



**Response to the UR Northern Ireland Electricity Networks Ltd  
Transmission and Distribution 6<sup>th</sup> Price Control (RP6)**

**19 May 2017**

## **1 Introduction**

- 1.1 The Consumer Council is a non-departmental public body (NDPB) established through the General Consumer Council (NI) Order 1984. Our principal statutory duty is to promote and safeguard the interests of consumers in Northern Ireland (NI).
- 1.2 The Consumer Council welcomes the opportunity to respond to the Utility Regulator (UR) Draft Determination (DD) on the Northern Ireland Electricity Networks Ltd (NIEN) Transmission and Distribution 6<sup>th</sup> Price Control (RP6).
- 1.3 We welcome the engagement undertaken by NIEN in conjunction with stakeholders, including The Consumer Council, in the development of its RP6 Business Plan (BP). The UR has also had the benefit of this engagement as it developed the DD. The stakeholder engagement culminated in a report produced by The Consumer Council called 'Empowering Consumers'<sup>1</sup>. We look forward to continuing to work with both parties to enhance the level of stakeholder engagement and consumer input to the price control process.

## **2 Executive Summary**

- 2.1 A strong, resilient and flexible electricity network is needed to deliver on consumers' and businesses' needs. However, such aspirations must be balanced with the need to contain network costs that ultimately are borne by NI domestic consumers and businesses.
- 2.2 The RP6 Price Control is an opportunity for UR to continue to safeguard the interests of consumers and to consider their preferences when deciding on network investment and expenditure decisions. The interests of consumers must be at the heart of the Final Determination (FD).

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<sup>1</sup>Empowering Consumers, The Consumer Council, June 2016.

2.3 The RP6 Price Control can benefit consumers by:

- Ensuring that NIEN delivers value for money for consumers;
- Ensuring that there is sufficient investment to maintain a safe and resilient network;
- Balancing equitably the financial risks in the business between consumers and the company;
- Providing a flexible framework that allows for additional investment decisions to address outstanding issues such as security of supply and renewable generation; and
- Allowing for investment in innovation that may have a positive impact on future consumers.

2.4 The Consumer Council welcomes UR's DD as we believe that it broadly delivers the benefits to consumers stated above. For example, from a cost perspective it would deliver £9 per year saving on the current network cost element of the electricity bill. We trust the UR will carry out the same robust economic tests on NIEN's investment plans and allowances when preparing the FD<sup>2</sup>.

2.5 In order to prepare a response to this Price Control we asked Economic Consulting Associates (ECA) to analyse the DD from a consumer perspective. A copy of ECA report is submitted alongside this response as Annex 1.

2.6 We would ask the UR to give consideration to this report alongside our response and respond to ECA's observations and recommendations as it develops its Final Determination (FD) and subsequent reviews of the industry.

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<sup>2</sup> Not accounting for the additional £200m of proposed expenditure allocated under the D5 mechanism.

### **3 Consumer context**

- 3.1 Despite the welcome drop in domestic energy prices since 2015, fuel poverty in NI remains at the highest level in the UK<sup>3</sup>. The Consumer Council research in April 2017, showed home energy prices remain the biggest concern for consumers, (27%)<sup>4</sup>.
- 3.2 Research also highlights that disposable income levels in NI are nearly half that of the UK average<sup>5</sup>. Furthermore, median gross weekly earnings for all employees in NI in April 2016 were £393, or 90% of the UK figure of £439<sup>6</sup>.
- 3.3 The cost of electricity for large and medium industrial and commercial businesses in the non domestic electricity market in NI is amongst the highest in Europe<sup>7</sup>.

### **4 Consumer Engagement**

- 4.1 The Consumer Council made the following statement about consumer engagement in our response to the UR RP5 DD:
- 4.2 *“Not only should consumers be informed of the expected outputs but actively involved in a process where they have contributed to setting the outcomes they expect and the value they put on such outcomes. It is absolutely essential that the regulatory process places a much stronger emphasis on engagement with consumers.”*

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<sup>3</sup> Annual Fuel Poverty Statistics Report, DECC, 2015 show that 42% of households in NI are experiencing fuel poverty.

<sup>4</sup> MillwardBrown Ulster: The Consumer Council’s NI Consumer Outlook Tracking – April 2017.

<sup>5</sup> Asda Income Tracker, Centre for Economics and Business Research, December 2016.

<sup>6</sup> Source: NISRA <https://www.northernireland.gov.uk/news/statistical-press-release-results-2016-northern-ireland-annual-survey-hours-and-earnings>

<sup>7</sup> Source: Northern Ireland Affairs Committee Electricity sector in Northern Ireland - Third Report of Session 2016–17.

4.3 We acknowledge the consumer engagement undertaken by the UR and NIEN to inform the development of the RP6 Price Control in the form of the Consumer Engagement Advisory Panel<sup>8</sup> (CEAP).

4.4 CEAP was tasked with coordinating consumer research to inform the development of NIEN's RP6 BP. The findings of the research were presented in the Empowering Consumers report, which included six high level recommendations. These are that NIEN should:

- Increase efforts to improve knowledge of its role;
- Take action to improve consumers' satisfaction with its connections process;
- Be aware of consumer preferences when developing alternative contact methods<sup>9</sup>;
- Ensure investment to make the network more resilient to severe weather is proportionate to the number of consumers it will protect;
- Balance the needs of today's and future consumers; and
- Continue to have ongoing engagement with consumers.

4.5 At the time of writing this response the UR is on the second phase of its review of NIEN's connections policy, and NIEN and the UR have formally agreed to maintain the CEAP as a working group to oversee consumer engagement throughout the RP6 period. Furthermore, network resilience in the event of severe weather features prominently in the RP6 DD. NIEN's focus on consumer focus and engagement is exemplified by its "Think Customer" initiative.

4.6 The Consumer Council recognises that the outcomes from the consumer engagement are at times ambiguous and inconclusive at a micro level. Indeed more work needs to be done to drill down further, and this was a specific

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<sup>8</sup> Comprising NIEN, UR, Department for the Economy and The Consumer Council.

<sup>9</sup> While recognising that the telephone remains the preferred method for most consumers.

commitment by NIEN and the wider CEAP group in its report. However, The Consumer Council believes that at a macro level the consumer engagement undertaken offers more to inform the RP6 Price Control than the UR's DD suggests. We have identified proposals in the RP6 DD that in our view are not supported by the findings of the RP6 consumer research. We have outlined also areas of the RP6 DD that we deem may be informed more effectively by additional consumer research during the RP6 period and beyond.

### Innovation projects

- 4.7 Innovation expenditure in GB has been noticeably higher than in NI<sup>10</sup>. The UR's approach is to only accept innovation projects that it deems would provide value to consumers. NIEN as a result has adopted a policy of implementing in NI only the most successful projects trialled in GB.
- 4.8 We note the UR provisional determination to allow NIEN £7.26m for innovation projects instead of the £10.48m the company included in its BP. The UR has asked NIEN to provide additional information about these innovation projects to assess further whether they will deliver value for money.
- 4.9 While we appreciate the need to ensure NIEN delivers value for money to consumers, this is the one area where consumers understand that a degree of uncertainty in the outcome is inevitable. However, they also appreciate the potential benefits, (even if they do not understand the technology), that the innovation could bring for them. The "Empowering Consumers" report shows that both business and domestic consumers support investing in innovation<sup>11</sup>.

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<sup>10</sup> Ofgem allowed up to £500m in funding in the 2010-2015 electricity distribution price control to trial new technology, operating and commercial arrangements under the Low Carbon Network Fund.

<sup>11</sup> p.27-29 "Empowering Consumers" Report (CEAP June 2016)

4.10 The Consumer Council recognises that the level of investment in innovation requested by NIEN in its BP represents a reasonable investment risk for consumers commensurate with the potential benefits to consumers and the NI economy. Having said this we would expect UR to have sufficient regulatory oversight of projects to ensure that any level of innovation allowance is spent as intended and prudently.

#### Optional investment

4.11 NIEN's RP6 BP set out £45.4m of optional investment projects as per Table 41 in the RP DD. This aims to improve the resilience of the network, in particular during severe weather events.

4.12 NIEN justified its decision to label these projects as optional due to "mixed levels of support during our customer and stakeholder engagement process". In particular businesses expressed unwillingness to pay whereas domestic consumers were more supportive.

4.13 We believe that this issue is one that would benefit from further and more detailed consumer engagement and research. It could be the case that investment decisions in this area could be deferred for later in the RP6 period, with the possibility of substituting them for other projects if they become a higher priority.

#### Key Performance Indicators

4.14 Connections came out as one of the key issues and priority areas for consumers in the research. This prompted CEAP to recommend that NIEN takes action to improve satisfaction in this area. Therefore we support the UR's proposed outputs and KPIs around connections.

- 4.15 The UR is currently carrying out a review of the Guaranteed Standards of Service (GSS) Regime in parallel to the RP6 process. At the time of writing the UR is consulting on the Electricity GSS to “bring it up to date with the current regulatory and legislative environment.”
- 4.16 Point 4.27 of the RP6 DD provides a summary of the proposals. However, The Consumer Council will be commenting on these in our response to the Electricity GSS consultation by 31 May 2017.
- 4.17 The Consumer Council welcomes the UR proposal to task CEAP to help develop “new customer focused and advocacy measures/metrics”. The experience of our water and sewerage policy team as part of the Consumer Engagement Oversight Group (CEOG) has been positive and fruitful for consumers. It has also helped NI Water to improve its customer service levels and consumer engagement. We ask the UR and NIE to examine and identify what outputs and work strands delivered by CEOG could be beneficial for electricity consumers.
- 4.18 The UR has proposed a number of reputational incentives linked to NIEN’s asset health and load indices, asset management, worst served customers and customer advocacy.
- 4.19 The Consumer Council welcomes these incentives. However, for the consumer benefit to be maximised, UR should give careful consideration to their design and use. We also ask the UR to consider carrying out additional consumer research to identify whether support exists for financial incentives that accompany the proposed reputational incentives.

#### Reliability incentive

- 4.20 We note the UR proposal to introduce a symmetrical reliability incentive from 2018/2019 based on GB regulatory precedent. This would be based on

Customer Minutes Lost (CML) and expose 1.25% of NIEN's distribution revenue, around £14m for RP6.

- 4.21 We are concerned that in practice consumers may end up paying twice. That is for the incentive as well as the cost of achieving the efficiency<sup>12</sup>. We feel also that further consumer research should be undertaken to ensure the improvements reflect their preferences.
- 4.22 The Empowering Consumers report highlights "a high level of satisfaction with the current service provided by NIEN" amongst domestic and non domestic consumers. The report identified also that "cuts are no longer a significant issue for most". It adds that only "around 5,000 homes and businesses every year experience unplanned power cuts which last over 10 hours."
- 4.23 This evidence would put a question mark on the value NI consumers place on network reliability and CML as an indicator. We recommend that willingness to pay research is carried out through CEAP to explore and inform this area of incentives further. The UR identifies this need in Point 14.35 of the RP6 DD.

## **5 Cost of Capital**

- 5.1 NIEN allowed revenue from the return on capital constitutes around 25% of NIEN's total allowed revenue and explains around 50% of the difference between the UR DD and NIEN's RP6 BP.
- 5.2 We acknowledge that the UR RP6 FD must ensure that NIEN is a financeable organisation and that this benefits consumers. So long as the rate of return is set at a level that properly reflects its business risk and allows the company to be financeable, the lower it is set, the lower consumer bills will be.

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<sup>12</sup> See Annex 1, Issue 12.

Therefore we note and welcome the UR's draft decision to set the rate of return at 3.29% compared to the 4.1% proposed by NIEN.

- 5.3 However, the analysis ECA has carried out highlighted that UR had chosen values for some of the elements of the cost of capital that were identified in the DD as at "the high-end" or at the "upper limit" of parameters. This suggests that elements of the rate of return could be set lower than UR has set out in the DD.
- 5.4 We ask UR to consider the Return on Regulatory Equity (RoRE) of GB DNOs that ECA has produced. This shows the returns in excess of the cost of equity that current DNOs are benefiting from as a result of recent price controls<sup>13</sup>.
- 5.5 We acknowledge that incentive mechanisms operate in GB but not in NI and that this may have an upward pressure on the RoRE. Nevertheless, the figures suggest that regulatory settlements on this issue in GB may not be working in the interest of consumers.
- 5.6 Given the UR practice to adopt GB regulatory precedent, we wish to express our view for choosing values at the lower end to ensure they are delivered at the lowest cost to consumers. For example:
- The risk-free rate, which the UR proposes to set at 1.25%. Recent regulatory decisions vary from 0.50% to 1.50%. On this basis we ask UR to consider setting NIEN's risk-free at 1%, ie halfway between the high and low values, unless a different decision can be clearly explained and justified; and
  - The DD sets an expected market return of 6.5%, also identified as at the higher end of parameters in the Competition Commission (CC) RP5 FD.

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<sup>13</sup> For details read issue 2, WACC in Annex 1.

## Other elements of the RP6 DD affecting the Cost of Capital

- 5.7 ECA states that there are components of the DD that reduce NIEN's overall risk relative to previous price controls. We ask the UR to consider these as additional evidence for adopting parameters at the lower end of ranges from previous GB regulatory decisions when calculating NIEN's Cost of Capital in the FD.
- 5.8 ECA highlighted the following: the cost of debt adjustment, the D5 mechanism, and the substitution of outputs and expenditure between network investment allowances.
- 5.9 We ask the UR to consider and respond specifically to ECA's analysis and evidence about these issues. Please refer to Annex 1, Issues 1, 9 and 11.

## **6 Costs and Benchmarking**

- 6.1 The Consumer Council recognises the considerable level of analysis and modelling the UR has carried out in this area.
- 6.2 NIEN's opex makes a significant contribution to its overall revenue of around 25%. Therefore it is essential for consumers that NIEN becomes the most efficient company it can be to deliver its services and outputs at the lowest possible cost. It is also positive for the company, from a reputational and performance management perspective. Therefore we welcome the UR decision to introduce a 2% efficiency gap.
- 6.3 However, we wish to highlight to the UR some issues raised in the ECA report on its costs and benchmarking analysis. We ask the UR to consider and respond specifically to Points 6.4 to 6.10 below, along with the ECA analysis set out in Issues 3 to 7 of Annex 1.

## Labour adjustment

6.4 The Consumer Council believes that the UR decision to apply the full local labour adjustment is not justified. ECA report explores this point in detail in Issue 3 of Annex 1, but we would like to highlight the following:

- The UR's own consultants recommend that the local labour adjustment is not applied to NIEN's costs<sup>14</sup>;
- 100% of NIEN's workforce and costs are located in NI<sup>15</sup>;
- There is no evidence that NIEN competes for workforce resources in a national market - eg if NIE needs a regulatory director, does it pay a local wage or a national wage (in other words does it compete to find a regulatory director against all other UK companies, or just against companies in NI).

6.5 Based on this evidence and analysis we ask the UR to implement in the FD, ECA's recommendation to "determine the efficiency gap using data with no local labour adjustment, or with the local labour adjustment applied only to the GB DNOs' cost data".

## Special factors

6.6 Points 5.51 (i to iv) of the RP6 DD identified four areas where NIEN's policy and standards are lower than those applicable in GB. From a cost perspective this would mean that NIEN's Inspection, Maintenance, Faults and Tree cutting (IMF&T) and indirect costs should be lower than GB DNOs.

6.7 Therefore we are surprised with UR's decision in the RP6 DD against applying a negative special factor adjustment to the comparative benchmarking of

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<sup>14</sup> As per page 26 of Annex B of the RP6 DD.

<sup>15</sup> Paragraph 5.167 of the RP6 DD.

NIEN's IMF&T and indirect costs. Furthermore, the UR has not given any explanation to support the provisional decision.

- 6.8 Given that making a negative special adjustment would reduce costs for consumers, we ask the UR to apply this in the FD. We expect the UR to provide robust evidence or to support any decision to the contrary in the FD.

### Severe weather allowance<sup>16</sup>

- 6.9 ECA's analysis highlighted that there are differences between the GB DNOs and NIE Networks that mean the costs of responding to severe weather events may be greater in GB. This assessment is supported by the information in Table 5 of the UR RP6 DD. This shows that the line length of the average GB DNO is 56,741kms compared to NIEN's 48,659kms, and the number of customers served 2,110,353 compared to 854,580 respectively.

- 6.10 The Consumer Council suggests the UR reconsiders NIEN's severe weather allowance, factoring in the difference in customer numbers and length of lines with GB DNOs.

## **7 Other Issues**

- 7.1 In this section we comment and make recommendations on further proposals within the RP6 DD that we have deemed may have an impact on consumers<sup>17</sup>. We ask the UR to consider the following for the RP6 FD.

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<sup>16</sup> Issue 6 in Annex 1.

<sup>17</sup> Further analysis is provided in Annex 1 under Issues 9, 10, 11, 13, 14 and 15.

## Uncertain transmission investments

- 7.2 Given the uncertainty about the cost and timeframe of transmission projects such as the second north south interconnector, we believe it is prudent that the UR maintains the D5 mechanism in RP6.
- 7.3 We also welcome the UR commitment to transparency by providing information about the potential impact of these projects on consumers' bills, estimated in the DD at around £200m for RP6, or £5 per year on the annual consumer bill.
- 7.4 However, we note that the UR has not specified how it will assess and approve specific D5 projects during RP6. Given the significant potential cost involved, we ask the UR to provide clarity about this process to ensure any such investment decision is subject to appropriate regulatory scrutiny and approval. We ask the UR also to clarify that the rate of return established in the RP6 FD will also apply to D5 projects.

## Metering volume driver

- 7.5 We note the UR RP6 metering programmes approach based on a volume driven allowance and set unit cost. Given that the UR has not identified any issues around this allowance for RP5, we accept the rationale for applying this to RP6.
- 7.6 We ask the UR to apply a catch up efficiency to NIEN's indirect costs in respect of metering activities as this will have a direct benefit to consumers.
- 7.7 We note the proposal to set a cap on the meter recertification programme at 20,000 units across RP5 and RP6. We understand the rationale for the proposal, as to limit the inherent incentive NIEN has to install more meters as a result of the volume driven allowance.

- 7.8 However, the recertification program was introduced during RP5 with support from industry and consumer representatives in the face of incontestable evidence of significant illegal electricity meter interference in NI.
- 7.9 This activity is costing an estimated £14m a year<sup>18</sup> to the electricity industry and NI consumers. Therefore we ask the UR to assess whether a cap may have a negative impact on the success of the program.
- 7.10 We ask the UR also to identify and implement in the FD alternative remedies that reduce NIEN's incentive, such as applying a catch up incentive to the company's indirect costs or setting a lower unit rate.

#### Direct network allowance substitution

- 7.11 The UR proposes to introduce a direct network allowance substitution. This is designed to allow NIEN a reasonable degree of flexibility to reallocate investment between allowances to complete outputs defined in the RP6.
- 7.12 We recognise the rationale behind the UR proposal to introduce a direct network allowance substitution for RP6. However, the information in the UR's DD seems to contradict the proposal. Paragraph 13.13 states that NIEN "has applied substitution within individual allowances" during RP5. Paragraph 13.11 of the DD reminds us the CC already rejected the introduction of a substitution mechanism for RP5.
- 7.13 Furthermore, UR admits itself the concern that the substitution mechanism, "could be a source of complexity that limits our ability to assess the outcome of a price control period effectively and make a robust assessment of any

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<sup>18</sup> Estimates provided by Power NI in 2015-2016.

potential double funding of outputs across price controls.” This would be detrimental for consumers.

7.14 We see no explanation as to how the UR has concluded that a 20% cap on the value of outputs that NIEN can substitute from any of the allowances set out in Annex P of the RP6 DD is appropriate; particularly given that it is higher than the figure originally requested by NIEN of 15%. We ask the UR to explain and support with evidence the substitution allowance cap in the FD.

7.15 We believe strongly that UR should introduce processes and mechanisms that enable it to assess potential double funding in the face of added complexity. We welcome the proposals set out in Points 14.27 (i to v) of the DD.

7.16 We note NIEN’s capex underspend for RP5 and the back end load nature of the company’s program delivery. On this point we would support the UR proposal in Point 14.21 of the DD to reprofile retrospectively the allowances for planned network investment in RP6 to reduce risk to consumers.

### Pensions

7.17 The Consumer Council accepted the outcome of the CC RP5 FD to fund NIEN’s pension deficit for the period running to 2022, but we did not support it. We remain of the opinion that regulators ought to minimise where possible allowed revenues in respect of deficits linked to pension schemes.

7.18 We do not support the UR decision to reset the regulatory fraction to 100%. We recognise that the impact for consumers is not significant in monetary terms, £0.8m over the course of the RP6 period. However, we cannot see strong justification to increase NIEN’s request of £114.5m by £0.8m.

## Indexation of revenues

- 7.19 We ask the UR to start planning for the adoption of the Consumer Price Index (CPI) instead of RPI, in line with a recent decision by Ofwat that is likely to be followed by other regulators in GB.

## Rates

- 7.20 The Consumer Council agrees with the UR assessment that Rates are not wholly uncontrollable. Therefore we support the UR provisional determination against allowing rates as a passthrough item in RP6.

## **8 Conclusion**

- 8.1 We welcome the UR and NIEN their measured and consumer focused approach to developing the RP6 project plan. We are pleased with the level of consumer and stakeholder engagement undertaken as well as with the improvements in terms of quality and transparency of the information.
- 8.2 We look forward to continued working with UR and NIEN as part of CEAP and elsewhere to help contribute to the further development of a strong and efficient electricity network that delivers for NI consumers.
- 8.3 If you require further information or you wish to discuss any aspect of this response please contact Richard Williams on 02890 251649 or [Richard.Williams@consumercouncil.org.uk](mailto:Richard.Williams@consumercouncil.org.uk).



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