

## **NORTHERN IRELAND ELECTRICITY RP5 PRICE CONTROL REFERENCE UR PAPER ON THE REPORTER**

### **Introduction**

1. This paper introduces and summarises the issues arising on this RP5 price control reference in relation to the arrangements for NIE T&D's reporting. It explains: (i) the reasons why we consider that NIE T&D's current level of transparency and accountability operates against the public interest; (ii) the details of our proposal to address that public interest deficit through (amongst other things) the establishment of a Reporter and how that proposal compares with other UK regulatory reporting frameworks; and (iii) our responses to NIE T&D's concerns that imposing a Reporter would amount to "*micromanagement*".
2. In essence, the Commission has been asked to consider in this reference is what reporting arrangements would best ensure that we obtain all of the information we need to implement the RP5 price control effectively and to learn from the successes and failures of that price control for the future without imposing undue costs on customers. As explained below, our proposal is the establishment of a Reporter, but we would welcome any other proposals that the Commission may make as well.

### **The current level of transparency and accountability operates against the public interest**

3. As set out in paragraph 1(b) of the reference notice, in addition to the standard price control issues that the Commission has been asked to investigate, we have also asked the Commission to investigate whether the continuation of NIE T&D's licences in their current form operates against the public interest absent the inclusion of further conditions designed to improve the recording, reporting and monitoring of information related to the price control mechanisms. In essence, we are asking the Commission to evaluate the current levels of transparency and accountability in NIE T&D's activities and to consider whether the public interest requires that more should be done to improve those levels. Our view is that a significant improvement is needed as a matter of urgency.
4. Our reasons for that conclusion are two-fold. First, we believe that historically, the quality and quantity of reporting from NIE T&D on its regulated activities has not been

adequate. Second, in light of NIE T&D's proposed substantial increase in capex over RP5 (as to which see the paper on capex), the need for high quality reporting is even greater now than it has been in the past. Those points are discussed in turn below.

5. It will already be apparent to the Commission from the matters set out in our other papers that the history of our regulation of NIE T&D has been blighted by the asymmetry of information between us and NIE T&D. The most striking illustration of that point is the capitalisation practices issue discussed in our paper on that topic. As explained in that paper, towards the end of RP3, just as NIE T&D and we were in the process of setting in place a regulatory framework for the treatment of opex and capex for RP4, NIE T&D changed its approach to capitalisation in such a way that the effect of that regulatory treatment of opex and capex was that customers would have to pay twice for the same items of work.
6. That may be an extreme (but important) example, but we consider that it reflects a broader trend. At a basic level, it is obviously essential for the success of economic regulation that the regulator should be able to measure with confidence what customers have funded with their money. But time and time again we have found that to be impossible.
7. For example, in the course of devising a new capex mechanism for predictable asset replacement work that only rewards NIE T&D for the volumes of work that it actually does, it transpired that there was a subset of that work (fault repairs "betterment") for which NIE T&D was unable to provide any record of the improvement to the network that it claims to achieve (see the description of the "input driven items" element of the Fund 1 capex mechanism in our paper on capex).
8. Other examples that have raised concerns relate to NIE T&D's inability to provide records to substantiate monies claimed under their capex efficiency mechanism and NIE T&D's inability to provide a copy of their previous capitalisation practices document when requested as part of the capitalisation review. The common theme linking these examples is not only the inadequacy of the data retained to inform our decision making processes but that problems are only discovered after the fact.
9. It is clear that something needs to change. That need is all the more pressing, however, in light of the extraordinary scale of capex that NIE T&D has proposed for RP5 and that it has foreshadowed will need to continue in RP6. To be clear, we agree that a substantial amount of capex will be necessary over that period (so much is clear

from the substantial amount that we approved in the FD). But if customers are to be asked to fund such an infrastructure investment programme, they must be given assurances that it will be well spent and that we (on their behalf) will be able to verify that the money has been well spent. Moreover, as the Commission will appreciate from our paper on capex, our proposals for the projects for which the necessity, timing or scale is not yet clear is that they should be reconsidered and approved on an annual basis throughout RP5. That will clearly require constant communication and transparency between us and NIE T&D throughout the price control period, and not just at the end of it when the next price control comes to be set.

### **Our proposal**

10. Our proposal that a Reporter should be established is explained in Ch 11 of the FD. In addition, we annexed to the FD a draft set of terms of reference<sup>1</sup> that makes clear more precisely what we had in mind. Essentially the Reporter's role would be three-fold:
  - (a) A technical role, auditing the outputs and unit costs of NIE T&D's capex for the purposes of implementing the RP5 capex proposal, and advising us in relation to NIE T&D's annual submissions for approval of further projects under capex Funds 2 and 3 in the following years;
  - (b) A financial role, reviewing NIE T&D's accounting practices and advising us in relation to the same, so as to identify potential problems such as the capitalisation practices issue referred to above before they arise; and
  - (c) A general ad hoc role, investigating and reporting on any particular issues that we consider give rise to concern from time to time.
11. As the Commission will appreciate, the establishment of a Reporter would not add materially to our power to require NIE T&D to produce information or documents. We already have wide powers in that regard. Moreover, the advisory roles and the auditing of the documents produced by NIE T&D could (and would) be carried out by consultants appointed by us in the absence of such a Reporter. The extent to which the establishment of a Reporter will increase the degree of intrusiveness of regulation to which NIE T&D is subject or on the costs of that regulation should therefore not be

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<sup>1</sup> [Reporter for NIE T&D Ltd - Terms of Reference](#)

overstated. Set against those costs, however, in our view the substantial benefits of the Reporter are as follows:

- (a) The Reporter would be independent of both us and NIE T&D and would be selected and appointed by NIE T&D (subject to our approval). That is important because it will foster a greater degree of trust and a more constructive relationship in the reporting process than NIE T&D would be likely to have with consultants appointed directly by us; and
  - (b) The Reporter would be embedded within NIE T&D on a part time basis, which would greatly enhance its understanding of NIE T&D's business and therefore the effectiveness and efficiency of reporting. It would also allow the Reporter to identify potential problems and bring them to our attention before they arise, to the mutual benefit of all concerned.
12. It also bears emphasising that the reporting arrangements that we have proposed for this price control are much less onerous than those which Ofgem have imposed for some time.
13. Ofgem sets out and manages its reporting requirements in substantial detail – for instance, no fewer than twelve conditions of the GB electricity distribution licence (standard licence conditions 44 – 50A<sup>2</sup>) are devoted to the recording, reporting and monitoring of information associated with the price control conditions. Those conditions prescribe detailed requirements in relation to the recording and reporting of information on network outputs, performance, standards measured against the targets for incentive schemes, costs and revenues. Each information requirement is subject to its own set of Regulatory Instructions and Guidance (RIGs) with which each DNO is required to comply. The RIGs provide Ofgem with the power to specify, in a subsidiary document, detailed further obligations as to: the objectives to be achieved in information reporting; the manner, form and frequency of reporting; the precise definition of terms and standards; the standards of accuracy to which information must be estimated, measured and reported; commentary and supporting information to be provided with reported data; and so on. Each set of RIGs may be modified by Ofgem, after consultation, to change the recording and reporting standards during the price control period.

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<sup>2</sup> [Consolidated Standard Conditions of the Electricity Distribution Licence](#), Ofgem, April 2013.

14. The RIGs collectively amount to several hundred pages of detailed requirements, reporting workbooks and spreadsheets; the glossary of terms alone runs to hundreds of pages.<sup>3</sup> The licence conditions require the DNOs to co-operate with an Ofgem appointed ‘Examiner’, whose role is to scrutinise and report on their systems, processes and procedures, the quality and accuracy of information collected under them, and their compliance with the RIGs.
15. Provisions relating the recording and reporting by National Grid in relation to its electricity transmission system are no less extensive.<sup>4</sup>

### **NIE T&D’s objections**

16. Notwithstanding the matters set out above, NIE T&D has objected to our proposed establishment of a Reporter. According to NIE T&D, our proposal amounts to “*micromanagement*”, “*runs counter to the trend in best practice regulation, weakens accountability and gives [NIE T&D] little confidence that the [UR] is embracing principles of incentive-based regulation*”.<sup>5</sup>
17. We disagree. First, as explained above, any increase in regulatory burden brought about by the proposed establishment of the Reporter will be outweighed by the benefits for effective regulation that greater transparency and accountability will bring. Moreover, as noted above, the *means* by which that reporting takes place also offers benefits to NIE T&D in the form of the Reporter’s independence.
18. Second, NIE T&D’s reference to “*the trend in best practice regulation*” is vague and ultimately misses the point. To the extent that comparisons with other regulators’ practice shed useful light on our proposal, what matters is not the “*trend*” but the level of reporting. As explained above, our proposal provides for much less onerous reporting by NIE T&D than Ofgem requires of the DNOs in GB. It is a proportionate response to the informational challenges at hand.
19. Third, NIE T&D’s reference to “*incentive-based regulation*” fails to take account of the fact that an essential pre-condition to the setting of incentives by a regulator is that the regulator has confidence in its ability to measure the utility’s performance accurately.

<sup>3</sup> [DPCR5: Version 1 of the Regulatory Instructions and Guidance](#), Ofgem, May 2010. (Ofgem has subsequently made several modifications of individual RIGs documents.)

<sup>4</sup> [Electricity Transmission Licence: Special Conditions](#), Ofgem, April 2013.

<sup>5</sup> [NIE T&D’s Response](#) to the [DD](#), Ch 11 §3.4.

Our proposal to improve the quality of reporting should therefore be understood as a first step towards what is our preferred outcome of ultimately shifting to a more “outcomes” based model of regulation. But that will not be possible until the basics have been established. In any event, as the comparison with Ofgem set out above shows, even when regulators are able to move in the direction of more “outcomes” based regulation, they still require very detailed reporting on the “outputs” that the utilities spend customers’ money on. NIE T&D has a long way to go before it can claim to provide anywhere near as much detail on the network in Northern Ireland as GB DNOs provide in relation to their networks.

## **Conclusion**

20. As explained above, there is a clear need for improved accountability and transparency of NIE T&D’s operations. The historical record on NIE T&D’s reporting speaks for itself, as does the extraordinary scale of the capex proposals for RP5 and beyond. That is why we have included in this reference the question of whether the public interest requires some amendment to NIE T&D’s licence conditions to improve reporting.
21. Our proposed solution is the establishment of a Reporter. That proposal is a proportionate response to the information deficit that we face. It will improve the effectiveness and efficiency of the reporting process by embedding the Reporter in NIE T&D and it should give NIE T&D some comfort from its role in appointing the Reporter. Contrary to NIE T&D’s submissions, the overall level of reporting would still be much less onerous than that which is imposed by Ofgem.