

Northern Ireland Electricity's  
Transmission System Operator Business

**Initial Consultation Paper**

Price Control Proposals issued by  
The Director General of Electricity Supply (NI)  
for the period April 2002 – March 2004

**February 2002**

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# CHAPTER 1

## Introduction

The Transmission System Operator (TSO) is a separate business under NIE's combined Transmission and Public Electricity Supply Licences. The TSO business was created as a separate entity by the modifications made to the NIE Licences to implement the European Directive on the Internal Market in Electricity (IME), which came into force in Northern Ireland in February 1999. The Directive, amongst other things, required that the transmission system be separate at least in management terms from generation and supply. As a result the TSO was established as a separate regulated business by transferring the functions previously carried out by System Operations under the Power Procurement Business (PPB). PPB's new licence conditions reflect the change in its role. PPB is currently undergoing a similar price control review process.

## Background

The role of the TSO is pivotal in the development of market structures for the liberalisation of generation and supply markets in the NI electricity sector. The TSO is responsible for dispatch of generation, for the management of outages, the levying of System Support Services (SSS) charges, the operation of settlements, management of interconnector flows and for the maintenance of the operational security standards as set out in Section III (C) of Part III of the NIE Transmission and Public Electricity Supply Licence ("the Licence").

The TSO own-cost allowance for the period up to 31 March 2002 was set as a fixed amount when the price control revenues for the pre-2000 PPB business were split to reflect the new market structure. The TSO own cost for the year 2001/02 is expected to be £6.02 million (including excluded costs). This revenue is recovered as part of the charge under the SSS levy, which also includes ancillary service costs and fast start gas turbine charges. SSS charges are recovered across all customers in the Northern Ireland market.

It should be acknowledged that the market opening has increased the responsibilities and therefore the costs of the TSO as settlement of payments between market participants was not necessary when NIE had a monopoly in purchasing and selling electricity. This additional function has been managed in a cost effective way.

## **A Transitional Arrangement**

The Director General of Electricity Supply for Northern Ireland (DGES) believes that, in principle, the TSO should be incentivised to manage the system at least cost compatible with running an efficient system on a sustainable basis. A consultation paper will be published shortly on the longer term future role, status, ownership structure and method of rewarding the TSO.

This review is designed to manage the transition to that new status when the TSO requires to be adequately funded and allowed the revenue necessary to meet its costs and assume its increased responsibilities.

## **CHAPTER 2**

### **The existing TSO Price Control**

The price control currently in force is as laid out in Schedule 5B of [NIE's combined Transmission and Public Electricity Supply Licences](#). The revenue allowance for the TSO was set as £5.95 million (2000/01) prices. This figure was derived from the split of allowed revenues between PPB and the new TSO business, and was set to continue until the end of the control in March 2002. The nominal amount is increased annually by inflation (RPI) less 0.5%.

Details are attached at Annex 1.

### **The next Review Period (1 April 2002 – 31 March 2004)**

The DGES proposes that the duration of the next review period is two years. The change under way in the electricity sector in Northern Ireland, and the important role to be played by the TSO business, is such that a longer term would be unsuitable both because it is not yet known how the sector will develop over the next 5 years, and because the TSO price control should not tie us into a particular approach. A two year period is therefore appropriate.

The role of the TSO in a new market, and its ownership structure is the subject of a separate consultation process, which will seek to establish a means to define the role of the TSO for the longer term. The Department of Enterprise Trade and Investment (DETI) may decide to legislate to establish the longer term status of the TSO.

For the period 2002 – 2004 the DGES proposes that there be no radical change to the funding of the TSO business. The revenue levels as set in 2000, when the TSO was split from PPB, should be carried forward for the two year period.

The DGES proposes that, for simplicity, the TSO price control revenues be set as fixed (indexed) amounts in each year. The short duration of the control does not lend itself to a RPI-X incentive mechanism. By extension this removes the link between revenue and the asset base of the TSO business, although the implicit link between assets and revenue was established when the revenue levels were set in the 2000 split from PPB. The DGES would propose that a suitable asset value for the TSO business should be established in the event that the TSO is separated or sold by NIE, if this is the outcome of the consultation on the future role and ownership of the TSO. The proposals put forward in this document should not therefore cloud that discussion.

## TSO Incentives

The existing TSO price control does not include specific performance incentives. In the two year period under consideration, the DGEN is seeking to establish whether some form of external incentive measure is feasible as an addendum to potential TSO revenues. There may, for example, be scope for the TSO business to manage system costs in a manner which would allow a proportion of the system benefit which accrues to be retained by the TSO. The DGEN welcomes any input which may assist in defining such measures, if any.

The combined Power Procurement Business established at privatisation made profits of nearly £38 million (2001 prices) in the ten years since privatisation. These are almost entirely attributable to the power purchasing function, and the TSO was not treated as a separate profit centre. While NIE, during the period 2002-2004, will own both PPB and the TSO it seems reasonable to continue to treat PPB as the profit earner and simply allow the TSO its reasonable costs, which have incentives included to minimise costs.

## Suggested Price Control Formula

The interim control formula for the TSO Business could take the following form:

$$M_{TSO_t} = A_{TSO_t} + B_{TSO_t} + D_{TSO_t} + K_{TSO_t}$$

The  $A_{TSO_t}$  term will remain unchanged from the existing control.

Under the proposed control  $B_{TSO_t}$  would be modified such that it becomes :

$$B_{TSO_t} = B_{TSO_{t-1}} \times (1 + RPI_t) / 100$$

Where  $B_{TSO_{t-1}}$  equals £6.02 million in the relevant year commencing 1 April 2001. This would be uplifted by inflation to set the opening allowance for the first year of the interim control.

$D_{TSO_t}$  remains unchanged.

$K_{TSO_t}$  remains unchanged.

## **Conclusion**

The proposals outlined above allow the TSO business to continue to operate on effectively the same terms as at present.

Comments on the issues contained in this Initial Consultation Paper should be sent by Friday 22 March 2002, to

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Please include a one-page summary with submissions.

## ANNEX 1 : TSO Price Control : Schedule 5B, NIE's combined Licences.

### SYSTEM SUPPORT SERVICES (SSS) CHARGE RESTRICTION CONDITIONS<sup>1</sup>

The transmission system operator (TSO) shall, in setting the SSS charges, use its best endeavours to ensure that in any relevant year the regulated SSS revenue shall not exceed the maximum regulated SSS revenue calculated in accordance with the following formula:

$$M_{TSOt} = A_{TSOt} + B_{TSOt} + D_{TSOt} + K_{TSOt}$$

where:

$M_{TSOt}$  means the maximum regulated SSS revenue in relevant year t.

$A_{TSOt}$  means the cost of System Support Services in relevant year t including the cost of the gas turbines contracted under the cancellable generating unit agreements as outlined in Schedule 8 in relevant year t and including amounts payable by the transmission system operator to any person for the provision or use of any System Support Services provided over any interconnector in relevant year t.

$B_{TSOt}$  means the allowed SSS revenue in pounds millions in relevant year t which is derived from the following formula:

$$B_{TSOt} = B_{TSOt-1} \times (1 + (RPI_t - 0.5) / 100)$$

Where

$B_{TSOt}$  equals £5.95 million in relation to the ninth relevant year (see Schedule 10) but in previous years  $B_{TSOt}$  equals zero;

$rpi_t$  means the percentage change (whether a positive or negative value) in the Retail Prices Index between that published or determined with respect to October in the relevant year t and that published or determined with respect to the immediately preceding October;

$D_{TSOt}$  means any other cost in relevant year t not included in  $A_{TSOt}$  and  $B_{TSOt}$  and approved by the Director;

$K_{TSOt}$  means the correction factor (whether a positive or negative number) to be applied to the maximum regulated SSS revenue in relevant year t derived from the following formula:

$$K_{TSOt} = (M_{TSOt-1} - R_{TSOt-1}) (1 + I_t / 100)$$

Where :

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<sup>1</sup> Licence modification dated 6 December 2000.



$M_{TSO_{t-1}}$  means the maximum regulated SSS revenue in relevant year t-1;

$R_{TSO_{t-1}}$  means the regulated SSS revenue in relevant year t-1;

$I_t$  means the average specified rate.

In respect of the first and ninth relevant years commencing 1<sup>st</sup> April 1992  $K_{TSO_t}$  will have the value zero.