NIE RP5 Price Control referral to the Competition Commission
Date: 30 May 2013
Contact: Marian Cree - Head of Energy
The Consumer Council welcomes the opportunity to make a submission to the Competition Commission on the NIE (RP5) Price Control referral.

The Consumer Council is an independent consumer organisation, working to bring about change to benefit Northern Ireland (NI) consumers. Our aim is to make the consumer voice heard and make it count.

We have a statutory remit to promote and safeguard the interests of consumers in NI and we have specific functions in relation to energy, water, transport and food. These can include considering consumer complaints and enquiries, carrying out research and educating and informing consumers.

The Consumer Council is also a designated body for the purposes of supercomplaints, which means that we can refer any consumer affairs goods and services issue to the Office of Fair Trading, where we feel that the market may be harming consumers’ best interests.

In taking forward our broad statutory remit we are informed by and representative of consumers in NI. We work to bring about change to benefit consumers by making their voice heard and making it count. To represent consumers in the best way we can, we listen to them and produce robust evidence to put their priorities at the heart of all we do.
Introduction

The current RP5 Price Control referral is significant for NI consumers as it contains proposals for a significant increase to spending on the network both to maintain performance and to increase further the amount of renewable energy on the system. The cost of this will be paid for by consumers and in a time of economic downturn and rising household prices the need to balance the maintenance and enhancement of the network against the increase in costs is vitally important.

The importance of cost is set in the wider energy context of:

- 70 per cent of consumers surveyed across NI in June 2012 by the Consumer Council to inform our initial response to RP5, stated that the biggest energy priority for them was cost.

- Fuel Poverty levels are currently at 42 per cent in Northern Ireland the highest levels in the United Kingdom\(^1\)

- The cost of electricity for large and medium industrial and commercial businesses in the non domestic electricity market in NI are amongst the highest in Europe\(^2\)

- On 22 May 2013, a 17.8 per cent price increase for domestic and small business customers was announced by Power NI and received with consternation by the media, politicians, consumers and businesses. The NIE element amounted to 22 per cent of the whole tariff;

- The cost of the main heating source in NI, home heating oil, (68% of homes rising to 82% in rural areas\(^3\)) has risen over 62 per cent since 2009\(^4\).

\(^1\) HECA 2012 report.
\(^2\) NIAUR March 2013: NI Electricity Prices Data and Comparisons Information paper
Furthermore, Consumer Council Research in November 2011 found that 47 per cent of NI consumers were concerned about their ability to make ends meet.

Background

In 2012 the UK Department for Business Innovation and Skills (BIS) undertook a consultation that aimed to establish a set of cross-sector Principles for Economic Regulation. We believe that it is relevant to make reference to two of the principles that BIS produced. These are:

1. The Government will regulate to achieve its policy objectives only where the regulation and the enforcement framework can be implemented in a fashion which is demonstrably proportionate; accountable; consistent; transparent and targeted;
2. There will be a general presumption that regulation should not impose costs and obligations on business, social enterprises, individuals and community groups unless a robust and compelling case has been made.

In July 2012 the Consumer Council submitted a response to the Regulators RP5 draft proposals followed by a response in September 2012 to the Regulators paper on NIE’s capitalisation practices. In the Regulators Final Determination of April 2012, the only changes made were movements on the allowances to NIE, but no further consideration or information was given on the underlying issues raised by CCNI in the responses referred to above. The issues which we raised in our first consultation response remain the substantive ones to be addressed in this Price Control and we therefore invite the Commission to consider our original consultation responses. A copy of the documents is attached5. and to understand the Consumer Council position it

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3 House Conditions survey 2009
4 CCNI Oil v Gas brief May 2013.
5 Appendix 1 and 2
will be necessary to read them in conjunction with this submission. In summary, the main issues of concern for CCNI are:

1. **CAPEX**: NIE requested £776m – NIAUR allowed £396m
2. **OPEX**: NIE requested £237m – NIAUR allowed £182m
3. **PENSIONS**: NIE deficit of £156m in their pension scheme + £10m for ongoing pension costs – NIAUR has allowed a total pension cost of £58m
4. **CAPITALISATION**: NIAUR has recommended adjusting the RAB by £32m
5. **RATE OF RETURN**

**Questions for the Competition Commission**

In addition to the two responses we made in 2012, we would like to add some comments and summarise four questions that we would like the Competition Commission to answer. The detail associated with these questions is outlined in the main body of this submission.

The four key questions are

1. To what extent should consumers be required to pay for the outcome of a regulatory process and asset management system that has failed to provide a transparent and robust evidence base;
2. We would like to see the Competition Commission modify the NIE licence conditions so that NIE are required to adopt an accredited industry standard recognised asset management system;
3. Was the Regulators decision to increase every metric in NIE’s favour between its Provisional and Final Determinations based on robust new information? If the answer is yes, then why was that information not available at the outset of the process?
4. Would the public interest be served by the introduction of a Reporter into NIE?
Lack of robustness and transparency of information

The issue at the heart of the referral is that there is a lack of information and transparency on how NIE runs and plans its business. Initial submissions to the Competition Commission, from both the Regulator and NIE, highlight this and reveal the extent to which they both feel that this has damaged confidence in the price control process.

Throughout its submissions on RP5 the Regulator has assigned responsibility for the information gap to NIE, by highlighting the limitations of its asset management system, the lack of robust information and unusual and opaque accounting practices. The Regulator recently commented on the ‘level of transparency and accountability in NIE T&D’s operations’ by saying ‘It creates opportunities for NIE T&D to profit at customers’ expense. It also saps us of confidence in NIE T&D’s claims about the need for capex, which makes it difficult to balance our duty to protect customers with our duty to ensure NIE T&D’s activities can be financed’.

For its part, NIE sees the responsibility for the information gap sitting with the Regulator because it claims the Regulator ‘has not recognised the need to specify appropriate output measures at the beginning of RP5 and clearly define in advance the associated reporting requirements’.

This lack of confidence in the regulatory process and information systems is shared by the Consumer Council. However, whilst arguably NIE and the Regulator blame each other for the information gap and breakdown in confidence, it is the consumer who is being asked to pay the cost of taking what is essentially a leap of faith. The overall impact is a lack of openness and transparency which leads to uncertainty and a lack of confidence for consumers. This puts organisations such as the Consumer Council, which has a statutory duty to represent consumers, in a difficult position as we

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6 Northern Ireland Transmission and Distribution Price Control Review (RP5) 2012-2017
7 Letter from Joe O’Mahony (NIE Managing Director) to the Competition Commission Inquiry Manager, 10 May 2013
cannot provide reassurance to consumers. The question that we put to the Competition Commission is to what extent should consumers be required to pay for the cost of a regulatory system that does not provide sufficient and appropriate information on which decisions can be made that have a significant cost impact on consumers?

**Accredited Industry standards**

We raised our concern about the lack of an Accredited Industry Standard asset management system, (such as PAS55), in our initial response to the Regulator’s consultation. On this subject NIE have recently stated that ‘its asset management processes meet the substantive requirements of PAS55’. The Consumer Council does not have the evidence to dispute this, but it is clear that whatever asset management system NIE does have, it has not produced the empirical evidence that is needed for a robust Price Control that all parties can have confidence in.

It seems that there is little that can be done to rectify this in time for the current price control determination. However, we would ask the Commission to modify the NIE licence conditions so that NIE will be required to adopt an accredited industry standard recognised asset management system. If NIE fail to do this, one penalty could be to reduce its profit margin (rate of return) at the next price control.

**Final Determination**

In the Final Determination, every cost that NIE is allowed to recover from customers has increased from the Draft Determination. Notably the Capital Expenditure allowance has increased by 26 per cent, and the Pension Allowance by 162 per cent, whilst at the same time the Rate of Return the company is allowed to earn has increased.

To consumers this could appear as inexplicable and a concession to NIE. For CCNI this further brings into question the robustness of the information that
forms the basis of this Price Control. We would ask the Competition Commission to determine if the Regulators decision to increase every cost metric in NIE’s favour, between its Provisional and Final Determinations, is based on robust new information? If the answer is yes, then why was that information not available at the outset of the process?

A Reporter

We gave our support for the introduction of a Reporter in our consultation response. The further submissions from both the NIE and the Regulator only emphasise the need for a Reporter to help resolve the information gap that exists at NIE. We would reiterate this approach, citing the introduction of a Reporter at NI Water which has given stakeholders and consumers an increased confidence that the information made available is robust.

Public interest

Unfortunately the information gap at the centre of the RP5 Price Control means that consumers cannot tell what is really going on with their electricity network and to what extent more of their money is required to be spent on it. If the interest of consumers can be defined as a safe, reliable and cost efficient network then the objective of the Utility Regulator is to protect the short and long-term interests of electricity consumers with regard to price and quality of service.

NIE meanwhile is a company run on behalf of its shareholders. NIE’s operating plan has a number of priorities and performance indicators but ultimately it must deliver for its shareholders. In the nine months up to 31 December 12, NIE showed a profit after tax of £44.6m. However, the company did not pay any dividends during the same period. During this same period NIE declared assets worth £202.8m; up from the previous year.

*www.uregni.gov.uk/about_us/what_we_do/*
The profit of NIE is derived from the rate of return it earns on its asset base. When either the asset base or the rate of return increases, the profit for the company increases too. The cost of increasing the value of the NIE asset base as proposed in the CAPEX requirements within RP5 will be paid for by consumers. Increasing the value of the asset base increases both the profitability of the company and the sale value of the property.

The Competition Commission aims to provide an outcome that best serves the public interest. In our view the public interest is best served by Northern Ireland having an electricity network that is both safe and reliable and that provide this at the lowest possible cost to consumers. These core objectives and further public interest objectives, such as sustainability, will be achieved if the network also delivers the NI Government objectives defined in the 2010 Strategic Energy Framework as:

- building competitive markets;
- ensuring security of supply;
- enhancing sustainability; and
- developing our energy infrastructure.

**Conclusion**

CCNI would ask the Competition Commission to keep the public interest at the forefront of their deliberations on the RP5 referral and consider our initial RP5 response and Capitalisation⁹ as part of this inquiry together with the issues and questions raised in this submission. We would also welcome the opportunity to give oral evidence to the Commission.

⁹ Appendix 1 and 2
Appendix 1- Response to the Utility Regulators consultation on the Northern Ireland Energy (NIE) Transmission and Distribution Price Control 2012-2017

19th July 2012

Introduction


The Consumer Council is an independent consumer organisation, working to bring about change to benefit Northern Ireland (NI) consumers. Our aim is to make the consumer voice heard and make it count.

We have a statutory remit to promote and safeguard the interests of consumers in NI and we have specific functions in relation to energy, water, transport and food (the Consumer Council and the Food Standards Agency (FSA) have a memorandum of understanding and the Consumer Council's strategic focus on food is primarily in relation to food prices and customer experience). These include considering consumer complaints and enquiries, carrying out research and educating and informing consumers.

The Consumer Council is also a designated body for the purposes of supercomplaints, which means that we can refer any consumer affairs goods and services issue to the Office of Fair Trading, where we feel that the market may be harming consumers’ best interests.

In taking forward our broad statutory remit we are informed by and representative of consumers in NI. We work to bring about change to benefit consumers by making their voice heard and making it count. To represent consumers in the best way we can, we listen to them and produce robust evidence to put their priorities at the heart of all we do.

Background

Like the rest of Europe, Northern Ireland is facing potentially conflicting policy aims for its energy sector. With energy prices rising, fuel poverty is growing and businesses and industry are struggling to compete in an international market. However, the need to keep energy prices as low as possible has to be shared with the need to create an energy industry that is both economically and environmentally sustainable. The requirement to increase the amount of energy from renewable sources will only increase energy costs, at least in the short run, due to the impact of carbon taxes and infrastructure development costs.
Consumer Context

It is important to understand the context for NI consumers against which the Northern Ireland Electricity (NIE) Price Control is taking place. Northern Ireland consumers, along with those living in other areas of the UK have seen their overall spending power diminished in recent years. A recent report from the Joseph Rowntree Foundation\(^\text{10}\) has examined the impact of the economic downturn on households in Northern Ireland since 2009.

The report found that 22% of people in Northern Ireland were living in poverty and that the number of retired households living in poverty had increased from 55,000 to 70,000. It also confirmed a higher percentage (21%) of pensioners live in poverty in Northern Ireland compared to their counterparts in the rest of the UK where the figure is 16%.

The Consumer Council’s own research\(^\text{11}\) shows that half of the adult population here is worried about making ends meet and over half are worried about making ends meet in the future. Furthermore, only half are managing to keep up with bills and credit without difficulties and more than one in four stated that they are worried that they, or someone in their household, will lose their job within the next year.

The Consumer Council acknowledges that reliance on home heating oil, as a key energy source for NI homes, is a major contributor to high energy bills. Nonetheless, the cost of electricity in Northern Ireland is a crucial issue as consumers already face the highest energy bills in the UK, (see Table 1).

### Table 1 Heating Fuel Bills NI and GB

<table>
<thead>
<tr>
<th></th>
<th>Average bill 2001</th>
<th>Average bill 2011</th>
<th>% increase 2001 - 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern Ireland</td>
<td>£768.55</td>
<td>£2,368.71</td>
<td>208%</td>
</tr>
<tr>
<td>Great Britain</td>
<td>£541.33</td>
<td>£1,258.09</td>
<td>132%</td>
</tr>
<tr>
<td>Difference</td>
<td>£227.22</td>
<td>£1,110.62</td>
<td>389%</td>
</tr>
</tbody>
</table>

Source: DECC, CCNI, Sutherland Tables, Consumer Focus, Power NI, Phoenix Supply Limited, firmus energy

The increasing cost of energy is affecting nearly everyone in our society. Around 302,000 households in Northern Ireland are struggling to heat their homes to an adequate level and at 44 per cent NI’s level of fuel poverty is by far the worst in any part of Great Britain and Ireland.

In June 2012, the Consumer Council surveyed just over 1000 electricity consumers across Northern Ireland on what is the most important thing that

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\(^{10}\) Monitoring poverty and social exclusion in Northern Ireland 2012, Joseph Rowntree Foundation

\(^{11}\) Consumer Proficiency Research, 2011/2012. The Consumer Council
they want from their electricity supply. Table 2 details the responses received when consumers were asked:

**Thinking about your electricity supply, which of the following would you say is most important to you? And which is second most important?**

<table>
<thead>
<tr>
<th>Priority</th>
<th>1st priority</th>
<th>2nd priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>The lowest possible price</td>
<td>69%</td>
<td>20%</td>
</tr>
<tr>
<td>A highly reliable supply with the lowest possible number of power cuts</td>
<td>19%</td>
<td>52%</td>
</tr>
<tr>
<td>That as much electricity as possible is generated by renewable means, i.e. from sustainable sources such as wind power</td>
<td>7%</td>
<td>18%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>5%</td>
<td>10%</td>
</tr>
</tbody>
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Table 2: Priorities for electricity consumers, June 2012 (Base: 1020)

The lowest possible price can be seen as the clear priority for most consumers. However, it can also be seen that a significant number of consumers regard having a reliable supply as their first or second priority.

**Strategic Context**

DETI’s Strategic Energy Framework recognises these consumer priorities (cost and reliability) setting them in a long term strategic context aligned to four key energy goals for Northern Ireland:

- building competitive markets;
- ensuring security of supply;
- enhancing sustainability; and
- developing our energy infrastructure.

The NIE (RP5) Price Control is a key element to deliver both the consumers’ short to medium term priorities as well as the Strategic Energy Framework’s long term energy goals. It sets the level of **24 per cent of the consumer’s energy bill**, the level of network maintenance and signals the amount of electricity infrastructure that will be built (or replaced).

**Regulatory Framework**

In the context of meeting and representing consumers’ views The Consumer Council undertook research to understand how comparable electricity networks are regulated. GB network operators broadly face the same operational and strategic issues as NI. The GB Regulator, Ofgem, has...
undertaken significant work in recent years to further develop its model for regulating Utilities with a specific focus on benefits to the consumer. The resulting RIIO model\textsuperscript{12}, has seen a greater emphasis on outputs and incentives that are aimed at achieving them, in order to facilitate required investment at the lowest possible cost to the consumer. The framework mimics the competitive markets by rewarding companies that deliver on the outputs valued by consumers, and penalising those that don’t.

The RIIO approach describes six main output categories:

- Environment;
- Reliability;
- Connections;
- Customer Satisfaction;
- Safety; and
- Social Obligations.

Under the RIIO model a heavy emphasis is placed on the Business Plan submitted by the network company. The Business Plan requires the company to demonstrate that its plans are designed to deliver outputs that are based on genuine and ongoing engagement with consumer representatives and other stakeholders. This consumer engagement is as much a responsibility of the company to undertake as it is of the Regulator.

The Business Plan also requires the company to detail and justify its costs. The business plan has to be specific in what outputs companies will deliver on, and what consumers will get for their money. Performance is then benchmarked against delivery on those outputs, which allows for networks to think differently about how to meet consumer needs – e.g. deferring traditional investment or meeting requirements in different ways.

Consumers expect to benefit from a robust regulatory process which provides confidence and clarity together with clear outcomes for the significant investment (coming from their bills) involved. Throughout this response the Consumer Council will detail specific areas where we believe the regulatory process has not met this expectation.

Additionally there are elements of the determination which the Consumer Council simply cannot make a judgement whether to support or not. Because for some issues information is inconclusive, is deemed subjective, or is contested (all equally undesirable) this means a full assessment and position for the Consumer Council is not achievable.

Uncertainty such as this should not exist in a Price Control process, especially with the model in NI so heavily concentrated on economic regulation at the

\textsuperscript{12} http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/RIIO\%20handbook.pdf
expensive of a sufficient focus as outlined above on customer, environmental and safety aspects.

**Summary & Key Points in response to Draft Determination**

**Overall cost to consumers**

The cost of electricity is the key priority for consumers but needs to be balanced with their second priority relating to reliability of supply. The cost savings that the Regulator’s proposals represent for all classes of consumers, when set against the NIE proposals, are welcome. However, the extremely significant difference (£776 million compared to £315 million) between the NIE request and the Regulator’s draft determination raises concern about the regulatory process, and the accuracy/extent of information used by parties to arrive at these proposed investment levels.

The comments provided by the Regulator in relation to the NIE CAPEX request which suggest it was based on ‘subjective engineering judgements’ and ‘heavy on opinion’ are worrying. It raises questions both of the company regarding its submission but also of the regulatory framework which did not ensure thorough engagement and clear requirements that information provided should be sufficiently robust.

The significant difference of opinion on investment requirements as well as the uncertainty regarding information quality will be concerning to consumers for this Price Control. However consumers will rightly ask if information is a problem in this Price Control process was it also a problem in previous Price Control processes and if so why has it not been effectively addressed by now?

**Regulatory Model**

The Consumer Council would strongly argue that the current regulatory model employed by the Regulator is outmoded when compared to the Ofgem model (RIIO). This has in our view contributed to concerns regarding the accuracy of information and compounded the uncertainty regarding the actual requirements for investment going forward over the next five years. Specifically the NI model lacks outputs, detailed business plans, transparent information and consumer engagement. As highlighted the vast difference between what NIE deemed to be required and what the Regulator deems to be required is a cause for concern and raises issues about the suitability of the current regulatory model.

Price Controls are significant in determining the cost of energy going forward. Consumers should not be put in a position where they are hindered in any way in assessing the complete and detailed information that has informed the Price Control and the subsequent impact of the agreed costs. Unfortunately this Price Control has placed consumers in that very position.
Accredited Industry Standards

The Consumer Council believes the absence of recognised industry standard processes such as PAS55 or existing processes being certified in previous Price Controls has contributed to the lack of information and clear difference of opinion between the Regulator and NIE. A continued absence of an approved and certified process to support the whole-life management of physical assets within NIE will result in continued uncertainty in relation to the scale of investment required for asset replacement and development.

Outputs

Consumer focused regulation means being clear on what improvements or benefits are derived as a result of investment programmes. The Consumer Council is concerned that there is not greater emphasis place upon outputs. Whilst it is important to bear down on costs the consumer needs to know what they will get for their money. Not only should consumers be informed of the expected outputs but actively involved in a process were consumers have contributed to setting the outcomes they expect and value. It is absolutely essential that the regulatory process places a much stronger emphasis on engagement with consumers.

Renewables

As stated in our introduction, the NIE Price Control will play a key part in contributing to Northern Ireland’s energy strategy. The Consumer Council supports the Regulator’s broad commitment to develop an infrastructure to facilitate an increase in renewable energy. The NI Executive has set a clear policy target for 40 per cent of electricity consumed by 2020 to be derived from renewable energy sources.

The Consumer Council would seek assurance from the Utility Regulator, given its role to support implementation of Government policy, that the determination allowing developments to facilitate renewable energy on a project by project basis will support achievement of the 40 per cent target.

Strategy

As stated the Regulator has a key role in supporting Government to implement energy policy. It is important that the Regulator confirms that within the current determination, developments on a wide range of strategic issues have been fully considered. These issues include:

- Smart Metering;
- Electric vehicles;
- European interconnection;
- The potential for the export of renewable energy into an interconnected European wholesale electricity market;
- The impact of the planning system in NI; and
• The grid requirements of potential and planned development of renewable heat and renewable micro-generation.

**Consumer Council Assessment and Conclusions**

To provide further detail on the issues raised within the summary above specific comments on the Draft Determination have been broken into two sections.

**Section 1 – the key strategic issues relating to RP5**

**Section 2 – comments relating to specific details/elements of RP5**

**Section 1 – Key strategic issues**

The areas of Capex, Opex and Renewables are of specific concern for the Consumer Council as they represent the three main areas where there is a significant difference of opinion between the NIE submission and the Regulators Determination.

**CAPEX**

The Regulator’s conclusion that NIE can provide a reliable service for consumers at a cost that is well below that which NIE requested is welcome. However given the concerns which exist over the accuracy of information provided and indeed its robustness it is difficult for the Consumer Council to provide a view on whether we believe the Regulator’s position is correct (and effectively balances the issue of cost and reliability in relation to the Transmission and Distribution infrastructure).

This is a vital matter. As a responsible consumer advocate we take the position that the investment in the electricity infrastructure must be given the correct priority to ensure that the ‘lights stay on’. This is the same position that we have taken in relation to Water and Sewerage Services and we believe it is a proper and responsible one. It is essential that the need for investment in the infrastructure is properly balanced against the actual cost to consumers of that investment.

The information provided by the Regulator upon which this conclusion is based gives concern about the way that NIE manages its assets, and the regulatory requirements that are placed upon the company.

The Regulator states ‘we concluded that, from the information available, the processes used to build up the submission were based on subjective engineering judgements without sufficient guiding corporate strategy and/or threshold criteria for acceptable risk. This meant that the submission was heavy on opinion regarding the need for investment, but lacked the supporting factual evidence.’
and;

‘we have not been able to identify any tangible reasons why NIE T&D’s request for business as usual capex in RP5 was substantially higher than for a comparable company in GB.’

and;

‘we do note that NIE T&D’s current asset management approach has not been assessed to a recognised standard such as PAS55. We understand that NIE T&D is currently considering implementing PAS55.’

It appears the difference in Capex requirements between the Regulator and NIE can be, at least partially, explained by different views on physical assets owned by the company and the investment required to maintain and/or develop these. It is the Consumer Council’s view that NIE should now be directed to introduce PAS55 by the Regulator in this Price Control. It should be noted that we raised the same issue in our response to the Phoenix Natural Gas Price Control Draft proposals 2012-13. It is unacceptable given the existence of a recognised industry approach to managing assets that this hasn’t been introduced in previous Price Controls to provide certainty on investment requirements.

PAS55 is published by the British Standards Institute and is recognised by Ofgem as industry best practice. PAS55 can provide benefits to both the company and consumer. NIE should be required or provided with an incentive to introduce it, at no cost to consumers.

• Network Effectiveness

It appears the Regulator relies primarily on the Customer Minutes Lost (CML) metric to support its assertion that the network is operating well. However the CML is a retrospective metric looking back not forward. NIE needs to adopt a far wider range of outcome metrics that measure the overall performance of the network and engage with customers to develop KPIs

• Information and Data

Questions over the availability and accuracy of information have been a recurring theme throughout this Price Control process. The Consumer Council believes accurate information is a fundamental element of a Price Control process and that this situation has arisen reflects extremely poorly both on the regulated company and Regulator.

The contention by the Regulator that NIE submitted subjective information and an overall lack of detail has been referred to in this

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submission. If this is the case it not only raises concerns regarding the information requirements placed upon the company but also how the Regulator has arrived at its determination if this has depended on information which is questionable.

Given the concerns which exist in relation to the current Price Control the Consumer Council must question the extent to which information concerns have been evident in previous Price Controls.

It would appear that previous Price Controls have failed to provide a regulatory framework in which NIE was required, or felt it necessary to systematically assess the quality and performance of its network and make decisions that aspired to the most efficient outcome.

For example, the Regulator states that ‘the RP4 capex mechanism did not incentivise NIE T&D to take prudent risks with asset replacement’. This reflects poorly on the Regulator who is, to a certain extent, admitting that this aspect of RP4 did not work. It is also a blatant disregard by NIE of the implications of such negligence on the potential cost to the consumer in going forward. Again it is essential to assess whether the financial implications to the consumer are being effectively considered as they will ultimately have to meet the costs of this asset replacement? Consumers should not have to pay for mistakes by the Regulator and NIE.

Within the Ofgem RIIO model the Business Plan discussed earlier should provide the starting point for detailed data submissions. NIE did publish a Business Plan in April 2011 but it appears that this submission lacked the detail required.

Furthermore, the NIE submission does not contain outcomes based on consumer research as RIIO requires. Outcomes should reflect the needs of all stakeholders that depend on the performance of NIE’s network. As a consumer representative organisation we are concerned with performance not only on matters that directly impact consumers but also those that do so indirectly.

Finally, we understand that NIE believes the Regulator has only undertaken a limited modelling exercise on a small element of its RP5 investment submission in comparison with the far more detailed approach taken by Ofgem under RIIO. NIE has argued that its RP5 capex plan would withstand scrutiny against an Ofgem type analysis.

**OPEX**

The Regulator’s methodology of establishing a ‘base year’ of actual audited accounts is sound. The Consumer Council welcomes the proposal of a nine

14 Transmission and Distribution Price Control for RP5. Capital Investment Requirements for the Fifth Regulatory Period. 4 April 2011
per cent efficiency factor and notes that this is based on a detailed benchmarking exercise carried out by consultants which shows NIE as being the ninth most efficient organisation compared to GB Distribution Network Operators. NIE will need to provide compelling evidence in order to challenge this efficiency factor.

However, the fact that such a high efficiency factor has been proposed and that the Regulator is suggesting only a two year glide path provides for potentially two scenarios. It may firstly suggest that NIE has been operating relatively inefficiently for a number of years. If this is the case it raises questions of how effective previous Price Controls have been in providing the best outcome for consumers. Secondly such a tight period (two year glide period) could suggest that the Regulator is being unrealistic in the likelihood of the company achieving these efficiencies. In the absence of further information the Consumer Council is unable to determine which scenario represents the actual reality.

The practice during RP4 whereby ‘the allowed controllable opex in any year was the actual controllable opex five years previously’ failed to capture in the longer term efficiency gains for consumers. It is therefore appropriate that this practise is abandoned. Any efficiencies the company produces must be shared appropriately between the company and consumer and captured for consumers into the future. This is what would happen in a competitive environment. Regulation is a proxy for competition and must mirror this effect as far as possible.

The Regulator’s proposals in relation to ‘new opex’ costs are generally sound and it is good to see that the Regulator is challenging NIE’s cost. However, it could be argued that there is an element of micro-management in the Regulator’s approach and the balance must be struck between allowing the company to manage itself and challenging all costs. We would prefer to see more emphasis based on outcomes rather than inputs and this again reflects our concern with the regulatory process adopted in NI as compared to developments elsewhere.

**Renewables and Inter-Connection**

The approach proposed by the Regulator to restrict NIE’s proposals for facilitating renewable energy is understandable in the context of the absence of the North South Interconnector. By granting allowances on a project by project basis, the problem of creating deferred capex is avoided which is desirable. The Consumer Council believes that in principle the consumer should only be expected to pay for an asset if it exists and when they are receiving a benefit from it.

The Consumer Council seeks assurance from the Regulator that this approach (i.e. project by project) is compatible with the renewable consumption targets as outlined in DETI’s Strategic Energy Framework.
It is essential NI consumers have confidence that their money is spent on renewable projects that form part of a coherent NI strategy and deliver value for money. There is no doubt consumers will voice concern that a project by project basis could become piecemeal, uncoordinated and ultimately cost more due to additional issues regarding finance and economies of scale. The Consumer Council would request the Regulator provides further detail on the benefits of this approach to renewable projects against the potential risks. Specifically in relation to financing renewable projects, we would prefer to see a cost reflective Regulatory Rate of Return combined with an efficiency and service output incentives model.

Furthermore, adopting a case by case approach does create uncertainty for consumers’ bills as project costs are added as they arise. This approach is not coherent and may pass higher cost to the consumer. The Consumer Council would urge the Regulator to consider how it can minimise the price uncertainty to consumers.

Section 2 – Comments relating to specific elements of RP5

Outputs and incentives

The Consumer Council believes that the Regulator has effectively borne down on the input costs of NIE in its Price Control determination and some relevant incentives are contained within RP5.

The Regulator has signalled its view that its proposals in RP5 are not a complete statement on the framework required to regulate NIE in the future. The Regulator has stated that it intends to review the current Guaranteed Standards of Service (GSS), creating a new GSS for ‘worst served customers’, and creating new incentives for distribution loss, health and load indices. This a welcome development but the Regulator must develop a clear approach for engaging with consumers to ensure it fully understands consumer needs and to test proposed changes to service standards. Consumers are primarily concerned about the cost of their energy supply. However, as 52% stated reliability as their second priority this suggests consumers are not prepared to accept a service that provides poor reliability, poor customer service, lower safety standards, ignores environmental concerns and is indifferent to the plight of vulnerable customers.

Capitalisation

In material terms the possibility that the consumer has overpaid up to £118.5 m is unacceptable and if it is the case this must be repaid in full.

This issue is of great concern for consumers both in its potential materiality and what it may reveal about how NIE has been regulated and how it has conducted its business in previous Price Control periods. It is appropriate that this matter is investigated thoroughly and a full disclosure is provided of how this situation may have arisen.
The fact that this has only emerged now when the changes NIE made to its capitalisation practice took place in 2005/06 suggests a weakness in the regulatory process and a lack of asymmetrical information. We will await the outcome of the Regulator’s investigation before considering how this reflects on the internal management at NIE during the period in question.

**WACC**

The Rate of Return a regulated company is allowed within the Price Control has a direct correlation with the price that it charges its customers. The higher the allowance, the higher the price to customers. It is therefore important that the Rate of Return applied by the Regulator is not inflated as this will result in the consumer paying more than is necessary.

The company will benefit when its actual cost of capital is lower than its allowed Regulatory Rate of Return. The higher the Regulatory Rate of Return the more it will benefit at the expense of the consumer.

In comparison to the NIE proposal and with other UK network companies, the Regulator’s proposal appears to represent a fair balance of risk between NIE and the consumer.

However, we recognise that the WACC must be kept under review as other elements within the draft determination may yet turn out differently in the final determination. Therefore it may be necessary to reconsider the WACC again to ensure the balance of risk between consumer and company is equitable. These elements are notably the investigation into capitalisation, the final amount of Funds One and Two and the treatment of pensions.

**A Reporter**

The Consumer Council supports the introduction of ‘a Reporter’; an approach that has proved useful in the regulation of NI Water. This approach should address the issue of the lack of sufficient information needed within the regulation of NIE to improve the quality of information available to the Regulator. However, the use of a Reporter does not diminish our assertion that the company must develop a comprehensive and coherent Business Plan based on sound data and consumer engagement.

**Powerteam**

The Consumer Council supports the Regulator’s proposals for the NIE Powerteam. The Regulator statement ‘that customers have been paying higher costs than necessary in relation to NIE Powerteam Ltd during RP4’ is another example of where the previous Price Control did not serve customers well.


**Pensions**

The Consumer Council welcomes the efforts by the Regulator to develop a position on the NIE pension fund and to devise and apply pension principles.

The Consumer Council cannot accept the basic premise underlying the principles that NIE should be allowed to recover all of the costs and bear none of the risks associated with both ongoing pension costs and pension deficits as long as they are legally unavoidable. In our view this is an inequitable balance of risk between the company and the consumer.

Whilst we appreciate, and welcome, the Regulator’s proposal to disallow the recovery of ‘avoidable and inefficient actions’ in previous Price Control periods, the consumer is still left exposed to deficit recovery costs that fall outside of these categories. Within the risk sharing principle of incentive based Price Controls, shareholders should also bear the burden of reducing the deficit. The problem for consumers is exacerbated by the fact that it is not clear if the deficit amount is crystallised or could increase in the future thereby adding further risk and liability for consumers to carry alone.

In 2009-10, Ofgem undertook a detailed and systematic review of the treatment of pensions in network companies. In July 2009, Ofgem stated in its comparison with other Regulators that ‘all other economic regulators, including the Competition Commission have a policy framework that leaves shareholders of the regulated company with at least some, and in certain cases, all of the risk attached to deficit funding’

This principle of the sharing of risk applies equally to ongoing pension costs. The fact that the Regulator has identified ‘avoidable and inefficient’ costs from previous Price Controls amounting to £33.4m (38 per cent of the total deficit) shows that the legal obligation placed upon trustees to manage the funds prudently does not guarantee efficient investment. We accept that even with prudent investment there is no guarantee of an efficient outcome. This risk should not be borne alone by consumers.

**Connections**

The Consumer Council welcomes and supports the Regulator’s proposals for new connections.

However with the removal of the 40 per cent subsidy for domestic connections, there must be a scheme that provides financial assistance for vulnerable customers who are unable to afford to pay the full cost of a connection.

The Regulator’s proposal to require NIE to provide a schedule of works is welcome if rather late. Furthermore, it does not address the root problem that there is little risk to NIE in wrongly estimating costs. Consumers not only want

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to be able to see the cost estimate in detail, they need assurance that it is the best possible estimate.

We support the development of competition in connections as this is the best way of assuring the best deal. We urge the Regulator to prepare options for competition for connections as soon as possible. In the meantime, the Regulator needs to require NIE to produce an itemised menu of its scheduled costs, which is reviewed and agreed by the Regulator annually.

**Innovation**

As the Vulnerable Customer Programme has been successful in helping reduce fuel poverty we would like to see a cost benefit analysis undertaken before it is discarded. The reported £7m of unclaimed benefits the scheme has helped identify suggests that it may provide a cost effective use of money.

Understanding the cost benefit of the scheme would also allow stakeholders to consider if it could, and should be borne by the company rather than consumers.

We agree with the Regulator’s conclusions on the cost of developing the use of advancing technology. It is the Consumer Council position that smart meters should be installed at no extra cost to consumers, as they will create significant recurring savings for the energy companies that far exceed the cost of installation and operation. Savings will come as a result of ending the need to dispatch meter readers and estimate bills, whilst reducing significantly the call centre requirements and providing better load management through smart grid applications.

**Environment and safety**

In line with developments in regulatory practice elsewhere which focus more on outputs we are disappointed that the RP5 draft determination does not provide any outputs on environmental and safety issues. As discussed earlier the Ofgem approach contained in its RIIO programme identifies both the Environment and Safety as output categories. The type of outputs envisaged by Ofgem relate particularly to carbon emissions and initiatives that are beyond those required by the Health and Safety Executive but are in the public interest.

We urge the Regulator to bring forward suggestions for monitoring outputs in environment and safety issues as soon as possible and ensure that they are subject to full public consultation.

**Financeability**

Whilst we support the Regulator’s Price Control Determination where it delivers identifiable benefits to consumers, we also recognise that it is in the consumer’s interests that NIE is financially robust and able to finance its current business and future development.
The Regulator has a vital role to provide certainty that an ongoing pressure on costs is maintained balanced against the long term sustainability of the network and its operator. In this respect we note the assurance provided by the Regulator that NIE is able to finance its business now and in the future and that the proposals contained in the draft determination do not undermine this.

Conclusion

If you wish to discuss the attached in more detail, please do not hesitate to contact Marian Cree, Head of Energy on 028 9067 4804 or e-mail mcree@consumercouncil.org.uk.
Appendix 2- Response to the Utility Regulators consultation on its investigation into Northern Ireland Electricity’s capitalisation practice: Draft Determination

September 2012

Introduction

The Consumer Council welcomes the opportunity to respond to this consultation.

The Consumer Council is an independent consumer organisation, working to bring about change to benefit Northern Ireland (NI) consumers. Our aim is to make the consumer voice heard and make it count.

We have a statutory remit to promote and safeguard the interests of consumers in NI and we have specific functions in relation to energy, water, transport and food (the Consumer Council and the Food Standards Agency (FSA) have a memorandum of understanding and the Council’s strategic focus on food is primarily in relation to food prices and customer experience). These include considering consumer complaints and enquiries, carrying out research and educating and informing consumers.

The Consumer Council is also a designated body for the purposes of supercomplaints, which means that we can refer any consumer affairs goods and services issue to the Office of Fair Trading, where we feel that the market may be harming consumers’ best interests.

In taking forward our broad statutory remit we are informed by and representative of consumers in NI. We work to bring about change to benefit consumers by making their voice heard and making it count. To represent consumers in the best way we can, we listen to them and produce robust evidence to put their priorities at the heart of all we do.

Summary

The whole issue of NIE’s capitalisation practice is a serious concern to consumers. We welcome the fact that the Regulator has managed to uncover a hitherto undisclosed and unauthorised change by NIE to its regulatory accounting and furthermore proposes to return to consumers’ money that this has caused them to unwittingly overpay.

The evidence presented in the ‘Investigation into Northern Ireland Electricity’s capitalisation practice’, (‘the consultation’), in our view constitutes an allegation that NIE failed to inform the Regulator of a change that it made unilaterally to its accounting practice and as a result, inflated its profits at the expense of consumers. We are aware that NIE have publicly denied any wrongdoing in their auditing and intend rebutting this allegation.
Until we see the evidence that NIE provide to rebut the allegation we can only comment on the information we have in the consultation. On the available information, consumers will be quite rightly shocked that NIE did not inform the Regulator that it had changed its auditing practice. Perhaps less shocking but of equal concern is that over a period of seven years the Regulator’s office failed to detect this practice by NIE.

Now that the Regulator has uncovered this practice of NIE, the Consumer Council wants to see the following take place:

- Every penny that consumers have overpaid must be accounted for and returned to them;
- Any culpability on the part of NIE be assessed and appropriate sanctions imposed against them;
- An assurance given by the Regulator that no similar practices have been or are presently taking place within regulated utilities in Northern Ireland; and,
- Steps taken by the Regulator to ensure that similar practice does not happen again.

Quantifying the loss

It has been at times difficult to compare information in the consultation with corresponding information in the earlier ‘Northern Ireland Electricity Transmission and Distribution Price Controls 2012-2017 Draft Determination’ (the ‘Draft Determination’), on the same issue.

In the Draft Determination, a figure of £118.5m as the total outperformance against controllable, opex allowance is stated. This figure was calculated using the five year period of 2005/06 to 2009/10. However, in the consultation at Figure 1, what appears to be the corresponding figure over the same period amounts to £90.1m.

Point 8.1 in the consultation asks the reader to consider a seven year period covering RP3 and RP4, whereas in the ‘Draft Determination’, we are asked to consider a five year period.

Furthermore, the Draft Determination states that the £118.5m may include an amount that is due to ‘genuine improvements in operational efficiency’. However, there is no indication whether in arriving at the final figure of £35.32m in the consultation a test of these possible efficiencies has been carried out.’

Thus we have a rather confusing picture and we would ask the Regulator to confirm that the exact amount they have arrived at of £35.32m overpaid is a settled one. Consumers need to be certain that the extent of the problem has been correctly quantified and that the refund they get will be final.
The Regulator states that it will be adjusting NIE’s RAB and revenues by £35.32m which represents two per cent off the network charge for two years and 1 per cent off the network charge for the following 38 years. Currently network charges account for around 23 per cent of the average domestic electric bill. Based on the average domestic electricity bill of £505 per year\textsuperscript{16} the adjustment will save consumers £2.32 per year for the first two year and £1.16 per year for the following 36 years or a total of £46.46 over the 40 year period.

The material loss to the consumer is therefore relatively small. However, the undermining of trust between NIE and consumers is significant. NIE must have been aware of its responsibility to inform the Regulator when it changed its capitalisation practice and to produce accounts on a ‘consistent basis’\textsuperscript{17}. If it did not, then it would have been unaware of important legal and regulatory requirements.

**Culpability and sanctions**

The Regulator must investigate the culpability of NIE in withholding information from the Regulator and thereby inflating its profits at the expense of consumers. The evidence that has appeared so far already casts NIE in a negative light. If the allegation is correct, this matter will undoubtedly and rightly have a reputational damage on NIE and its parent company ESB. Despite having a vital role at the centre of NI’s energy infrastructure NIE has no competitor for consumers to switch to. Thus, reputational damage will have a limited impact on the company’s business and will not be sufficient to act as a deterrent to prevent such activity recurring in the regulated NI utilities in the future.

The Regulator has powers to impose financial penalties under Article 45 of the Energy (Northern Ireland) Order 2003, and having considered the culpability of NIE and considered regulatory precedent, must publicly state whether a fine or an alternative sanction should be imposed. If no sanction is deemed appropriate, the Regulator must explain why, as giving consumers back their money is not a penalty to the company. A deterrent is required if regulation is to protect consumers going forward.

**Regulatory scrutiny**

This issue also puts the Regulator’s office in the spotlight. The Regulator acts as a proxy for competition and must ensure that unnecessary costs and unreasonable profit is driven out of the final price through its scrutiny processes, just as competition drives out these costs by the need to offer the lowest price.

\textsuperscript{16} Based on the Power NI average domestic bill from 1st October 2012 at 3300 kwh.
\textsuperscript{17} NIE Licence, Condition 2, 3(b)
We recognise that the Regulator’s office has worked diligently to uncover this issue and is seeking to return consumers their money. This is the right thing to do and what we expect of the Regulator’s office. However, consumers also expect the Regulator to have in place a framework that ensures that this type of practice does not occur in the first place and where it does exist is able to detect and deal with it as quickly as possible. The issue of capitalisation appears to expose a weakness in the past practices of the Regulators office. A number of statements within the Regulators documentation support this view. For example:

- The statement in the consultation at 4.2 that, ‘given the time required for this necessary process, we did not have visibility of NIE T&D’s actual outperformance for the last two years of the RP3 period at the time we came to set allowances for RP4’;

- The statement at 4.3 that ‘Once RP3 was complete we had the information we needed to calculate actual outperformance during the period’, appears to contradict with the statement in the Draft Determination at 6.16 that: ‘The total outperformance against the controllable opex allowance in the five years between 2005/06 and 2009/10 was £118.5 million. We accept that some of this may be due to genuine improvements in operational efficiency. It is not clear however how much is due to efficiency and how much may be due to the change in capitalisation practice’. It appears that despite having the information required in April 2007, by April 2012 the Regulator was still unable to decide on the level of efficiencies that NIE had actually achieved;

- Table 2 in the consultation shows outperformance in RP3 at 40 per cent and in RP4 at 42 per cent. It describes this as ‘significant’ and requiring more detailed evaluation. The statement at 4.3 in the consultation and repeated in the bullet point above indicates that the RP3 outperformance was known to the Regulator once RP3 was complete. However, the statement in the consultation at 4.7 that ‘After publishing our RP5 determination, in which we raised concerns about NIE T&D’s capitalisation practice, the company provided additional information with regards to its claimed outperformance over RP3 and RP4’ raises the possibility that it was only then that the full extent of the outperformance figures were known. The Regulator should have flagged up the issue of the significantly high efficiency savings immediately they were known and this should have been before the RP5 draft determination was published;

- The CEPA Report into the ‘Confirmation of capitalisation practice materiality’ states at 1.2 that ‘When the CEPA Consortium was appointed by the Utility Regulator to support the review of the RP5
price control, NIE’s operating expenditure had not been subjected to an external efficiency review for 10 years\textsuperscript{18}.

- Point 5.8 of the ‘consultation’ states: ‘The consultant auditor’s investigation revealed difficulties when trying to understand the company’s reporting systems. We intend to discuss this area further with NIE T&D to allow effective reporting for RP5 and future price controls’.

Consumers need to feel confident that the Regulatory process is robust and up to the job of protecting their interests. We need assurances that:

- There are no other similar practises occurring in NI utilities now;
- This type of practice will not be able to occur again;
- That when such practices are uncovered they are resolved and consumers refunded in the shortest possible time.

The Regulator must address this issue if confidence in the Regulators’ office is to be maintained by consumers.

**Asset Management**

In section 9 of the consultation, it states that some efficiencies that NIE claimed for were as a result of stopping or reducing activity. The concern here is that this may not represent best asset management practice as increased maintenance or replacement costs may occur in the future. Whilst the Regulator does not propose penalising NIE for this it does intend ‘exploring reporting arrangements and asset management practices further with NIE’. This highlights our concern previously stated in our response to the RP5 consultation that:

‘It would appear that previous Price Controls have failed to provide a regulatory framework in which NIE was required, or felt it necessary to systematically assess the quality and performance of its network and make decisions that aspired to the most efficient outcome.’

We reiterate our view that NIE should now be instructed by the Regulator to introduce PAS55 or other accredited industry standard methodologies.

**Conclusion**

All stakeholders who support the best interests of consumers and the energy industry in Northern Ireland should be concerned at the findings of the Regulators report. We support the Regulator’s proposal to return all the money to consumers. However, the Regulator must go

\textsuperscript{18} Cambridge Economic Policy Associates Ltd Report into RP5, August 2012
further and take action to reassure consumers that the regulatory process is sufficiently robust to identify and prevent any reoccurrences of such practice and so protect consumers’ interests.
Making the consumer voice heard and making it count

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