIE (T&D's) assessment and the target it has set itself. BGES notes that external consultants have been engaged in this aspect of the review and request that such documentation be made available to interested parties.
4. NIAER states that a paper detailing a system for rewarding Capex efficiency to NIE will be issued *next* Spring. BGES requests that NIAER commit to a reasonable timeframe for the publication of this paper.

SMART

1. BGES does not understand the relevance of this section to the consultation paper.
2. Can NIAER confirm whether or not this cost would be viewed as an allowable cost which customers will ultimately pay for? (And therefore is not an actual NIE T&D cost?).

Regulatory Asset Base and Depreciation

1. It appears from the consultation that NIE T&D is allowed a rate of return of 4.84% post tax rate of return on its distribution base (82%) and a 0.35% reduction of same on its transmission base (18%). This is despite the fact that NIAER states

that it does not believe that the cost of capital for NIE is necessarily the same as that estimated by Ofgem in 2004 for the GB DNO's.

2. Table 2 clearly illustrates that NIAER believes a reduction of between 0.4 and 0.7% should be made to Ofgem's figures. This is in addition to the fact that NIAER incorporated a 2.3 – 3% Risk-free rate even though 'there is evidence that the risk-free rate in the UK market has fallen?
3. The current proposal that Capex be allowable as actual rather than projected costs further erodes the argument for a risk-free rate which is excessive.
4. In view of the points above, it would appear to BGES that a reduction more to the order of 1% be applied to the GB DNO allowable rate of return with a further reduction applied to the identified 18% transmission portion.

Vulnerable Customer Fund

BGES does not understand the relevance of this section other than the reference to bringing this initiative forward should an overall agreement on the price control package be reached by April 2006. BGES disagrees with any incentives being placed on NIAER to agree to a NIE T&D proposed Price Control in any specific timeframe. This would not concur with normal regulatory practise.

Embedded Generation, Peak Demand and Research Capability

1. BGES does not understand the relevance of this section to the consultation paper.
2. NIE has indicated it will separately fund this facility. BGES requests NIAER confirm that the costs of funding such a facility are not ultimately borne by consumers.

Responses

- (i) Proposal for a 5 year term:
As indicated earlier, BGES agrees with the principle of a 5 year review period. It is the precise content of a review which is ultimately more important than the duration itself. NIAER has indicated that any adjustments made during this 5 year would not result in an increased benefit being attributed to NIE T&D.
- (ii) Approach for setting operating cost allowance, the allowed rate of return, rolling forward the RAB, depreciation and the price cap:
Discussed above.

- (iii) Proposal to continue with the SMART programme and (iv) NIE's proposal to separately fund the network planning and research facility and the Vulnerable Customer Programme:

As referred to above, BGES requests confirmation that none of the proposed NIE T&D schemes will ultimately be funded by customers through Use of System charges.

Conclusion

Given the incomplete nature of the consultation paper, the points raised above are made in broad response to the consultation paper on the NIE T&D Price Control Review for 2007-2012. Given the importance of this issue to market participants and customers alike, BGES would like to request that additional disclosure of full information be made to market participants. The absence of such makes it difficult to provide an elaborate response on this important issue. Furthermore, as a current market participant, we would recommend and request that NIAER seek external independent advice in relation to this issue.