

Alan Craig
Utility Regulator
Queens House
14 Queen Street
Belfast BT1 6ED

21 December 2016

Dear Alan

Proposed licence modifications – November 2016

Please find attached NIE Networks' response to the UR's consultation on proposed modifications to the electricity distribution and transmission licences.

The UR may also wish to consider –

- amending the definition of 'RP6'; the end date should be 31 March 2024;
- amending the definition of 'Fuel Security Event' to reference the newly named Department for the Economy; and
- adding a row to Table 9 of Annex 2 of the distribution licence, to provide a unit cost allowance category for keypad meters which are replaced due to suspected magnetic interference.

Please let me know if you wish to discuss any aspects of this reply.

Yours sincerely



CARL HASHIM
Compliance Manager

Enc

L 161221 NIE Networks reply to RP5 mods

NIE Networks – 21 December 2016

Comments re UR draft licence modification published November 2016

Draft licence ref	NIE Networks' comments
Definitions	<p data-bbox="353 344 981 371"><u>Demonstrably Inefficient or Wasteful Expenditure</u></p> <p data-bbox="353 395 2042 488">The UR's drafting is not in line with the CMA determination. Paragraph 5.110 of the FD puts the onus on the UR to present evidence in support of its conclusion. NIE Networks' view is that the term "demonstrably inefficient or wasteful expenditure" should be defined by reference to expenditure "which the Authority has demonstrated to be inefficient and/or wasteful". The FD requires nothing less.</p> <p data-bbox="353 528 2042 719">Moreover, UR's rationale for declining to incorporate a test of "reasonableness" on the part of the UR in making any determination as requested by the CMA (see paragraphs 4.3 and 4.4 of the draft Second Consultation) is wrong in law. Contrary to the assertion in paragraph 4.4, the UR is not subject to a public law requirement to act reasonably; rather it must not act irrationally. That is a significantly higher threshold for the purposes of any legal challenge to the UR's determination. An express obligation on the UR to act reasonably (in the conventional, rather than Wednesbury sense) in making a determination would therefore impose a higher standard of obligation on UR than would otherwise arise. It would be misleading for the UR to suggest otherwise in its consultation on the draft Second Consultation.</p>
Definitions	<p data-bbox="353 772 524 799"><u>Related party</u></p> <p data-bbox="353 818 2042 903">NIE Networks does not understand why it is appropriate that an Affiliate or Related Undertaking should remain as a Related Party for the whole of the price control period even if it is no longer part of the group due to restructuring. The UR is requested to reconsider this aspect of the definition of Related Party.</p>

Draft licence ref	NIE Networks' comments																												
4.27	<p><u>Depreciation allowances</u></p> <p>The UR has reduced the depreciation allowance in the year of addition by 50%. This was not contemplated by the CMA and should therefore not form part of the Article 17 modifications. The effect of the change is to increase NIE Networks' financing needs in RP5 by in excess of £12.7m.</p> <p>The UR has not provided any evidence to show that they have considered the CMA views as expressed in paragraph 20 of its initial views paper on 6 August 2015. The CMA states here that the UR should consider whether their preferred approach would be consistent with the CMA's financeability assessment.</p> <p>The proposed formula allows only for half a year's depreciation in the year additions are made to the RAB; whereas the CMA's FD model and NIE Networks' normal method of calculation is to provide a full year's depreciation in the year of addition. The UR's approach results in a reduction in the RP5 depreciation allowance of £12.7m (and hence NIE Networks' cash flow) compared to the CMA's FD model and NIE Networks' normal method of calculation. This revision was not considered, or proposed, at any time during the CMA's inquiry and should not be included in the Article 17 licence modifications.</p> <table border="1" data-bbox="353 770 1727 1107"> <thead> <tr> <th>RAB</th> <th>Depn rate % per annum</th> <th>CMA's FD allowances RP5 total, £m</th> <th>Draft Mods Reduction in depreciation allowance RP5 total, £m</th> </tr> <tr> <td></td> <td>A</td> <td>B</td> <td>(A*B)*0.5</td> </tr> </thead> <tbody> <tr> <td>T&D</td> <td>3%</td> <td>468.8</td> <td>7.0</td> </tr> <tr> <td>Keypad</td> <td>6.67%</td> <td>33.8</td> <td>1.1</td> </tr> <tr> <td>5 year</td> <td>20%</td> <td>43.3</td> <td>4.3</td> </tr> <tr> <td>Enduring solution</td> <td>10%</td> <td>5.9</td> <td>0.3</td> </tr> <tr> <td>Total</td> <td></td> <td>551.8</td> <td>12.7</td> </tr> </tbody> </table> <p>The formula should instead be:-</p> $\text{DEPNADD}_Xt = \text{DEPN}_Xt + (\text{DEPNADD}_Xt-1 * \text{RPI}_t / \text{RPI}_{t-1})$ <p>where DEPNADD_X2012= zero</p>	RAB	Depn rate % per annum	CMA's FD allowances RP5 total, £m	Draft Mods Reduction in depreciation allowance RP5 total, £m		A	B	(A*B)*0.5	T&D	3%	468.8	7.0	Keypad	6.67%	33.8	1.1	5 year	20%	43.3	4.3	Enduring solution	10%	5.9	0.3	Total		551.8	12.7
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4.37(b)(i) (T only)	<p><u>Distribution works necessary to facilitate transmission development</u></p> <p>Restricting the drafting to simply refer to distribution capex is not clear. NIE Networks submits that the following formulation is more apt: "distribution network expenditure save for expenditure where the only purpose of that work is to enable enhancement of the transmission system and can reasonably be allocated as transmission expenditure rather than distribution expenditure"</p> <p>This wording closely parallels paragraph 60 of the CMA comments on 12 January 2016.</p>

Draft licence ref	NIE Networks' comments
4.37(b)(ii) (T only)	<p><u>Investment Projects to increase transmission system capacity</u></p> <p>The D5 mechanism is intended to cover projects which increase the transmission network capacity. The baseline for this test should be the transmission network capacity which the CMA assumed in its FD.</p> <p>However, under the current drafting, the Ballylumford cable replacement project is excluded. We do not believe this is what the CMA intended. In order to address this issue, NIE Networks proposes that the drafting in paragraph 4.37(b)(ii) should be amended as follows so that the exclusion of asset replacement expenditure does not apply to asset replacement projects that are driven by the transmission capacity required to import from Ballylumford.</p> <p>(ii) Asset replacement expenditure (other than works associated with replacing the Ballylumford cable);</p> <p>The background is as follows:-</p> <ul style="list-style-type: none"> • The CMA FD made the assumption that the Ballylumford units would be decommissioned and therefore there would be no need to replace the cable and no allowance was given accordingly. • The need to replace the cable has arisen because of security of supply issues and the decision by the Utility Regulator and DETI to carry out a market test exercise in March 2014 for the provision of additional adequacy margin of between 220MW and 300MW. • Following this process the Utility Regulator and DETI agreed that SONI would enter into a contract with AES which will provide 250MW of additional generation capacity, available from January 2016 • The procurement of this additional generation capacity has therefore created the need for additional transmission capacity above the level which the CMA assumed in its FD and the need to replace the cable has arisen as a result of this. • The effect of the draft modifications is that NIE Networks would be required to fund 50% of the cost of the cable notwithstanding that the need to replace the cable has arisen for reasons entirely outside NIE Networks' control. <p>Please refer to the CMA comments on 6 August 2015 (paragraphs 28 – 32) which proposed that the Ballylumford cable project should not be excluded.</p>

Draft licence ref	NIE Networks' comments
4.37 (e) Table 7 (T only)	<p><u>Provisional allowances</u></p> <p>Paragraph 4.37(e) should be amended as follows to align more closely with the CMA FD:</p> <p>e) the Authority may only make a fresh assessment of projects considered in the Final Determination where there has been substantial changes to the nature or scope of these projects, otherwise, the provisional allowances for these projects shall be based on the project cost estimates are provided in Table 7 below. The list of projects in Table 7 is not exhaustive. The Licencee may apply for funding for other transmission system capacity or capability related projects under 4.37(a).</p> <p>Table 7 heading should read as follows to reflect Appendix 9.4 of the CMA FD:</p> <p>Table 7 – The Transmission Owner Business pre-determined transmission load related project provisional allowances (2010 prices)</p>

Draft licence ref	NIE Networks' comments
6.17	<p><u>Costs associated with regulatory reporting (RRt)</u></p> <p>Although there is a term provided in the licence modifications (RRt), the UR has decided not to provide an additional allowance in respect of RIGs reporting over the £1m initial allowance set by the CMA (reference letter dated 19 May 2015). This decision is not in line with what the CMA intended and renders the RRt term redundant.</p> <p>In relation to the RIGs allowances the CMA said it “could not confidently forecast NIE’s costs to report against the Ofgem GB DNO RIGs. We therefore set an initial allowance for implementation costs of £1m, with the ability for NIE to apply to the UR for a further allowance that should be granted if the UR is able to satisfy itself that any additional implementation costs are efficient and in the public interest”.</p> <p>NIE made a submission in respect of additional costs of £1.6m in April 2015 (copy attached). However, our proposal was rejected by the UR on the basis that it had not seen the evidence to justify additional costs (copy attached). We went to considerable effort to identify the additional costs associated with the RIGs and we do not know what else we could do or what further evidence we could provide.</p> <p>We would ask the CMA to review whether the UR’s decision is in line with what the CMA intended.</p> <div style="display: flex; justify-content: space-around; align-items: center;"> <div style="text-align: center;">  <p>2015-05-19 RIGS response ltr to NIE.PIPaper - submitted to I</p> </div> <div style="text-align: center;">  <p>RIGs Cost Recovery</p> </div> </div>
9.1	<p><u>Tax Amount</u></p> <p>The amount of capital allowances is based on QCE. However, not all QCE may qualify for tax allowances. NIE Networks therefore proposes the following change to the definition of QCE_Xt to QCET_Xt</p> <p>"QCET_Xt means the qualifying capex expenditure amount, calculated in accordance with 4.17 (QCE_Xt), <u>excluding any capital expenditure which does not qualify for capital allowances in accordance with HMRC guidelines:</u>"</p>

Draft licence ref	NIE Networks' comments
12.8	<p><u>Forecasts / estimates with regards to setting Transmission/ Distribution Charges</u></p> <p>We suggest that this provision be deleted. All relevant information will be provided to the UR by NIE Networks as part of the tariff submission. There should be no need to supplement this with further data.</p>
12.35 12.36	<p><u>Information on Tax</u></p> <p>The following amendments are proposed:</p> <ul style="list-style-type: none"> • Amend paragraph 12.35(a)(i) as follows: “Information submitted to HMRC on the Licensee's tax affairs relating to the calculation of the Licensee's capital allowances including the amortization of deferred revenue expenditure.” • Amend paragraph 12.35(b) as follows: “Information submitted to HMRC on the Licensee's tax affairs relating to the calculation of the Licensee's capital allowances including the amortization of deferred revenue expenditure.”