



**Northern Ireland Electricity
Transmission and
Distribution
Price Control Review
(RP5)
2012-2017**

**Response to the Competition
Commission's Provisional
Determination**

29 November 2013

UR RESPONSE TO PROVISIONAL DETERMINATION

OVERVIEW

Introduction

1. This document sets out our response to the Commission's provisional determination, published on 8 November 2013 (the "PD").
2. We wish to make two points upfront.

RP5 Allowed revenues

3. On the whole, our view is that the Commission has struck a broadly appropriate overall balance across the building block calculations that it has had to make in this inquiry. We differ slightly in the revenue calculation and more detail is provided in our response to Chapter 18. We strongly encourage the Commission to stick at this provisional allowance in its final determination in the face of the inevitable cherry-picking and selective, narrowly focused criticisms that it will get.

Implications for RP6 and beyond

4. We are, however, concerned that a few important aspects of the PD, if maintained in the final determination, operate against the longer-term public interest for RP6 and beyond. Those aspects are:
 - (a) The overly strong incentive that the Commission is giving NIE T&D to defer and abandon planned capital expenditure during RP5, which we believe will permit NIE T&D to earn sizeable windfall profits at customers' expense;
 - (b) The pay-back over three regulatory periods of £24m of supposedly "stranded" pension contributions from RP4, which amounts to a reopening of the RP4 settlement and which will result in customers paying more than NIE T&D could ever claim to be entitled to; and
 - (c) The capitalisation practices issue, which will require customers to pay twice for work which we fear will set a damaging precedent that will encourage NIE T&D

and other regulated companies to exploit any opportunities they can find to game the regulatory system at customers' expense.

5. In all three areas, we urge that the Commission reconsiders its approach, with a view to ensuring that its final determination strikes a more appropriate balance between the interests of customers and the interests of shareholders.
6. Our concerns in relation to those three main issues are summarised briefly in turn below. Our full response to each of the substantive chapters of the PD (including the chapters in which those issues arise) follows.

Treatment of deferred/abandoned capital projects

7. We consider that there is a high probability that NIE T&D will not deliver the level of capital expenditure that the PD suggests is both appropriate and necessary. Among other things:
 - (a) The Commission's and its expert advisers, BPI, have expressed concerns about the extent to which NIE T&D will be able to ramp up work volumes; and
 - (b) The Commission has provisionally decided that NIE T&D should receive £195m worth of funding for projects that the Commission considers don't actually need to be undertaken in RP5, most of which the Commission considers could be deferred to RP6 or beyond without any increase in overall cost or additional risk to service delivery.
8. We note that the Commission have said that it is "particularly desirable" that NIE T&D should be given strong incentives (to earn extra returns) if it defers or abandons planned work.
9. In a supporting paper to this submission¹, we illustrate how NIE T&D could defer at least £100m of capital expenditure without any difficulty. We also demonstrate that the Commission's proposed incentive scheme would give NIE T&D around £25m of extra return per £100m of effortless capital under-spend, equivalent to one extra year of equity returns. We fail to see how this incentive can be in the public interest.

¹ UR-150 D1: Cost Risk Sharing Mechanisms

10. We ask that the Commission should reconsider this issue. We suggest that the D1 incentive rate should be reduced to 30% as we consider this should be sufficient stimulus for the company to seek prudent deferrals. And we ask that the Commission should improve reporting requirements, so as to enable us to identify deferrals where they take place.

Capitalisation practices

11. The Commission has clearly put a lot of work into investigating the capitalisation practices issue and through this work the Commission has been able to confirm the accuracy of the factual propositions that we set out, namely:
 - (a) During RP4 NIE T&D reclassified as capital expenditure that would previously have been classified as operating expenditure; and
 - (b) As a result, unless action is taken, customers will pay again in RP5 and beyond through return on and of the RAB for work that they have already funded once during RP4.
12. We remain of the view that it cannot be in the public interest for customers to be required to pay twice for work that is only done once.
13. The closest that the PD comes to addressing this point is to say that the RP4 determination failed to stipulate explicitly that NIE T&D could not reclassify expenditure, and also failed to stipulate explicitly that if NIE T&D chose to do so, an adjustment could be made to prevent customers having to pay twice.
14. In our view, that is a one sided interpretation of the regulatory settlement. Economic regulation is not like the tax code, where anything that is not expressly forbidden is permitted. Regulators and regulated companies understand that price settlements and associated licence conditions are frameworks that need to be applied in a sensible and pragmatic ways with considerable trust being critical to success. As we explain in a supporting paper² to these submissions, that process has on several occasions in the past (one of which involved the MMC inquiry into NIE T&D's price control arrangements in 1997) seen adjustments being made ex post to correct for unforeseen outcomes. If the Commission is signalling in this inquiry that such adjustments will not be permitted in future, we think that this is a very material matter. In order to reduce

² UR-151 Correcting for Unforeseen Outcomes: Regulatory Precedent

the risks of regulated enterprises gaming and/or exploiting weaknesses in a regulatory framework, we and our sister regulators will need to be ever more prescriptive in our economic regulation of the enterprises. We urge the Commission to consider carefully whether this is the type of regulatory regime that the PD is promoting.

15. More specifically, whatever the flaws may have been in the RP4 price control, the one principle that matters for these purposes has always been crystal clear: NIE T&D's Composite Proposal, which we accepted for RP4, assured us and assured customers that expenditure should be remunerated either through opex or through capex, but not both. When construing the RP4 regulatory contract for the purpose of assessing whether it really requires customers to pay twice in this case, we would urge the Commission to consider the following question: if a bystander had asked whether it was intended that NIE T&D should be free to classify expenditure inconsistently between operating expenditure and capital expenditure during RP4, with the result that customers would have to pay twice for the same work, is there any doubt at all as to how NIE T&D, its investors, or we would have responded?
16. We remain of the view that the answer to the question is obvious, and once the matter had been exposed an adjustment to NIE T&D's RAB must be made to preserve the terms of the RP4 deal. In our detailed submissions below, we respond to the Commission's factual analysis and its concern about the difficulty of estimating the right adjustment. We recognise the challenge that the Commission faces here. However, we consider that the Commission must make at least a modest and cautious adjustment to NIE T&D's RAB to correct for the most obvious examples of double counting and to send the message to regulated companies that customers' interests will be protected if a company tries to game the system.

Pensions

17. The third aspect of the PD that causes us serious concern is the Commission's response to NIE T&D's claim that customers should compensate it for £24m of supposedly "stranded" excess pension contributions that NIE T&D made during RP4. On one level we find it difficult to reconcile the Commission's strict view about not revisiting old price controls generally (see in particular the Commission's view in respect of capitalisation practices) with its approach to this issue, which amounts to the backdating of the Commission's new pension policy from the start of RP5 to the start of RP4. Backdating does not sit well with the accepted principles of regulatory certainty, but in this case it is an arbitrary imposition on customers. If the new policy

could be backdated at all, there is no reason why it should be backdated to the start of RP4 rather than to, say, the start of RP2 when NIE T&D took a pension holiday and NIE T&D was contributing less than customers had funded it to.

18. Even if the Commission wanted to protect NIE T&D from the effects of the change from the rolling pension allowance in RP4, £24m goes far further than that. Even if the rolling pension allowance had continued indefinitely – which no reasonable observer could have expected on the basis of statements we made in the RP4 review – NIE T&D would never have recovered £24m of value for shareholders. In net present value terms, the very most that NIE T&D can claim is that the change in policy has cost it £11m.

The rest of this document

19. The remainder of our response is structured to work through the Commission's PD on a chapter by chapter basis:
 - (a) In chapters 4 to 6 we give our views on the regulatory design that the Commission has proposed. In most cases, we agree with the Commission's proposals, but in a few key areas we suggest simple changes that the Commission can make to safeguard the interests of customers;
 - (b) Between chapters 7 and 16 we review the individual building blocks in the calculation of allowed revenues. In the case of stranded pension costs and capitalisation, as set out above, we ask the Commission to revisit its provisional findings so as to protect customers' interests, principally in RP6 and beyond. Elsewhere, our primary concern is that the Commission should not revise up its calculation of RP5 allowed revenues in response to the criticisms that NIE T&D will make of the PD. We therefore seek to highlight to the Commission where we think it has been generous to NIE T&D in its PD, with the intention that the Commission might take these matters into account when considering NIE T&D's response and thus be able to consider side-by-side both the 'swings' and 'roundabouts' that there are in the decisions that it has provisionally taken;
 - (c) In chapter 17 we respond to the Commission's proposal for a new licence condition on reporting; and
 - (d) In chapter 18 we give our views on NIE T&D's overall RP5 revenue requirement.

20. We hope that our submissions are of assistance to the Commission, and if it would help for us to clarify anything in advance of our hearing, we are as always happy to help.

RESPONSE TO THE DETAILED FINDINGS

Chapter 4: Timing and duration

21. Chapter Four of the PD addresses a number of distinct issues connected with the timing of NIE T&D's price controls:
- (a) The start and end dates for RP5;
 - (b) Clarification of the restrictions on NIE T&D's revenue in the period between 1 April 2012 and the commencement of RP5 in October 2014;
 - (c) Adjustments made to the revenue allowed during RP5 to compensate consumers or NIE T&D in respect of deficiencies in the calculation of revenue between 1 April 2012 and the commencement of RP5 in October 2014;
 - (d) Licence price control conditions to cover the period after the end of RP5; and
 - (e) Changes to NIE T&D's financial year for price control licence conditions and regulatory reporting.
22. We agree with the Commission's proposals, save for some concerns, set out below, about the Commission's proposals in respect of issue (e).

Changes to NIE T&D's financial year

23. In §§4.52-4.57, the Commission discusses the possibility of changing NIE T&D's regulatory reporting year from its current 1 April to 31 March year to a 1 October to 30 September year. We support that change. NIE T&D has now moved its financial year to align with that of its parent company from 1st January to 31st December and the tariff year runs from 1st October to 30th September. Keeping the current 1 April to 31 March financial year would therefore require the reconciliation of three different periods each year. Moreover, the misalignment between the price control and the tariff year (which, it should be noted, is an all-island tariff year) can contribute to over- and under-recovery of revenue relative to the allowed revenues in the relevant year. This is a cause of concern for us, given the terms of NIE T&D's licence which require it to use its best endeavours to ensure that in any relevant year the revenue collected does not exceed the revenue cap.

24. We note that the Commission's concern with the proposal to change NIE T&D's reporting year (discussed at §4.55 of the PD) is that it is important for the purposes of price control cost assessments that NIE T&D's regulatory accounts should be aligned with those of GB DNOs (which run 1 April to 31 March year). Having discussed the issue of benchmarking with Ofgem, we do not consider this to be a concern. Ofgem benchmarks internationally, using data from countries with different financial rules and time frames. They have made it clear to us that what is required is a defined 12 month period and they do not consider when this 12 month period starts and finishes impacts on the ability to benchmark effectively. They have also indicated that the sooner NIE T&D start trying to populate the RIGS and tease out any issue the better quality and the sooner the report can add the value required. Confidence grading is also an area they feel it would be worthwhile for us to develop. We are currently progressing discussions with Ofgem to obtain possible dates to meet them and NIE T&D to discuss the population of the RIGs in more detail.
25. For those reasons, we would propose that NIE T&D's reporting year should be changed to align with the tariff year of 1st October to 30th September.

Chapter 5: Price control design

26. In Chapter Five, the Commission sets out the structure of its proposed price control in some detail. Some elements of the Commission's proposal (and in particular D1) are somewhat novel and (as discussed below) give rise to some concerns about whether the right incentives are being put in place to best serve the public interest. Nevertheless, and in light of the reasons advanced by the Commission in support of its proposals, we can see merit in trialling most of those proposals (subject to some modifications set out below), without prejudice (naturally) to our right to take a different approach in RP6 if our experience during RP5 is that the Commission's proposals have operated against the public interest.
27. We set out our reaction to the Commission's various proposals in turn below:

D1: Cost risk-sharing mechanism

28. Perhaps the most radical proposal that the Commission has made is its unified cost risk-sharing mechanism, to be applied across both opex and capex. The Commission has provisionally proposed that NIE T&D and customers should share 50:50 any under- or over-spending by NIE T&D during RP5 relative to the opex and capex allowances that the Commission determines.
29. While we understand the logic of increasing the degree of alignment as between opex and capex incentives in this way, we are concerned about the impact of the Commission's proposals on customers in the particular context of this price control. Before considering those issues, however, it is useful to note the impact of aligning the incentive rate across opex and capex relative to the incentives that we had proposed:
- (a) capex incentives would be substantially increased under the Commission's proposals. Whereas, subject to a D3 mechanism for changes in volumes, our proposed five-year lagged RAB adjustment mechanism would allocate to NIE T&D roughly 30% of any under- or over-spend, the Commission's proposal allocates 50% of that risk to NIE T&D. This is equivalent to keeping projected capex in the RAB for just over nine years before it is replaced by NIE T&D's actual expenditure; and
 - (b) in contrast, opex incentives would be halved under the Commission's proposals. Whereas under our proposal, every pound of over- or under-spend relative to the

benchmarked opex allowance goes straight through to NIE T&D's profits, under the Commission's proposal, only 50 pence in every pound of over- or under-spend would be retained by NIE T&D with the other 50 pence passing to customers.

30. We provide further discussion of these points in UR-150, issued alongside this submission.
31. In the abstract, there might be nothing wrong with those changed incentives. However, we are concerned that in this particular case, both changes operate against customers' interests. In respect of opex, the Commission has, as discussed below, identified an efficiency target which, while requiring some work from NIE T&D to achieve it, is far from over-ambitious (only requiring NIE T&D to reach the standards of the fifth most efficient DNO in GB). It would be unfortunate if NIE T&D's incentives to achieve that target were dulled by the knowledge that if it does not achieve that target, customers will make up half of the shortfall, or for the incentive to out-perform and become the first most efficient DNO to be weakened by having to share half of all RP5 opex efficiencies with customers.
32. Of even greater concern, however, is the situation with respect to capex. It seems to us that there is a high probability that NIE T&D will spend less than the full capex allowance that the Commission has proposed to give it, particularly in light of the unprecedented increase in network development for renewable connections work that NIE T&D will also need to do over the same period. BPI has highlighted in respect of several of the projects for which the Commission has granted an allowance that it has concerns about "achievability".³ As discussed below under D3, unless changes are made to the Commission's proposed anti-deferral mechanism, customers will have to pay NIE T&D for work that it defers or abandons. The D1 incentive rate is effectively providing a reward to NIE T&D for capex deferral and we consider the incentive rate of 50% is inappropriate.
33. In light of those concerns, we would urge the Commission to reconsider the 50% rate that it has provisionally proposed. We are concerned that this will prove to have been an expensive experiment for customers if the capex deferral scenarios discussed below in relation to D3 come to pass. We think that an incentive rate of 30% would be more appropriate in the circumstances. We also note that the reasoning supporting our

³ See, for example, p 22 of the BPI Report.

proposal in that regard is consistent with Ofgem's approach of rewarding more robust business plans with sharper incentive rates. If we were confident about the evidence of need for capex that NIE T&D has put forward and on which BPI has had to base its capex work, we would have supported a higher incentive rate. But in the circumstances of NIE T&D's poor quality plan, we cannot support that approach.

D2: Inefficient spend clause

34. We agree with the Commission's proposal for a "demonstrably inefficient or wasteful" expenditure clause and support the Commission's analysis of the circumstances in which it would apply.

D3: Measures to tackle risks from deferral of planned network investment

35. We are pleased that the Commission has explicitly considered how best to deal with deferral and abandonment of planned capex. As we have previously said, a mechanism to protect the interests of customers in the event of deferral and abandonment is essential for this price control.
36. We continue to believe, however, that the Commission's approach provides too great an incentive for NIE T&D not to do the work that it has said it will do. We accept that there are some circumstances in which utilities should be given financial incentives to defer capex where deferral is efficient. Specifically, (a) if the regulated company's upfront capex allowance constitutes a robust and challenging view at the time of the periodic review of the work that the company will need to do in order to give a defined level of service to customers, and (b) if changes made subsequently to that plan, including deferral, are likely to represent genuine new efficiencies, then we would agree that a company should be rewarded for not doing work since this will ultimately lower the costs that customers pay.
37. Unfortunately, these are not the conditions that we or the Commission face in this inquiry. The circumstances before us are that:
- (a) the Commission is proposing to provide allowances in the sum of £195m for 'category B'⁴ projects that BPI considers to be not strictly necessary during RP5,

⁴ See PD §9.11(b) for the definition of category B and see Table 9.2 on p 9-5 of the PD for the quantum within that category.

most of which the Commission considers could be deferred without any increase in overall cost;

- (b) the Commission has recognised that practically delivering the volume of work that it has provisionally provided for within the RP5 timeframe will be a major challenge for NIE T&D;
 - (c) NIE T&D will not have control over the deferral of transmission related work after April 2014; and
 - (d) there are no “nominated outputs” (to use Ofgem’s terminology) in place to demonstrate that the deferral has not jeopardised the outcomes (such as the health of the network) that customers care about, nor is the Commission proposing to put in place financial incentives around network performance (i.e. customer interruptions / customer minutes lost).
38. These things, taken together, mean that there is a high likelihood that NIE T&D will under-spend its capex allowance in RP5 and that the under-spend will be a result of factors other than efficiencies against a tight business plan.
39. In the circumstances that we have just described, we do not agree with the Commission’s provisional view that it is “particularly desirable” for NIE T&D to have a financial incentive to defer or abandon planned works. It seems to us that the effect of the Commission’s proposal would be to encourage NIE T&D to replace its current business plan with a “do minimum” alternative, configured in such a way as to extract the maximum profit for shareholders out of the RP5 determination.
40. As we explain in supporting submission to this response,⁵ focusing exclusively on category B projects, it is entirely realistic to think that NIE T&D could fall short of its capex allowance by £100m. For the avoidance of doubt, £100m is less than the total value of “category B” projects which are, by definition, not necessary for this price control period. There is no magic in being given an allowance for unnecessary work and then choosing to delay it until later or abandon it completely. And yet with the incentives under D1 and D3, NIE T&D would profit to the tune of approximately £25m

⁵ UR-150 D1: Cost Risk Sharing Mechanisms.

under the Commission's proposals. That is roughly equivalent one extra year of equity returns for no real effort on NIE T&D's part.⁶

41. We consider that it would not be in the public interest for NIE T&D to be given the opportunity to earn this kind of windfall profit.
42. In addition, we also have concerns about the robustness of the "no double counting" rule that the Commission has put forward as a means of protecting customers from deferral. Our principal concern lies in the potential for NIE T&D to rebrand projects in RP6 and beyond. The introduction of ESQCR, in particular, provides an opportunity for rebranding significant amounts of work on the overhead line network that would have been required anyway in subsequent price controls as a new obligation. Other examples are that replacement of ageing transformers can be included in load related projects and replacement of smaller assets can be replaced under fault/reactive budgets. We urge the Commission to stress test its final determination to ensure that full clarity is provided and that the public interest is protected in the long term.
43. We have provided a draft set of deliverables for each project (and specifications to clarify what they mean) that we believe helps to protect customers from under-delivery of infrastructure against the public interest. We consider that annual reporting against these deliverables should also be required. We are concerned that the proposed approach of NIE T&D self-certifying pre-funded amounts for RP6 and beyond is open to exploitation and perpetuates the asymmetry of information that has caused so many problems in NIE T&D's regulation to date. Instead, we propose a specific report that is verified within the annual RIGS process, which clearly flags the outstanding deliverables. These are included in a supporting paper to this submission (UR-148).

D4: Investment projects for distribution network load-related expenditure

44. In relation to distribution network load-related expenditure, the Commission has provisionally rejected our proposal for a mechanism to deal with uncertainty as to need by allowing for approvals during the RP5 price control period based on better evidence than NIE T&D has been able to produce to date. We disagree with the Commission's view that this would amount to excessive micromanagement. On the contrary, in our view it merely reflects the degree of oversight that is necessitated by NIE T&D's poor quality business plan.

⁶ The average annual return on equity under the Commission's provisional determination is approximately £25m.

45. In the intervening period NIE T&D has developed Load Indices for its network. While these are still a work in progress, we would propose that these should be published so that customers and other interested parties can see for themselves the impact that NIE T&D's load related investment (or deferral) has on the network. We can then look at using those indices more substantively in our RP6 price control.
46. We are in any event concerned that the Commission has not taken adequate account of the fact that NIE T&D has an obligation to consider alternatives to infrastructure investment for load related projects. These alternative options would result in opex costs over a considerable period of time in place of the capex costs of the load related projects. Some of these may be incurred in the wholesale market or by the TSO rather than by NIE T&D. If NIE T&D did not consider these alternatives it would be in breach of licence.
47. It would in our view be a perverse outcome if customers should have to pay NIE T&D for capex projects that are avoided as a result of NIE T&D's decision (made pursuant to that licence obligation) to increase the costs to consumers in other parts of the supply chain. We therefore ask for clarification of how the Commission proposes to address this issue. We have provided further information about our concerns in a supporting paper to this document – "UR-148 Detailed Comments on Deferred Capex incentive".
48. At a minimum, if the Commission maintains its position that this category of investment should be remunerated by a straightforward allowance, we would urge the Commission to reconsider its proposal that this category of investment should be exempt from the Commission's proposals in relation to investment deferral set out under D3. The Commission does not offer any reasons at all for that provisional conclusion. In our view, the need for protection against double funding is at least as important for this category of work as it is for asset replacement work. If customers slow the growth of the demands they make of the network so that this load related work becomes unnecessary during RP5, it would be perverse to penalise them by making them pay for the work a second time when it ultimately does become necessary during RP6 or RP7 (see case studies identified in UR-148).⁷ Moreover, under the Commission's proposals, NIE T&D would have very strong incentives to postpone any load-related work that would otherwise take place in the last 12-18

⁷ UR-148 Detailed Comments on Deferred Capex incentive

months of RP5 into RP6, since this would mean that NIE T&D is eligible to be funded twice for the same project.

49. For those reasons, we consider the extension of the D3 mechanism to distribution load-related expenditure to be essential. Detailed reporting on the projects that are, and are not, undertaken, will also be required in the same way as for asset replacement work.

D5: Investment projects to increase transmission system capacity

50. We welcome and endorse the Commission's proposals in relation to transmission system capacity improvement projects. However, we also propose that transmission load related schemes that have already been allowed by the Commission should also be remunerated under the D5 mechanism. This is because, as the Commission is aware, from April 2014 NIE T&D will no longer have responsibility for deciding whether these projects go ahead. That responsibility will transfer to SONI. We are concerned that the incentives for deferral that the Commission proposes to make available under D3 should not be applied to these projects. Given that NIE T&D has no control over whether these projects go ahead, it should not be given any reward for deferral. Our concerns on this topic are explained in more detail in UR-148.

D6: Smart grid initiatives

51. In relation to smart grid initiatives, we had proposed a project-by-project approval approach to ensure that good projects could take place and that customers would not be required to pay for projects that do not take place. The Commission has rejected that approach, instead proposing an allowance for this category of work. The Commission has not explained, however, how it proposes to protect customers from the risk that, having obtained an allowance for this work, NIE T&D will simply not carry it out and will instead use it as a contingency fund to make up any inefficiency on its part in other projects. Our view is that, just as with other categories of capex, there needs to be a deferral protection mechanism of the kind set out in D3 (at a minimum), and detailed reporting. We note that these projects may comprise a mixture of capex and opex.

D7: Electricity meter investment and smart meter programme

52. We welcome the Commission's provisional view that it should impose "a form of 'volume driver' for NIE's capex on electricity meters". This seems to us to be a sensible means of ensuring that customers only pay for work that actually takes place.

D8: Pass-through of connections charges to NIE's RAB

53. We agree with the Commission's proposals in relation to connection charges.

D9: Pass-through of specified operating costs

54. We are pleased that the Commission has taken a fresh look at the optimal regulatory treatment of what we had previously characterised as "*uncontrollable opex*". We agree with the conclusions that the Commission has reached and are confident that we will be able to implement the Commission's proposal that we make a separate allowance for injurious affection once the outcome of the Lands Tribunal determination becomes known. For the avoidance of doubt, we would expect to consult on any allowance that we make in that respect.
55. For the reasons given below, however, we would urge to Commission to reflect upon its exclusion of Rates from the application of RPEs and productivity.
56. **First**, we have in previous determinations on water, in both PC10 and PC13, adopted an approach consistent with Ofwat whereby Rates, whilst excluded from benchmarking analyses, are included in the opex expenditure to which an efficiency challenge is applied.
57. **Second**, we are concerned that a consequence of taking a half-way house approach to Rates (whereby they are granted an allowance which is not subject to any efficiency challenge) may be that confusion will ensue as to whether other categories of expenditure are analogous to Rates and might arguably receive the same treatment. Rather than solve the conundrum posed by the question of what is and is not controllable expenditure, the Commission's proposal may support protracted debates between parties in the future.
58. **Third**, Rates are undergoing a local revaluation. As a result, there is a potential for quite large swings in costs around RPI. On this basis alone, NIE T&D's Rates cost may require a RPE adjustment in a symmetrical manner to insulate both consumer

and company from any material changes to NIET&D's future Rates bill. The relevance of this for NIE T&D within RP5 or future price controls can be accommodated within the RPEs analysis which, as is the case for other opex, can accommodate either the scenario in which Rates follow RPI, or the scenario in which they do not. Where Rates do follow RPI, the RPE becomes NIL and whatever is the weighting accorded Rates the end result is the same, a NIL impact on the overall weighted RPEs applied to the total opex.

59. Finally, whilst there may be some argument that the productivity or ongoing efficiency challenge may be inappropriate to apply to Rates, the Commission's own assessment of productivity, having been derived from a range of 0.5% to 1.5%, reflects the fact that as with all items of opex, some will be harder to extract efficiencies from than others. Overall, given the inevitable swings and roundabouts in the operational cost base any company faces, Rates is no more different to other categories of opex which NIE T&D and other regulated companies may choose to argue are more difficult to control, and hence are 'uncontrollable'.
60. At a minimum, we would ask the Commission to explain more clearly why it proposes to treat Rates differently from other categories of opex so that such confusion is avoidable in future.

D10: Other items to remove from current Licence conditions

61. We have no objections to the removal of any of the terms in NIE T&D's licences that the Commission has identified as redundant.

Chapter 6: Quality of service

62. We agree generally with the Commission's analysis of the quality of service issues raised in Chapter 6, and in particular are content for the revenue protection mechanism to be extended beyond its current scope of vacant non-domestic premises.
63. We have a concern, however, that the benefits from deferring capex provided for in D3 are not offset by an incentive to maintain customer interruptions and customer minutes lost at current levels. This distorts the decision making process further towards avoiding capital investment. Some form of obligation to maintain current standards would be welcome.
64. As noted in our comments on chapter 5, the absence of any incentive for network performance needs to be taken into account when calibrating the rewards/penalties for capex under-spending.

Chapter 7: Overview of cost assessment

65. Chapter seven provides an overview of the Commission's approach to quantifying efficient cost allowances for NIE T&D across the range of its activities over RP5.
66. Specifically in relation to chapter seven, we note that the Commission's pre-capitalisation approach to benchmarking based on GB DNO cost data (which is similar to the approach that we took) necessarily requires various assumptions to be made to translate the outputs of the benchmarking model into cost allowances for:
- (a) transmission and distribution;
 - (b) opex and capex; and
 - (c) specific items within capex.
67. We think the Commission's judgments in that respect are broadly reasonable and do not propose to second-guess them. However, we may wish to return to this matter in a separate submission if NIE T&D chooses to cherry-pick at the Commission's assumptions in its response.

Chapter 8: Benchmarking

68. We welcome the extensive work that the Commission has done to benchmark NIE T&D's costs against those of GB DNOs. We are pleased that the Commission has managed to obtain a better data set from Ofgem than we or NIE T&D previously had to work within our benchmarking exercises. We also consider that the difficulties that the Commission has experienced in mapping NIE T&D's costs to those of the GB DNOs (which was very much in line with the difficulties we experienced during our benchmarking exercises) underlines the need for a step change in the quality of NIE T&D's data reporting, both in terms of accuracy and reliability (as discussed below).
69. We can see the sense of the Commission's reasoning at §8.111 that benchmarking analysis is always imperfect and that there are swings and roundabouts in each direction. Standing back from the detail, we think that the Commission's overall approach to benchmarking in the PD is reasonable and that the overall outcome of that exercise serves the public interest well.
70. That said, there are a number of aspects of the Commission's approach with which we respectfully disagree, as discussed below. While we are not asking the Commission to award NIE T&D substantially less revenue in the final determination, we feel it is important to bring these issues to the Commission's attention (not least given our statutory duty to assist the Commission). In particular, in the event that the Commission were to accept requests made by NIE T&D for special treatment in the benchmarking exercise, we consider that the overall balance that the Commission has struck would be distorted unless these countervailing points were also taken into account.

Modelling of IMF&T costs

71. We continue to believe that the Commission places excessive weight on econometric analysis of IMF&T costs that is highly suspect because the explanatory variables employed are too general to have any real explanatory power in respect of direct network costs. We have noted previously that the Commission's modelling implies that NIE T&D is super-efficient in its IMF&T costs. But we know that at least some of this efficiency is an illusion: BPI explains very clearly how comparisons of NIE T&D's tree-cutting costs to GB DNO tree-cutting costs favour NIE T&D due to lower levels of tree cover in Northern Ireland. We remain unconvinced by the Commission's attempt to explain away those inconsistencies in §§8.113-8.114.

72. Moreover, we note that the GB DNOs conduct substantially more resilience tree-cutting than NIE T&D. If NIE T&D is to be remunerated for tree-cutting on the basis of that higher volume and specification of work, then customers should be entitled to expect that NIE T&D will deliver that work (which we estimate amounts to 5 ½ years worth of work) over the remainder of RP5).

Other omitted explanatory variables

73. NIE T&D's various claims for special consideration within the econometric modelling, such as the claim that it has already made about sparsity, and the numerous claims that NIE T&D is likely to advance in its response to the PD, must, even to the extent that they are *prima facie* justified, be set against the absence of other explanatory variables, like quality of service, or indeed scope of service.
74. By way of example, the benchmarking exercise takes no account of the fact that GB DNOs conduct extensive customer engagement, and report under the RIGs without receiving any additional allowances to change their IT system to accommodate the modifications to the RIGs that are made from time to time.
75. Another specific example is the ESQCR allowance, where we note that NIE T&D has requested separate funding for vegetation management.⁸ GB DNOs are more advanced in meeting ESQCR requirements in relation to tree cutting than NIE T&D. The Ofgem RIGs required the GB DNOs to report tree cutting under ESQCR (2006) under the 'tree cutting' category (rather than in ESQCR expenditure). This means that the models' predictions for NIE T&D should provide it with a sufficient level of expenditure to carry out 'vegetation management' under ESQCR. Therefore, we consider that the Commission should not make any additional allowance for tree cutting under ESQCR requirements.

Choice of 5th best firm as benchmark

76. We continue to believe that there are good reasons to demand more, on behalf of NIE T&D's customers, than for NIE T&D to match the efficiency of the 5th most efficient DNO.

⁸ Supra Note 1 pages 9-13, Tables 9.4 and 9.5.

77. **First**, there is no reason to believe that the weaknesses in the econometric models tend to understate rather than overstate the costs of an efficient DNO. As noted above, there are swings and roundabouts in any benchmarking exercise, and it is just as likely that the missing explanatory factors would point to inefficiency on NIE T&D's part rather than efficiency. There is accordingly no reason to react to the uncertainty inherent in the modelling exercise by allowing NIE T&D to "aim low". Moreover, for the Commission to suggest that "aiming low" is an acceptable consequence of NIE T&D producing poor quality data is to create perverse incentives on NIE T&D to resist our calls for progress on transparency between now and RP6.
78. **Second**, we would also ask the Commission to take into account that under the D1 cost risk sharing proposal discussed above, NIE T&D is much less exposed to the risk of underperformance than it would usually be. If (as we hope) the Commission accepts our submission that the capex incentives need to be softened in the public interest, and (as we anticipate) the Commission continues to set a single incentive rate across opex and capex, the result will be that NIE T&D's opex incentives are very soft indeed. In our view, that should mitigate the Commission's concern about the risk of setting an excessively ambitious target.

Implications of benchmarking for 'new' opex items allowance

79. We also note that the additional opex allowances included on top of benchmarked opex of £51.5m are generous to NIE T&D and represent an increase upon the amounts that we considered should be allowed for those items. Some of the costs are a result of NIE T&D simply catching up with custom and practice in GB. Indeed, some of these costs are quality of service related to the extent that new and better meters are being installed locally. The absence of any explicit treatment within the econometric modelling for the difference in quality of service locally compared to GB is important because any quality enhancements ought now to be readily fundable from within the benchmarked opex allowance without a further call on consumers to fund.

Chapter 9: Core network investment

80. Chapter nine of the PD presents the results of the Commission's project by project review of NIE T&D's capex requirements. In large part this follows the recommendations of BPI on which we have previously commented. As we said in those comments (see UR-72 and UR-107), BPI's approach incorporated an in-built upward bias in the amount of capex that it recommended. Those submissions do not appear to have been addressed in the PD. While it is now no doubt too late for the Commission to re-evaluate the entire set of projects, we think those upward biases should be taken into account when considering marginal judgment calls on capex. The upward bias is also of obvious relevance to our submission that capex incentives should not be set at too sharp a level in this price control.
81. In addition, as discussed above, we consider that the Commission's provisional decision to grant allowances for the entire £195m of projects that BPI endorsed in category B (i.e. projects that are justified but unnecessary for RP5), combined with the Commission's incentives for deferral and abandonment created by the combined effect of D1 and D3, operates against the public interest. Customers in Northern Ireland are still struggling with the effects of the recession and fuel poverty is at an all time high. While we could understand an allowance being made for well justified projects that, while not strictly necessary for RP5, would result in higher costs for customers if they were deferred (i.e. Category C), customers likely to be less than pleased about being asked to pay for work to be brought forward into RP5 if it could just as easily and cheaply be deferred. Requiring customers to pay for that work, and then find that it hasn't even been done, however, is beyond the pale. As discussed above, we would therefore ask that the Commission reconsider the combined effect of those three aspects of the PD. Moreover, given that the PD's capex allowances stretch all the way to the bottom of category B, we would urge the Commission not to contemplate increasing it any further in response to NIE T&D's submissions.
82. Chapter nine also sets out the Commission's own detailed analysis of three projects: the D56 Network Resilience project, D43 and T40 ESQCR compliance project, and the D48 11 kV network performance project. We are very pleased that the Commission has rejected the Network Resilience and 11 kV projects on the basis that NIE T&D has failed to establish customers' willingness to pay for them. Both projects spoke volumes about NIE T&D's attitude to customers' money, and we hope that the Commission's

determination of those issues will inspire NIE T&D to put customers' views at the heart of its investment plans in the future.

83. We are concerned, however, by the c. £8m additional funding that the Commission has provisionally determined should be made available for ESQCR compliance work. In particular, it seems to us that this gives rise to a substantial risk of double-funding. GB DNOs report the costs of their ESQCR tree cutting under the "tree cutting" category rather than under "ESQCR".⁹ This means that the benchmarking models used by the Commission to generate NIE T&D's IMF&T cost allowance should already provide NIE T&D with sufficient expenditure to carry out at least the "vegetation management" component of ESQCR compliance. If the Commission's £10.38m allowance for ESQCR compliance includes any allowance for tree cutting, then this would give rise to double-funding.
84. More generally, we are concerned that this substantial allowance comes with no description of what it is that NIE T&D is expected to spend the money on or the outputs that the expenditure is to deliver. The allowance should not be used as a general contingency fund for NIE T&D's capex. NIE T&D should be required to identify precisely what it proposes to do with that money, and to report on that work throughout RP5.
85. Finally, we note that in §§9.116-9.118 of the PD, the Commission refers to NIE T&D's last minute request for a £30m allowance for reinforcements of the 33 kV network for small scale renewable generation. That kind of approach is typical of our experience of NIE T&D's conduct throughout the RP5 process. The Commission's deadline for submissions for the PD had passed by the time it was submitted on 28 October 2013, notwithstanding that NIE T&D has known about the underlying issues for years. Even then, the submission was made without any detail as to the work that would be involved, without any cost benefit analysis, and without any evidence that the proposal is consistent with NIE T&D's statutory and licence obligations. We would suggest that the proposal should be rejected out of hand. It cannot be in the public interest to throw away £30m of customers' money in response to what is at best an unprofessional and unjustified request for funding out of time.

⁹ Ofgem, *Electricity Distribution Price Control Cost and Revenue Reporting - Regulatory Instructions and Guidance: Version 3*, April 2012, pages 51-52.

Chapter 10: Other elements of cost assessment

86. In Chapter 10, the Commission quantifies allowances for certain items of expenditure that are not covered by its benchmarking exercise or its analysis of capex costs.

87. Our comments are as follows.

Overall

88. We noted in our comments on chapter 8 that the additional opex allowances included on top of benchmarked opex of £51.5m are generous to NIE T&D and represent an increase upon the amounts that we considered should be allowed for those items. Some of the costs are a result of NIE T&D simply catching up with custom and practice in GB.

Metering costs

89. We recognise that there is a need to make a substantial investment in metering for the remainder of RP5 and (as noted above) agree with the investment proposals in the PD. However, we are concerned that an uncoordinated investment in 'dumb' meters (those that cannot support smart functionality) could lead to large amount of redundant investment thereby leaving stranded costs in the RAB. This is not in the customers' best interests and we therefore want to minimise the extent of such expenditure. We therefore ask that the following points are taken into account in the final determination.

90. We have appointed an Electricity Meter Examiner (from the National Measurement Office) under the Electricity (NI) Order 1992 (o paragraph 5(1) of Schedule 7 to the Order) and are presently liaising with the National Measurement Office and DETI on changes to the 1998 Regulations¹⁰. We hope to make significant progress in the next few months.

91. We are also working on our smart metering strategy for Northern Ireland and one of the outputs of this work will be a road map for implementation.

92. In light of those initiatives, we consider that there must be liaison between NIE T&D and ourselves in developing an RP5 three year Implementation Plan for metering capex. As a minimum this plan should include the strategy for the progressive

¹⁰ <http://www.legislation.gov.uk/nisr/1998/444/schedule/4/made>

replacement of existing meters, the procurement and market testing of all resources required, annual reviews to ensure new smart metering requirements can be adopted as soon as practical (and without any contractual termination costs). The Implementation Plan should be agreed as between us.

93. We also consider that reform of the RAB in respect of metering capex would be desirable. At present, metering capex is allocated to the general RAB that is depreciated over 40 years. That approach has resulted in stranded metering expenditure. We therefore propose that a new metering RAB is established with a depreciation period more aligned to actual metering life cycles (10-15 years) and operates as from the start of the RP5 price control. This change is even more important with the advent of smart metering that may have shorter lifecycles than dumb (non-smart) meters.
94. Finally, we note that the labour costs that the Commission has used to formulate its allowance for metering unit costs are based on NIE Powerteam's average labour cost. That is far too high. In reality, an efficient operator would employ cheap contracting labour to carry out this most basic of tasks. Customers are entitled to the benefit of lower market rates and the Commission should therefore adjust down the allowance that it has made for this item of cost.

Business rates

95. We are of the view that the Business Rates amount allowed for RP5 was generous. This amount has increased through the RP5 period, (in 09/10 prices) it was £13.1m in 12/13 which increased to £14.5m by 16/17. There was insufficient evidence provided to show that rates will increase over and above the initial 12/13 level. In addition to this, there is unlikely to be a significant increase in circuit length and transformer capacity on the network before the April 2015 Rates revaluation review.

Chapter 11: RPEs and productivity

RPEs

96. The Commission's overall approach to adjusting for RPEs accords broadly with our view of how RPEs should be incorporated into a price control framework.
97. There are, however, a few points of detail that we would like to highlight where the RPE adjustments seem to us to overstate the real prices that an efficient firm in NIE T&D's position has faced and will continue to face in the coming years, as discussed below. That is not to say that we think that NIE T&D should be allowed substantially less revenue overall, but they are points that we consider should be brought to the Commission's attention to assist with its preparation of the final determination.

Labour RPEs, 2010/11 to 2012/13

98. We note that the Commission has allowed for 3.25% per annum wage inflation over the three years 2010/11 to 2012/13. This matches almost exactly the average GB DNO union pay deal during this time (3.0%, 3.6% and 3.7%), and is significantly above the growth in economy-wide average weekly earnings during that period (1.6%, 2.0% and 2.0%). That seems to us to overstate the extent of wage inflation that an efficient company in NIE T&D's position would face, because it does not take into account the lower wage pressure in the contractor market that the Commission has identified.¹¹ It seems to us that, to be consistent with Commission's own remarks on this matter, a downward adjustment to the 3.25% figure is needed to capture the cost pressures that networks have experienced over the whole of their workforce.

Labour RPE, 2013/14 to 2017/18

99. There is a computational error in the Commission's forecasts of labour RPEs. The Commission's spreadsheet mistakenly inputs the value of average earnings growth for 2014/15 into the RPE calculation for 2013/14 (and so on for the rest of the forecast period). Because average earnings growth is trending upwards from a low base, this causes the Commission significantly to overstate the required allowance for RPEs.
100. We also note that the Commission has adjusted the OBR forecast up by 0.3 to 0.5 percentage points. This is said to be justified by the fact that average hours worked are

¹¹ See PD §§11.42(a), 11.46 and 11.48.

predicted to fall over the forecast period, and the Commission appears to think that this should mean that average hourly earnings will increase faster than average weekly earnings. We disagree. The reduction in hours worked may well reflect greater productivity, in which case hourly earnings need not increase faster than weekly earnings. We would urge the Commission to stick with the OBR set of forecasts since these are at least internally consistent, rather than adopt the inclusion of conjunctural analysis with the added complexity and risks this brings.

“Other” opex

101. We are disappointed that the PD does not mention our submissions in UR-83 that ‘Other’ opex is unlikely to move entirely in line with RPI inflation, not least because this element of the RPE analyses accounts for a sizeable 15% of total opex and 11% of capital expenditure. Given NIE T&D’s quite considerable allowance for IT related expenditure during RP5 (Enduring Solution alone accounts for some 13% of NIE T&D’s ‘Operating expenditure to be subject to RPEs and productivity’ with Capex for IT and Communications accounting for 3.6% of ‘Capital expenditure before RPEs and productivity’) we would urge the Commission to consider including the addition of our analysis of IT RPEs as part of the final determination. This will ensure the RPE analysis reflects NIE T&D’s considerable future expenditure in this cost category as well as accounting for the material and year-on-year downward move in the real costs of IT, which is also a very good proxy for the cost of telecoms.

102. Specifically, we ask the Commission to consider:

- (a) Including a 2% weight for IT related costs¹² in opex with ‘Other’ opex reducing its weight to a figure of 13% from 15%;
- (b) Including a 3.1% weight for IT related costs¹³ in capex with ‘Other’ capex reducing its weight to a figure of 7.9% from 11%; and
- (c) Calculating the IT RPE with reference to historical data from the ONS SPPI series for ‘Computer services’ (code: K8UK).

¹² Calculated using industry totals from Ofgem’s DPCR5 for IT&T (Information Technology & Telecoms) as a proportion of Network Operating Costs (NOCs), Closely associated indirects and Business Support Costs.

¹³ Calculated using industry totals from Ofgem’s DPCR5 for IT&T (classified as within Non-operational capex) as a proportion of Network investment and Non-operational capex.

103. If the Commission decides to stick with adoption of NIE specific weights in calculating RPEs we would ask the Commission to consider:
- (a) Including a 13% weight for IT related costs in opex with 'Other' opex reducing its weight to a figure of 2% from 15%;
 - (b) Including a 3.6% weight for IT related costs in capex with 'Other' capex reducing its weight to a figure of 7.4% from 11%; and
 - (c) Calculating the IT RPE with reference to historical data from the ONS SPPI series for 'Computer services' (code: K8UK).

Weights – labour, materials, equipment, etc.

104. The Commission states it has used NIE T&D's estimates of weights to bring together the line-by-line input forecasts into estimates of opex RPEs and overall capex RPEs. We are surprised by this approach. We had understood that the purpose of chapter 11 was to ascertain how benchmark levels of expenditure would change over time, not how NIE T&D's own costs would move. The Commission's selection of weights thus appears inconsistent with its introductory remarks in §1 of chapter 11.
105. Our principal concern is the one that the Commission identifies in §11.39. Unlike the Commission, we are very concerned that NIE T&D (and other companies that we regulate) will try to tilt the weights in their favour at future reviews and that we will be unable credibly to challenge NIE T&D's estimates.
106. It is worth noting Ofgem had also previously considered use of company-specific weights, which would effectively pass through NIE T&D's cost structure through to consumers, regardless of how in(efficient). Ofgem adopted 'common' weights to avoid setting in place perverse incentives which might otherwise reward inefficient business models or provide greater incentives for an inefficient firm to out-perform simply by shifting its cost structure towards that which might reasonably be expected to benefit it most from a favourable RPE adjustment.
107. In this instance, the difference in the RPEs that the Commission would calculate using Ofgem weights is material only for capex. This is because the opex weights submitted by NIE T&D are effectively the same as the 'common' weights adopted by Ofgem and our own determinations at RP5 using DPCR5 averages. We therefore suggest that the

Commission might first of all like to probe the basis for NIE T&D's choice of weights. We know from our own experience that it is very challenging to isolate the contributions of labour, materials, equipment, etc. to capex, not least given that costs are often located outside of the company within the supply chain. If NIE T&D is unable to give a satisfactory explanation for its weights, we would ask that the Commission uses Ofgem 'common' weights in its final determination, for both opex and capex.

Productivity growth

108. We note that the Commission's ongoing 1% per annum productivity growth assumptions align to the forecasts that the GB DNOs have made in their 2015-23 business plans. We agree that NIE should be capable of producing the same efficiencies.

Chapter 12: Pensions

109. Much of the Commission's analysis of the approach to pension costs mirrors our own approach. One key difference is that the Commission has proposed that future pension contributions (other than deficit repair) should be benchmarked rather than pass-through. We have no objections to that proposal.
110. There are, however, two issues of some importance with which we disagree with the Commission's provisional view
111. The first is the treatment of what the Commission refers to as "stranded deficit repair costs". We set out our concerns on the Commission's provisional conclusions on this matter in the introductory section of the response and explain our observations in more detail below. We urge the Commission to change this aspect of its determination, principally to protect customers from excessive prices in RP6 and RP7.
112. The second matter is the treatment of ERDCs, where we ask the Commission to reconsider the calculation of the costs for which NIE T&D's shareholder should be responsible.
113. We address these issues in turn below, and conclude with some queries as to the finer details of the Commission's proposed approach.

Stranded deficit repair costs

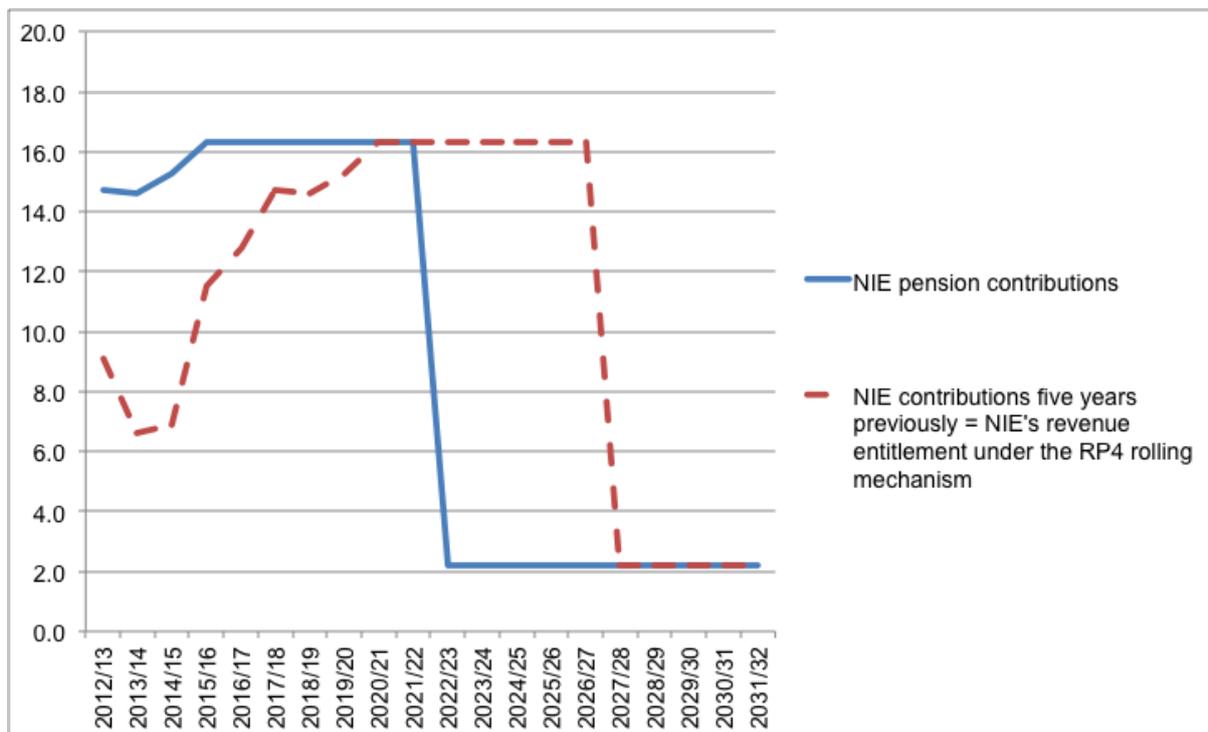
114. The core facts that are relevant to the stranded deficit repair costs issue are not in dispute:
- (a) During RP4, pension contributions were funded by a rolling mechanism, whereby the funding provided for contributions in year n of RP4 corresponded to the actual contributions made during year n of RP3;
 - (b) The RP4 FD did not contain any promise that the rolling mechanism would continue during RP5; and
 - (c) During RP4, NIE T&D's pension's contributions exceeded its allowance.
115. The Commission has provisionally decided that the rolling pension contribution mechanism should be replaced by a new policy in RP5, one element of which is that,

subject to removal of some ERDCs, customers should pay for the repair of NIE T&D's pension deficit. We agree with this new policy.

116. However, rather than calibrate the RP5 price control to fund the deficit to the deficit as it stood at 1 April 2012, the Commission has also provisionally decided that customers should pay for NIE T&D's £24m excess contributions during RP4. This amounts to a back-dating of the Commission's new pension's policy to 1 April 2007.
117. The effect of that back-dating is to re-write the RP4 settlement so that customers are now required to pay off the deficit as it stood on the first day of RP4. In our view, that approach is inconsistent with the Commission's strict rule against reopening past price controls other than in exceptional circumstances (as to which, see our comments on the Commission's PD in relation to capitalisation practices below). The mere fact that the Commission now thinks that its new pensions funding policy is a better one than the one that NIE T&D and we agreed should operate during RP4 is not a reason to reopen the RP4 settlement.
118. Moreover, the Commission's decision that customers should pay for the deficit as it existed on the first day of RP4 is arbitrary. There is no reason why that risk allocation should start at the beginning of RP4 (where it operates in NIE T&D's favour) and not, say, the start of RP2, when NIE T&D took a pension contribution holiday while continuing to receive funding for pension costs through its opex allowance. This, after all, is a contributing factor to the current mismatch between pension scheme assets and liabilities.
119. The retrospectivity in the Commission's provisional determination can further be seen by comparing the revenues that NIE T&D is entitled to under the Commission's new policy with the revenues that NIE T&D would receive if the RP4 pension rolling mechanism were left in place. Contrary to its assertions, NIE T&D could never have recovered the £24m excess contributions that it made during RP4, even if the rolling mechanism had been allowed to continue indefinitely. As noted above, the rolling mechanism did not provide for a straight true-up, in which excess contributions in one period are added to the next period's allowed revenues. Rather, the rolling mechanism provides for the pension allowance in year n to be set with reference to actual contributions in year $n - 5$. This has two important implications:

- (a) the pension allowance to which NIE T&D would have been entitled in RP5 if the rolling mechanism had been continued is significantly lower in RP5 than the contributions that NIE T&D will make to its pension fund in RP5; and
- (b) there would be no recovery of excess RP4/RP5 contributions under the rolling mechanism until the pension deficit is fully repaired – i.e. in RP7, under NIE T&D’s 13-year recovery plan.

120. This can be seen graphically in the chart below.



121. In the attached spreadsheet UR-149 (Pensions rolling mechanism vs. RP5 approach) we show that the present value of the revenues that NIE T&D would receive if its pension allowances were set according to the RP4 rolling mechanism (i.e. the dotted red line) exceed the present value of NIE T&D’s projected future contributions (i.e. the blue line) by only £11m. This £11m is the maximum possible loss that NIE T&D can claim to suffer as a result of the discontinuation of the RP4 licence condition, not £24m.¹⁴

¹⁴ In UR-77 we also calculate the loss that NIE T&D would suffer if its future contributions are in line with the Commission’s assumptions (i.e. with deficit repair over a 15-year recovery period). The loss in this case is £7m, which may be a better characterization of the effect of the PD.

122. In summary, therefore, the position is as follows. The Commission’s provisional view (with which we agree) that customers should now pay for the repair of NIE T&D’s current pension deficit does not justify the reopening of the RP4 settlement to apply that policy retrospectively. Moreover, even if it were right to compensate NIE T&D for the costs that have been “stranded” by the change in policy, the most that could possibly be required to achieve that compensation is £11m, not £24m.

ERDCs

123. We welcome the Commission’s provisional view that ERDCs should be stripped out of the deficit that customers are required to repair. We also welcome the Commission’s view that NIE T&D’s past shareholder contributions had nothing to do with ERDCs. However, we ask that the Commission reconsider its approach to quantifying the extent of the ERDCs that should be stripped out.

124. In §§12.45(c) and (d), the Commission accurately summarises the submissions that NIE T&D and we made in relation to that calculation. The key differences between our submissions are that:

- (a) NIE T&D in its analysis of leaving dates excluded retirements that were anticipated in the MMC RP2 report; and
- (b) NIE T&D claimed that 70% of the cost reductions from the early retirements were opex savings, and 30% were capex savings. We argued, however, that only approximately 5% were capex savings.

125. The Commission could not decide between the representations that it received on these issues.¹⁵ We are conscious that the debate between the parties on this issue took the form of a somewhat messy email exchange, and would therefore like to take this opportunity to restate and clarify our position:

- (a) On the first issue, the rationale for excluding “MMC leavers” rests on the assumption that the MMC headcount reduction was achieved through natural wastage or through a voluntary severance package that was fully funded within the RP2 price control – i.e. these individuals did not contribute to early retirement deficiency costs.¹⁶ In practice, we believe that some of the MMC leavers were

¹⁵ PD §§12.46 (including footnote 27 in particular) and 12.47.

¹⁶ See paragraphs 2.154-2.155 of and paragraph 11 in appendix 2.8 to the 1997 MMC report.

given early retirement pension benefits that NIE T&D funded out of the pension scheme surplus. We note that a simple query to NIE T&D will establish the facts of this matter; and

- (b) On the second issue, NIE T&D's assertion that 70% of the salary benefits obtained from early retirement resulted in lower opex and 30% resulted in lower capex is plainly not correct. NIE T&D significantly increased its investment between 1992/93 and the end of RP2, so 95% of the staff cost savings in 1997/98, 1998/99 and 1999/00 were recorded as opex and only 5% were recorded as capex. We show this in UR-82C.

- 126. For those reasons, we ask that the Commission reconsiders this calculation, and strips out 45%, rather than 30%, of the ERDCs.

In-period adjustment mechanism

- 127. The PD includes proposals for an adjustment mechanism, in which NIE T&D's price control could be moved up or down if: (a) NIE T&D pays down the deficit more quickly or more slowly than the Commission assumes; and/or (b) contributions move up or down following the next triennial valuation.
- 128. We are not convinced of the wisdom of (a), especially in light of the Commission's proposal to true-up differences between actual and allowed contributions using the full NIE T&D cost of capital. The Commission's 15-year notional recovery period has a purpose – it protects today's customers from bearing too high a burden in respect of pension deficits which they did not cause and which relate to services enjoyed by a previous generation of customers. It seems to us that (a) is tantamount to permitting NIE T&D to disregard the Commission's conscious policy decision to spread deficit repair costs over a 15-year period rather than any shorter period that it might agree with the trustees.
- 129. We also have a number of questions about how (b) would work in practice. It would be helpful if, prior to our hearing, the Commission could provide further detail of the mechanics behind its adjustment mechanism, so that we can understand how the price control reacts to both upward and downward movements in the deficit, including the possibility that the pension fund might move into surplus.

Chapter 13: Allowed rate of return

130. We are pleased that the Commission has conducted a fresh analysis of NIE T&D's cost of capital and given the parties the benefit of the substantial expertise that the Commission has in this area. The fact that the Commission has come out with a lower number than we adopted in our FD accords with our view that the cost of capital has fallen since we carried out our analysis in 2011.
131. We especially endorse the Commission's analysis of the so-called "NI risk premium". We have heard much about this alleged premium during the last two years, and yet it has been reported that Phoenix Natural Gas changed hands at a premium of 40% to its regulatory asset value during the summer in a deal that demonstrates the extent to which investors believe they can outperform the overall package of economic regulation in Northern Ireland. In the circumstances, we consider the Commission's analysis to be the right pragmatic response to the theoretical arguments that have been put to it.
132. Turning to the points of detail, we have noticed that a number of the Commission's judgments are quite generous to NIE T&D. In particular, (i) the inflation assumptions used in the cost of debt calculation seem to us to be too low, resulting in a real cost of debt that is too high; and (ii) the asset beta for NIE T&D seems to us to be too high, which pushes up the cost of equity. We would ask the Commission to reconsider these two issues in light of the submissions below.

Cost of debt

133. The Commission's proposed real cost of debt is the Commission's calculation of NIE T&D's nominal interest costs stripped of RPI inflation. The Commission correctly observes that the bulk of NIE T&D's RP5 interest costs have already been fixed, which means that the key number in the cost of debt analysis is the size of the RPI adjustment.
134. We note that the Commission allows for RPI inflation of 2.8% per annum when converting NIE T&D's embedded debt costs from nominal to real and uses the mid-point of a 2.7% to 3.2% range (i.e. 2.95%) when converting new debt costs. This surprised us for two reasons:

- (a) first, there is no reason why the allowance for inflation should be different in different parts of the calculation. Indeed, there is no reason why the assumptions about inflation in the cost of capital should be any different from the assumptions that the Commission is making about RPI inflation in the rest of the price control analysis; and
 - (b) second, we do not consider it is tenable to think that average RPI inflation will be less than 3% during RP5.
135. It is perhaps helpful at this point to recap on the reason why the Commission needs to convert a nominal cost of debt into a real cost of debt.
136. The return that NIE T&D gets from its price control comes in two parts:
- (a) the first is the real rate of return that goes directly into the calculation of allowed revenues; and
 - (b) the second is the indexation of NIE T&D's RAB in line with out-turn RPI inflation.
137. This structure makes regulated companies very similar to index-linked assets. It follows that if the Commission wants NIE T&D to receive exactly its 6.5% nominal cost of embedded debt or its ~5.7% nominal cost of new debt, it has to allow pound-for-pound for the value that it is expecting NIE T&D to get from the indexation of its RAB during RP5. This requires the Commission to obtain the best possible forecast of RPI inflation between 1 April 2012 and 30 September 2017.
138. Elsewhere in the PD – e.g. in the analysis of RPEs – the Commission has judged that the best available forecast of inflation is the most recent Office for Budget Responsibility (OBR) forecast. We agree with that approach. It is therefore quite logical that the Commission should also strip out the OBR's estimate of average annual inflation when converting nominal costs of debt to real.
139. We calculate that the OBR forecast of average annual inflation between April 2012 and September 2017 is 3.25%. We consider that this is the number that the Commission should have used throughout its cost of debt analysis – a significantly higher number than appears in the PD.
140. The Commission mentions three alternatives.

- (a) HM Treasury forecasts – we assume that ‘HM Treasury forecasts’ refers to the monthly survey of independent forecasts that the Treasury posts on its website. The latest survey was published on 20 November¹⁷ and the average forecast has inflation running at between 3.1% and 3.5% throughout the 2013-17 period;
- (b) CPI-RPI differential – the Commission states that the government’s 2% CPI inflation target has historically converted into RPI inflation of 2.8%. This is an out-of-date rule of thumb. The changes that the ONS made to the measurement of prices in 2010 increased the ‘formula effect’ and widened the natural gap between CPI inflation and RPI inflation to around 1.4 percentage points.¹⁸ This means that CPI inflation of 2% is now best thought of as converting to RPI inflation of 3.4%; and
- (c) gilt market readings – the Commission references estimates of gilt market break-even inflation. There is a large literature that cautions against using such measures as a forecast of future inflation.¹⁹ These warnings are especially pertinent at a time when the Bank of England is actively intervening in the gilt market and distorting prices.

141. The two credible alternatives (i.e. HM Treasury forecasts and the updated CPI-RPI differential) therefore broadly corroborate the OBR estimate.

142. Had the Commission used a 3.25% RPI inflation adjustment consistently across its cost of debt calculations, we calculate that the Commission would have found NIE T&D’s real cost of debt to be 3.0%. This is 40 basis points lower than the 3.4% figure that the Commission uses in its PD.

¹⁷ Available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/260252/201311_ForecastComparison.pdf

¹⁸ The OBR have a helpful analysis of this change in a recent research paper: <http://cdn.budgetresponsibility.independent.gov.uk/Working-paper-No2-The-long-run-difference-between-RPI-and-CPI-inflation.pdf>

¹⁹ See, for example, Hughes (2009), Understanding and addressing the pension liabilities of regulated utilities – a paper for the Regulatory Policy Institute, in which Professor Gordon Hughes, Chairman of the Water Industry Commission for Scotland, observes that [The yield curves for nominal and index-linked gilts are] potentially a very unreliable source of information about inflation expectations. Other references include: Golden, Adams, Liu and Sorensen (2010), Forecasting UK inflation: an empirical analysis; Garcia and van Rixtel (2007), Inflation linked bonds from a Central Bank perspective; and Deacon and Derry (1994), Deriving expectations of inflation from the prices of UK government bonds.

143. We therefore consider that the Commission in its PD over-estimated the real cost of debt that it has to give NIE T&D in order that the company should be in a position to recover the estimated nominal interest costs. The combination of the allowed real cost of debt and expected RAB indexation significantly exceed the interest payments that the Commission expects NIE T&D to have to make to lenders.

Cost of equity

144. The PD calculates NIE T&D's cost of equity by combining estimates of the risk-free rate, equity-risk premium and NIE T&D's asset beta. The first two parameters are not company- or industry-specific in nature and we recognise that the Commission has far greater expertise in these areas than either ourselves or NIE T&D.

145. The estimate of beta does, however, require an understanding of sector-specific matters. We expressed surprise in September 2013 when we received the Commission's cost of capital working paper and saw that the Commission wasn't proposing to do any work in this area. We were pleased to see that the Commission responded to our concern on this point, but would suggest that the Commission has come out with a very high beta range.

146. There are a number of reasons for this.

147. **First**, the Commission has made reference to empirical betas for SSE, National Grid, Pennon, Severn Trent, and United Utilities. We would suggest that the inclusion of SSE in this list is odd. There is no such thing as a perfect comparator, but SSE derives less than half of its profits from its network assets, with the remainder coming from generation and energy retail activities.²⁰ In a relatively small dataset of five companies, the Commission is thus rewarding NIE T&D for the higher risks that can be found elsewhere in the electricity industry value chain.

148. **Second**, the Commission gives equal weight to beta estimates derived from daily and monthly data. This is a departure from the Commission's approach in the Bristol Water, Stansted and Heathrow/Gatwick price control inquiries, where the Commission

²⁰ See

http://www.sse.com/uploadedFiles/Controls/Lists/Reports_and_Results/SSEplcAnnualReport2013.pdf

focused exclusively on beta estimates derived from daily data. The Commission explained the logic for this approach in its 2007 Heathrow/Gatwick inquiry report:²¹

BAA suggested that we should place more weight on estimates obtained from monthly data. While this might be preferable for companies whose shares are thinly traded, we are not persuaded that such considerations are relevant for BAA as a former FTSE-100 company. By using daily data and relatively short estimation periods, we obtain much more up-to-date insights into shareholders' perceptions of the riskiness of BAA.

149. It seems to us that the same logic applies in this case.
150. **Third**, the Commission quotes and makes use of 95% confidence intervals for its beta estimates. This is also a departure from the Commission's approach in previous inquiries, when the Commission has taken point estimates as the best available measure of beta.
151. **Finally**, the Commission focuses on the top ends of the confidence interval ranges on the grounds that "*the Northern Ireland regime may be less well understood by investors*". This is an extraordinary statement to make in the middle of a Commission inquiry. We would respectfully suggest that NIE T&D's shareholder has, during the last 12 months, spent the most time of all owners of regulated companies looking at the fine detail of the regulatory framework for the company it owns. It cannot possibly be that NIE T&D's equity provider does not understand the regulatory regime.²²
152. The effect of the above four factors is that the Commission has, in our view, significantly overstated NIE T&D's beta.
153. This can further be demonstrated by comparing the Commission's PD beta range of 0.4 to 0.45 with the 0.36 estimate it made of a water and sewerage company's beta asset beta in the 2010 Bristol Water inquiry²³ – a comparison between companies

²¹ Competition Commission (2007), BAA Ltd – a report on the economic regulation of the London airport companies (Heathrow Airport Ltd and Gatwick Airport Ltd), appendix F, paragraph 108.

²² A parallel may be drawn here to the line that the Commission has previously taken on small company premia. In *Bristol Water*, the Commission suggested that there may be a case for giving small listed companies a small company premium on the cost of equity. However, it declined to give Bristol Water such a premium on the grounds that the real-life Bristol Water was not a listed company. The same argument would suggest that ESB should not be given any premium as a result of the ignorance that a non-existent set of hypothetical shareholders might have about the Northern Ireland regulatory regime.

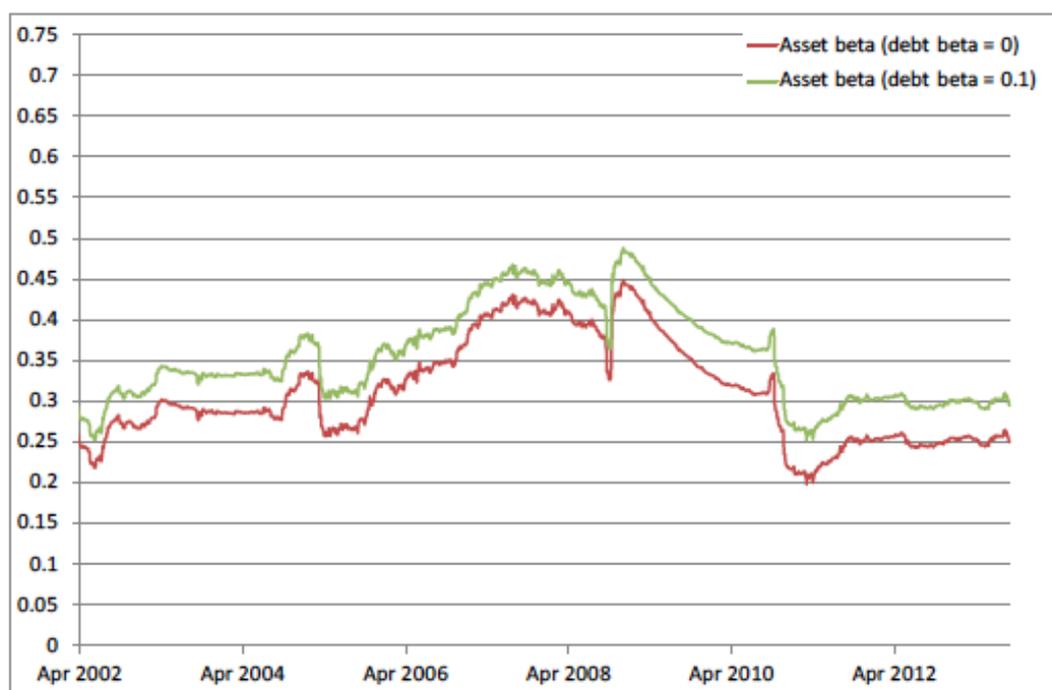
²³ This is the 'base' beta that the Commission awarded Bristol Water prior to giving an uplift on account of Bristol Water's atypical opex:revenue ratio. See paragraph 150(d)(iii) of the inquiry report.

regulated under standard five-year RPI X regulation and, hence, with very similar risk profiles.

154. Looked at side-by-side, the Commission's calculations across the two inquiries suggest that utility betas have gone up quite considerably in the last the last three years, increasing regulated companies' cost of equity and cost of capital. However, all of the empirical evidence suggests that betas have actually fallen in this time as investors have come to better appreciate the low risk nature of the sector. This can be seen very clearly in the charts in the PD, like the one that we reproduce below.

FIGURE 3

Two-year asset beta for utility portfolio



155. The transition from Bristol Water to NIE T&D therefore seems disjointed. We think that a consistent application of the same principles and estimation techniques ought to have led the Commission to an asset beta for NIE T&D of around 0.3 and that the Commission is over-rewarding the risk that NIE T&D's shareholders bear in its provisional determination.

Chapter 14: Unresolved RP4 issues

156. We welcome the Commission's response to NIE T&D's attempts to reopen issues that arose during RP4. We agree with the Commission's provisional view that, absent a public interest justification, the RP4 settlement should not be reopened on this inquiry. That proposition has run consistently through all of our submissions on this inquiry, including in relation to both the pensions issues discussed above and the capitalisation issues discussed below.

Chapter 15: Capitalisation practices

157. In the PD, the Commission has provisionally decided not to make any adjustment to NIE T&D's RAB in respect of its capitalisation practices during RP4. The Commission's reasoning on this point is a source of concern for us. The Commission has provisionally found in §15.64 that NIE T&D pursued a deliberate policy of inconsistently classifying expenditure from opex to capex, with the result that customers are now being asked to pay twice for the same item of expenditure. The Commission noted in that paragraph that the extent of that double-funding is non-trivial. Notwithstanding those findings, the Commission's provisional view is that the public interest requires customers to pay a second time for work that they have already funded during RP3/RP4. If that provisional conclusion is maintained in the Final Determination, we are concerned that a dangerous precedent will have been set.
158. The Commission's provisional view seems to be that the 'regulatory contract' is similar to the social contract between the State and its taxpayers that is embodied by (for example) the UK tax code, whereby anything that is not expressly forbidden by the regulator is permitted for the utility. Moreover, the Commission also seems to be endorsing the corollary of that proposition, namely that a regulator cannot do anything that it has not expressly signalled that it can or will do. In our view the regulatory contract in the context of UK economic regulation has never taken that form. It is neither practicable nor desirable for a regulatory framework governing something as complex as the operation and maintenance of an electricity network to be written down in its entirety in decision documents and licence conditions. There will always be gaps, and the legal and economic framework between customers and investors requires that the regulator should step in as necessary to fill those gaps, acting always in accordance with its statutory duties.
159. Moreover, and as discussed in more detail below, contrary to the Commission's provisional view, NIE T&D's capitalisation practices cannot fairly be blamed on the structure of the RP4 price control. Although it is right to say that the RP4 price control was flawed, and that it did provide the opportunity to profit from shifting expenditure from opex to capex, the RP4 price control had that in common with virtually every other model of economic regulation found in the UK at the time. It is in any event wrong to suggest that the RP4 price control permitted pure reclassifications of opex to capex: NIE T&D's Composite Proposal – offered by NIE T&D and accepted by us –

was clear that expenditure should be remunerated through either opex or capex but not both.

160. If the interpretation of the regulatory contract that the Commission appears to be provisionally supporting were to be confirmed in the FD, we would expect regulated utilities such as NIE T&D to perceive that they have *carte blanche* to exploit the loopholes that inevitably arise in all price controls, at customers' expense. That cannot be in the public interest. That view of the world would encourage regulated companies to scour each new price control framework for get-outs (and keep quiet about the issues that they uncover until a regulator has made a determination so that shareholders can extract maximum benefit from those get outs). Regulators would in turn have no option but to write ever-longer decision documents and ever more detailed licence conditions in an attempt to make their regulatory regimes watertight.
161. In the context of this specific inquiry, we would respectfully suggest that the Commission's proposed framework for capex regulation would be vulnerable to gaming. We do not doubt that the Commission has thought hard about possible RP5 scenarios, but we would also be surprised if the Commission were to claim that its proposed new rules deal with all possible eventualities. It would be of considerable concern if NIE T&D were to think, based on the position that the Commission has taken on capitalisation in this inquiry, that it has permission to exploit the boundaries that exist between different types of capex and different time periods or that the Commission will back the company rather than the regulator if we try to correct for the effects of gaming at the RP6 review.
162. The Commission has stated in relation to its provisional determination in capitalisation practices that *"flaws in the overall design of RP4, rather than there having been a clearly delineated and mispecified allowance incorporated into the RP4 price control settlement."* According to the Commission, those *"flaws gave rise to the risk that NIE would be able to outperform the controllable opex allowance as a result of any improvements that NIE might be able to make in its ability to identify all of its capex"*. We accept that RP4 created a stronger incentive to capitalised opex activities that existed before, however it should be noted that the Commission's provisional determination creates a stronger incentive to defer capex than we have seen before.
163. We therefore ask the Commission to think very carefully about the message that its provisional findings on capitalisation send. We appreciate that this has been a difficult

workstream in the inquiry and that quantification of past cost reclassification is not straightforward. However, we also believe that a decision on the Commission's part to make zero adjustment and to ask customers to pay twice for the same expenditure will have long-term detrimental consequences across the sectors we regulate and therefore operate against the public interest.

164. In this section, we begin by addressing the reasons given by the Commission for its provisional finding. We then briefly address the issue of tree cutting, in respect of which we think that the Commission has misread the evidence. Finally on the topic of the adjustment to NIE T&D's RAB, we identify a limited category of reclassification where the issue of quantification is clear, and propose that, at the very least, an adjustment should be made in respect of the sums identified in NIE T&D's submissions of 26 September 2013²⁴ which identified specific instances of reclassification – i.e. approximately £4.4m increase in Capitalised R&M from 2004/05 to 2010/11. In addition, we respond to the Commission's provisional conclusion as to whether changes need to be made to the period of time over which tree cutting is remunerated through the RAB.

The Commission's reasons for requiring customers to pay twice for the same work

165. Between §§15.66 and 15.87, the Commission identifies a series of factors that it considers are relevant to the question of whether an adjustment should be made. We agree that those are all relevant factors, but disagree with much of the Commission's analysis of them. They are addressed in turn below.

Regulatory certainty

166. The Commission places considerable importance on the issue of regulatory certainty (§§15.66-15.70). Central to the Commission's analysis of this point is its view that:

“The regulatory ‘contract’ (or understanding) is that firms, on the one hand, should have the confidence to invest and plan for the future confident that the regulator will not revisit the rules of a regulatory agreement after the event, and that, on the other, consumers should in the longer term reap the benefits of efficiency savings realized through outperformance. Therefore revisiting the terms of previously set price control should generally be avoided because it

²⁴ NIE T&D's email response to the CC's R&M queries of 11 September-- Repairs and maintenance response 26 Sept 13.pdf

undermines the regulatory contract or understanding by which firms in regulated industries operate, and therefore their confidence to act long term.”²⁵

167. We agree with this statement as a general principle. We also agree that the principle has to be applied within limits, as implied by the Commission’s use of the word ‘generally’.
168. In our experience, companies and their investors understand that regulatory rules can sometimes have unforeseen consequences and that a regulator has a right to step in and correct matters if the interests of customers are materially prejudiced to the benefit of shareholders (or vice versa). We give examples of past actions of this sort in the accompanying paper UR-151²⁶ across a range of regulated sectors.
169. In relation to the specific issue that is being considered in this inquiry, we do not think that action to correct for unforeseen reclassification of opex to capex, or to stop customers from paying twice for the same work, would adversely affect the way in which companies view future incentive mechanisms or cause investors to lose confidence in the regulatory regime. It is much more likely that investors would recognise the Commission’s actions as a self-contained remedy to a unique set of circumstances. That is to say that they would accept, as they have always done in the past, that it is unfair for a regulatory regime to produce perverse outcomes and unreasonable to expect a regulator to stand by and let such outcomes go uncorrected.
170. The Commission’s concern about regulatory certainty in this case, however, seems to be driven largely by its view that the double funding arising from NIE T&D’s capitalisation practices is attributable primarily *“to flaws in the overall design of RP4, rather than there having been a clearly delineated and mispecified allowance incorporated into the RP4 price control settlement.”*²⁷ According to the Commission, those *“flaws gave rise to the risk that NIE would be able to outperform the controllable opex allowance as a result of any improvements that NIE might be able to make in its ability to identify all of its capex”*.²⁸

²⁵ PD §15.66.

²⁶ UR-151 Correcting for unforeseen outcomes-Regulatory Precedent

²⁷ PD §15.68.

²⁸ PD §15.68

171. We are concerned that this overstated the importance of the RP4 price control design in relation to the inappropriate activities carried out by NIE T&D.
172. The RP4 price control design was no different from other price controls that were set in the UK from the 1990s until around 2009, in that all price controls of this generation on the face of it offered reward to companies that reclassified opex as capex. This is because regulators' opex allowances have traditionally been fixed allowances, whereas capex allowances have been adjustable ex post in light of a company's actual expenditure – i.e. a company that underspends on opex by £1 has traditionally kept £1 of additional profit, whereas a company that overspends by £1 on capex has traditionally been entitled to collect extra revenue from customers.
173. The RP4 design slightly amplified the rewards for reclassification by providing for immediate pass-through of new capex to the RAB rather than the lagged adjustment²⁹ that is seen in most other regimes. This increased the rewards for reclassification from approximately 85p per £1 reclassified under more standard price controls to £1 for every £1 reclassified. Had the RP4 price control had a 'standard' design, a debate about ~£36m of RAB additions would merely have become a debate about ~£30m of RAB additions³⁰ – i.e. there would still be ample reason for the Commission to investigate whether it is in the public interest for customers to pay for RAB additions that came about purely as a result of a change in cost classification.
174. This means that it cannot be said that the unique design of the RP4 price control created a unique problem. Similar rewards for cost reclassification have been apparent in all previous airport, rail and water RPI – X price controls and all pre-2009 energy RPI – X price controls, including price controls set by the Competition Commission. It would be acting with the benefit of considerable hindsight to state that we should or could in 2006 have set a price control that eliminated the problems that cost reclassification causes.
175. That is not to say that regulatory certainty is irrelevant to the question of whether an adjustment should be made. On the contrary, we think this is absolutely key. When

²⁹ In most regulatory regimes, forecast capex is replaced by actual capex either at the next periodic review or with a fixed lag of five years. . This means that each £1 of extra capex generates a RAB addition of at least 85p – i.e. the original £1 of expenditure less a maximum of five years of foregone depreciation (assuming a depreciation rate of 3% per annum).

³⁰ That is to say that £36m of costs reclassified from opex to capex would have resulted in RAB additions of $£36m \times 85\% = \sim£30m$ in most other RPI – X regimes.

considering whether an adjustment is necessary, the right question as far as regulatory certainty is concerned is whether the adjustment that is *prima facie* required in the public interest is consistent with the principles underpinning the RP4 price control.

176. The point can usefully be tested in the following way. If at the time of the negotiation of the RP4 price control, a bystander had asked “*does this mean that NIE can just unilaterally reclassify expenditure that used to be opex as capex, without any change in the underlying activity, so that customers end up paying twice?*” what would NIE T&D, its investors and we as regulator have said in response? There is really only one possible answer to that question.
177. Helpfully, the Commission doesn’t have to guess at the answer to that question, because NIE T&D answered it in advance in the terms of its Composite Proposal for the treatment of opex and capex in RP4. NIE T&D said, and we accepted that “*For regulatory purposes actual expenditure is recovered either via the RAB over 40 years or via the opex allowance but not both*”.³¹ Given that the stated purpose of the RP4 opex/capex mechanism was to avoid double-funding, there is no room for doubt as to whether an adjustment to NIE T&D’s RAB would be consistent with the principles underlying RP4. Without such an adjustment, the key underlying principle would be jeopardised. It follows that regulatory certainty and respect for the regulatory contract is therefore a strong reason in favour of making an adjustment, rather than a reason against doing so.

Customers funding expenditure on activities more than once

178. The next factor considered by the Commission is the presence of double-funding (§§15.71-15.74). In that regard, the Commission recognises that “*a simple reclassification of expenditure [of the kind that NIE T&D has undertaken] gives rise to an outperformance that does not reflect efficiency gains*”, and that that NIE T&D’s capitalisation practices will cause customers to pay more than they should.³² We strongly endorse those provisional findings.
179. But that is no answer to the case for an adjustment to be made in respect of the part of NIE T&D’s outperformance that does reflect mere reclassification.

³¹ As noted in PD §15.24.

³² PD §§15.72-15.73.

180. The Commission says that it is “*relevant that the UR had not specified that the rolling opex allowance had been set with the intention of covering similar items of expenditure as had been incurred in the previous period. Rather, it was in effect a general allowance, which NIE was incentivized to outperform in various ways including changes in its mix and levels of opex*”.³³ The Commission does not identify the factual or evidential basis for the second sentence in that provisional finding. Although no specific intention was identified within the seven pages of the RP4 final determination, as explained above, the purpose of the opex/capex mechanism was expressly identified in NIE T&D’s Composite Proposal which was adopted in the RP4 price control. That purpose was to ensure that expenditure was remunerated either through opex or capex but not both.
181. As discussed above, the RP4 design could not possibly have worked without the starting assumption that opex would comprise a consistent set of costs over time. It would also clearly be contrary to that purpose to allow NIE T&D to profit from a simple reclassification. The operation of the Dt term in the RP4 price control illustrates that the rolling opex mechanism was intended to cover opex in the sense that the term ‘opex’ had previously been understood. In particular, the fact that NIE T&D sought funding for new categories of opex under the Dt term during RP4 demonstrates that NIE T&D understood its opex allowance to be defined by reference to the categories of work that it had undertaken during RP3.

NIE T&D’s intent

182. The third factor considered by the Commission is NIE T&D’s intent (§§15.75-15.78). In that regard, the Commission says that “*with the elapse of time it is not possible to establish the precise intent of NIE*”.³⁴ It is fair to say that a considerable period of time has now passed since the events of 2005-2006 that lie at the heart of this issue. But our investigation started in 2010, when the evidence was considerably fresher. Notwithstanding that position, NIE T&D never produced a satisfactory account of the motivation for its conduct in this period. Given that all of the evidence has always been in NIE T&D’s hands, the fact that it has refused to produce any evidence provides a sound basis for adverse inferences to be drawn against it.

³³ PD §15.74.

³⁴ PD §15.76.

183. In any event, NIE T&D must have known the impact that its reclassification exercise would have on customers' bills. A company that puts the interests of its customers first (and especially in light of the high level nature of the RP4 price control) would have expressly brought this issue to our attention and would not now be pushing so hard to be allowed to charge customers twice for the same expenditure. To paraphrase the Commission's provisional finding at §15.77, if NIE T&D had acknowledged the detriment that customers suffer before we did, "*it would have allowed the UR to have much more effectively engaged with NIE and addressed these issues on a timely basis*".³⁵ Given that NIE T&D sought and was granted a "light touch" regulatory framework for RP4, involving minimal monitoring and reporting, it cannot now complain that we did not identify these issues earlier. The flip-side of a light touch regulatory framework must always be scrupulous good faith and transparency. Unless the Commission is satisfied that NIE T&D met that standard, it should not treat the passage of time as a reason to make customers pay for NIE T&D's capitalisation practices.

Robustly estimating the adverse effect

184. The fourth factor considered by the Commission is the ability robustly to estimate the adverse effect (§§15.79-15.80). In that regard, the Commission has provisionally concluded that "*there is no reliable way of disentangling the extent of the reclassification from other effects, including those arising from efficiency gains*".³⁶ That is in itself a sad indictment of NIE T&D's asset management record systems. All of the evidence as to the extent of NIE T&D's reclassifications and efficiency gains has always been (or at least should have been) in NIE T&D's hands. Customers should not be required to pay for NIE T&D's failings.

185. In any event, however, there is no reason why the difficulty in reaching a robust estimate should prevent the Commission from making any adjustment at all. Many aspects of a price control (including future capex requirements, predictions of unit costs, costs of capital, etc) are difficult to estimate precisely and require the exercise of judgment. But it is widely accepted, including by the Commission in this inquiry, that the difficulty in estimating those elements of the price control is not a reason to assume everything in the regulated company's favour. On the contrary, the public interest requires that the Commission should take the best estimate it can and work

³⁵ PD §15.77.

³⁶ PD §15.80

with that. A good illustration of this point is the approach that the MMC took in its 1997 report in relation to NIE T&D in which it sought to identify that portion of NIE T&D's outperformance in RP1 that represented genuine efficiency.³⁷

186. Even if the Commission were right to place greater weight on the risk of "*inadvertently penalizing NIE for outperformance of its controllable operating cost allowance through genuine efficiency gains*" than on the corresponding risk of inadvertently penalizing consumers for NIE T&D's change in approach to capitalisation,³⁸ the Commission could, at the very least, make a small adjustment which would clearly be an underestimate and therefore would give rise to no risk of inadvertently penalizing efficiency. How that adjustment might be made is discussed below.

Materiality

187. The fifth factor considered by the Commission is the materiality of the adverse effect (§§15.81-15.82). In that regard, the Commission concludes that "*NIE's outperformance was not likely to have been attributable mainly to reclassification effects*".³⁹ The Commission notes, in particular, that "*there was a substantial decrease in other opex between RP3 and RP4 in relation to which the UR has not alleged that NIE had changed its capitalization practices*".⁴⁰ Nevertheless, as noted above, the Commission accepts that the extent of reclassification was not trivial. In our view, while the scale of the effect is clearly relevant to the quantum of adjustment that would be justified, if the adverse effect is more than trivial, then at least a non-trivial adjustment ought to be made.

Revisiting past settlements

188. Finally, the Commission considered the undesirability of revisiting past settlements (§§15.83-15.85). It is not clear to us how this issue differs from the issue of regulatory certainty discussed above. In any event, the Commission's view that a factor militating against taking action is that "*the regulator and the firm will have reached settled expectations about the rules applying in the past*" rather begs the question as to how the RP4 price control was intended to operate. As explained above, in our view, the

³⁷ NIE 1997 Reference Final Report §§2.106-2.118.

³⁸ PD §15.79.

³⁹ PD §15.82.

⁴⁰ PD §15.82.

principles underlying the RP4 price control strongly support an adjustment now being made.

Summary

189. For all of those reasons, we urge the Commission to reconsider its position of principle that an adjustment should not be made. Ultimately, the question that remains unanswered is why it is in the public interests for customers to be required to pay during RP5 and beyond for work that they already paid for during RP4.

Tree cutting

190. We do not propose to rehearse in this response all of the detailed evidence of reclassification of expenditure that has been presented to the Commission over the past months. Rather, in this section we address one major issue in respect of which we think the Commission has erred, and which we are concerned might be partly responsible for the Commission's overall assessment of the materiality of this capitalisation issue. That issue is NIE T&D's approach to capitalising tree cutting.

191. Throughout this inquiry, NIE T&D has claimed that it has always applied a consistent approach to capitalising tree cutting, in that reactive tree cutting has always been expensed and programmatic tree cutting has always been capitalised. According to NIE T&D, what changed in the final years of RP3 was the establishment of a new, five yearly programme of tree cutting known as TAR. The Commission appears to have provisionally accepted that account.

192. In our view, that provisional conclusion is unsustainable. There is a factual dispute before the Commission as to how NIE T&D capitalised tree cutting before the establishment of the TAR. Our case is that NIE T&D has always cut trees on a five-yearly programmatic basis, and that historically the costs involved in that programme were expensed. It was only the 15-year programme of tree cutting (which has always been part of a full refurbishment of the overhead network) that was capitalised historically. All that changed at the end of RP3 was that the five-yearly tree cutting programme was relabelled TAR, expanded, and capitalised.

193. It is axiomatic that factual disputes must be resolved by reference to the evidence. The best evidence as to how NIE T&D capitalised tree cutting in the past is its capitalisation policy documents. We have discussed these at length in our submissions to the

Commission, and explained that every contemporaneous document that we have unearthed supports the proposition that NIE T&D used to expense five-yearly programmatic tree cutting.⁴¹ NIE T&D has never produced a single document that supports its case on this point. The only evidence to which the Commission refers is a table of opex and capex data for NIE T&D's tree cutting from RP2 to RP4. The Commission states that Table 1 shows that "*the most significant development over the period presented was the dramatic increase in programmatic tree cutting*".⁴² But the word "*programmatic*" does not appear anywhere in Table 1. All that Table 1 shows is that there was a dramatic increase in capitalised tree cutting over time, and a smaller decrease in expensed tree cutting. It sheds no light at all on the question of whether that increase reflected a relabeling of the 5-yearly programme as capex (as we argue) or whether it reflected no more than the expansion of a category of work that was always capitalised (as NIE T&D argues).

194. In the absence of any evidence to the contrary, we respectfully submit that the Commission must proceed on the basis that NIE T&D changed its approach to capitalising tree cutting in the last years of RP3, so that five yearly tree cutting was reclassified from opex to capex. In that regard, it has recently come to our attention (because of information provided by NIE T&D in response to a consumer complaint) that NIE T&D has detailed information on the tree-cutting work carried out by it on a 5-yearly basis and any other overhead line work. Please see for example, the level of detail submitted in UR-142A - NIE Tree Cutting Database Extract Examples.⁴³ At a minimum, we would suggest that the Commission should ask NIE T&D to produce that information so that the Commission can ascertain the position for itself
195. Even setting aside the other categories of reclassification, it is clear from that one instance that the scale of reclassification was highly material: well over £10m. An adjustment of that order could not give rise to any risk that NIE T&D was penalized for efficiency, and should be made in the public interest.

Alternative adjustment

196. If the Commission maintains its view that tree cutting is not an instance of reclassification, it nevertheless remains possible for the Commission to make a small

⁴¹ See §10-15 of UR-143 and §15 UR-79, also see, for example, NIE T&D response to UR-79, p.2

⁴² Appendix 15(1) §8.

⁴³ UR response to the CC 'Capitalisation practices and the public interest' putback paper. Response submitted 25/10/2013

adjustment to NIE T&D's RAB without giving rise to any risk of penalizing NIE T&D for efficiency. In particular, NIE T&D's submission dated 26 September 2013 identified a movement in Capitalised R&M from £5.8m to £10.2m from 2004/05 to 2010/11. This clearly shows a substantial increase in money moved to capital expenditure, without any change in performance, in an area where NIE T&D does not measure any outputs.

197. We note, however, that the Commission considers that any adjustment "*would be more appropriately described as a correction to a misspecified RP4 controllable operating cost allowance than a correction to a miscalibrated RAB going into RP5*".⁴⁴ With respect, we disagree. The opex allowance and the capex mechanism were necessarily set for RP4 on the basis of how those terms (i.e. opex and capex) were understood at the time. On that basis, the reclassified activities were intended to be remunerated as opex rather than capex, and so it is an adjustment to the RAB, and the return and depreciation that customers will pay on the RAB in RP6 and in future price controls, rather than a correction for past opex allowances that is called for.
198. In any event, however, an adjustment must be made. The public interest in customers only being required to pay for any given piece of work once does not depend on such niceties as the accounting distinction between opex and capex. If the adjustment must be made by way of correction to opex allowances during RP4, then in our view that has no impact at all on the public interest case for making the adjustment.

Treatment of tree cutting in the RAB

199. In §§15.88ff of the PD, the Commission expresses the provisional view that although tree cutting should continue to be capitalised, it should be subject to a shorter, five year, depreciation period. The reason for that proposal is that "*it is inappropriate for future generations to be paying the costs of investments which have such a short life in relation to the period of which they are being depreciated for pricing purposes (40 years) and which will result in non-trivial differences between the prices charged to customers across the generations*".⁴⁵
200. We agree with that analysis, but would propose a different solution: the public interest would be better served if tree cutting was not capitalised at all, save as part of a

⁴⁴ PD §15.87, referring to the discussion in §§15.56-15.57.

⁴⁵ PD §15.89.

programme of greenfield overhead line building (as opposed to maintenance of existing lines).

201. Rather than complicate the RAB by siphoning off tree cutting into its own special 5-yearly depreciated category, it would be far simpler and more reflective of the economic reality if tree cutting were accounted for as opex rather than capex. Indeed, given that tree cutting is itself far from a uniform activity, with some forms taking place much more frequently than every five years, we are concerned that adopting a single five-yearly RAB for tree cutting would not solve the problem either.

Chapter 16: Financeability

202. We welcome and endorse the provisional conclusions that the Commission has reached with respect to financeability.
203. We expect that NIE T&D will respond to the Commission's analysis of financeability in the same way that it responded to our FD, by highlighting to the Commission the cashflows and financial ratios that NIE T&D would have in RP5 if it were to spend in line with its business plan/Statement of Case and receive the revenues set out in the PD. We wish to be clear from the outset that this is a meaningless piece of analysis. The Commission's task is to set a price control that will enable an efficient company to finance its activities; if NIE T&D wishes to spend more than the Commission's assessment of efficient expenditure, this is NIE T&D's prerogative, but NIE T&D should not have any recourse to higher revenues from customers.
204. We agree that the target credit rating should be Baa1/BBB+. We have examined the Commission's financial modelling and have identified some line items that we think should be amended in order to give a complete and accurate picture of the cashflows and ratios that the PD price control would produce:
- (a) Starting net debt – NIE T&D's actual net debt at 30 June 2013 was £516.5m, made up of long-term borrowing of £572m less cash and cash equivalents of £55.m. This is a significantly lower than the starting £600m net debt in the Commission's modelling (line 25 in the 'Financial Ratios' worksheet);
 - (b) Cost of new debt – the Commission's modelling allows for a cost of new debt of up to 9% per annum (lines 12 and 51 in the 'Interest cost analysis' worksheet). This is significantly higher than the ~5.4% cost of new debt that the Commission has allowed for in its WACC calculations; and
 - (c) Pension deficit contributions – the Commission has provisionally determined that shareholders will take responsibility for the first £42m of NIE T&D's pension deficit, on the basis that the deficit would have been £42m lower had shareholders funded their fair share of early retirement benefits at the point of employee retirement. It is logical that the Commission should examine the cashflows and ratios that the business would have if its 31 March 2012 pension deficit were £114m, not £156m. There is no need for the Commission to concern itself with the arrangement that NIE T&D has with trustees for repaying its £42m.

205. The first two changes serve to correct the calculation of the interest that NIE T&D will pay in RP5. This leads to a commensurate improvement in interest cover ratios. The third change ensures that the Commission correctly captures the cashflow that its PD produces. This will also improve calculated interest cover.
206. We have not re-run the Commission's financial model to ascertain where NIE T&D's PMICR would sit after the making these adjustments. Even if the ratio still gives cause for concern, however, we support the Commission's approach of looking to NIE T&D to fix weak interest cover via dividend retention, equity injection, index-linked issuance.
207. Specifically, the Commission will recall that we highlighted in our introductory submission (UR-7) that the Commission might find it instructive to look at the way in which NIE T&D's net debt had been driven up by the dividends that NIE T&D has paid. The payouts for the last seven years have been:

2012/13 nil

2011/12 nil

2010/11 nil

2009/10 £55.5m

2008/09 £110.6m

2007/08 £94.4m

2006/07 £36.8m

208. This £300m total far exceeds the ~5% per annum dividend yield that one would normally expect of a regulated company.⁴⁶ We calculate that the result of NIE T&D's actions is that debts are today around £100m higher than they perhaps should be.
209. The Commission's approach in the 2010 Bristol Water inquiry was to wind net debt/gearing back to the level that it would be had the company made more modest distributions to its shareholders. We think that the Commission can apply the same logic in this inquiry. NIE T&D's interest ratio levels would look much healthier if one

⁴⁶ This is the benchmark that the Commission used in the Bristol Water inquiry. See paragraph 10.22 and appendix O to the inquiry report.

ignored the debt that NIE T&D is having to service as a result of the excessive distributions we identify above.

210. This reinforces the logic for looking towards shareholder fixes for financeability issues. To the extent that the 'problem' originates from shareholders taking too much money out of the company in the past, thus exhausting the balance sheet and taking away the company's ability to finance new investment via borrowing, it is right that shareholders should fix that problem via actions like dividend retention and equity injection.

Chapter 17: The reporter and information transparency

211. We welcome the Commission's provisional conclusion that a step-change in the quality and quantity of reporting that NIE T&D engages in is required. While we would have preferred the additional benefits that a reporter would have offered, the key point is the data that we receive. If NIE T&D delivers on the requirement to provide data that are comparable with the RIGs submissions made by DNOs, then that key point will have largely been satisfied.
212. There is one important amendment that we would propose to the reporting requirements, however. Our local experience in regulating similar utilities on a one-to-one basis and of developing our regulatory relationship with these companies over time has proven the best means of facilitating the evolution of robust, regulation-lite submission of reporting data has been reliant on the adoption of a Confidence Grading system, similar to that which applies to Ofwat. Reporting of data is a necessary but not sufficient condition for effective regulation. Confidence grading tends to depersonalise the submission of data from company to regulator and allows both the opportunity to develop agreed plans for more robust data submission in future, around an agreed template of confidence grading which emphasises both reliability and accuracy of data, along exactly the same line as a recent National Audit Office recommendation.⁴⁷ Confidence grading will also allow the Regulator to outline and agree with NIE T&D the steps it is required to make to improve its data submission over time, encompassing both the Commission supported submission of 2014/15 data on a 'best endeavours' basis and the Regulator's need for RP6 and beyond.
213. In order to ensure that we are able to monitor and enforce the principle of "no double funding" of capex projects it is essential that NIE T&D reports about the volume and cost of the work that it has undertaken from the start of RP5 (1 April 2012). This will need to be in the same format and level of detail as the reporting from 1 October 2014. The capex reporting that have been submitted to date to cover this period do not provide the level of detail necessary to identify the work against the deliverables specified by the Commission in its email of 25 November 2013.
214. We are concerned, however, by the Commission's proposals as to the timing of NIE T&D's compliance with this requirement. The Commission has provisionally decided

⁴⁷ *Infrastructure investment: the impact on consumer bills*, Session 2013-14, HC 812-I, National Audit Office, November 2013 also recommends regulators should, "assure themselves in a proportionate way that the data companies report to them are reliable and accurate".

that NIE T&D should first comply on a best endeavours basis for the year ending March 2015.⁴⁸ That is simply too late for us. Moreover, as discussed in connection with Chapter Four above, we consider that it is important NIE T&D should change its 1 April to 30 March reporting year to a 1 October to 30 April year. On that basis, the first RIGs reporting would take place in October 2014.

215. In that regard, we should also note that we have already commenced engaging with Ofgem on this issue. Ofgem's advice to us is that the sooner NIE T&D starts submitting data, the better. Even if the early submissions are affected by errors, the very process of working through those errors will bring forward the day on which we have access to a robust data set.
216. As to which of the RIGS should be incorporated, we refer to our previous submission on that topic, UR-145. We note that NIE T&D has now responded to that submission, raising various concerns. We found that response somewhat difficult to follow, but for the avoidance of doubt, our position is that:
- (a) It is essential that NIE T&D's licence should be modified as part of this Commission inquiry so as to include an obligation for NIE T&D to report to the RIGS;
 - (b) It is important, both for benchmarking and for implementation of the Commission's sharing mechanism that the RIGS should be implemented as fully as possible, and in respect of as much of RP5 as is possible; and
 - (c) The process of finalising the reporting framework is not likely to be complete until after the completion of this inquiry process, since it will also require consultation in Northern Ireland. We would therefore propose that the Commission's final determination in this respect should be implemented by way of a general licence condition empowering us to stipulate detailed RIGs for NIE T&D to comply with in due course via a 'direction'. We would as a matter of course consult with NIE T&D prior to issuing any directions within formal regulatory letters.

⁴⁸ PD §17.51.

217. A slightly more detailed but still general licence condition also appears to have some merit on grounds of enhanced transparency of roles, whilst remaining relatively straightforward to draft, and we would ask the Commission to consider the following proposal:

- a) introduce a general requirement on NIE T&D towards RIGs compliance; whilst,
- b) allowing a company-regulator consultation period, time-limited, to cover off specific data lines, data tables which NIE T&D and/or the Regulator deem as not appropriate to the good functioning of the RP5 Commission's FD; which then ultimately,
- c) facilitates the Regulator making the necessary direction(s) to NIE T&D as regards which elements of the RIGs and reporting years are exempt on the basis these are disproportionate to the good functioning of RP5; and which
- d) allows subsequent directions to NIE T&D to adjust the RIGs for:-
 - I. local circumstances, especially where the Regulator decides to pursue a more cross-utility approach to comparative regulation; and,
 - II. RIGs rule changes, as Ofgem term them, which may require refinement where these may not be practicable in our local context, or where such definitions may benefit from improved clarity.

Chapter 18

218. Chapter 18 of the PD brings together the Commission's provisional findings into a calculation of allowed revenues and tariffs.

The allowed revenue calculation

219. We recently submitted two papers to the Commission on the modelling environment for RP5 (UR-146 and UR-146A) and shortly after submitting these we also held a meeting with the Commission and NIE T&D regarding the same. From this engagement we are considering some additional work on the model and we are considering how best to bring this modelling forward in the interests of all concerned.

220. In the meantime, we would highlight the following points arising from our review of the Commission's provisional calculation of allowed revenues.

221. We highlighted in UR-146A that the model contains a number errors, several of which cause the Commission to overstate the revenues that its assessments of opex, capex, pension costs, RAB/depreciation and cost of capital produce. We give a corrected calculation of NIE T&D's revenue entitlement in UR-152. The errors we have corrected for are:⁴⁹

- (a) incorrect statutory corporation tax rates;
- (b) an overstatement within the financial model of the Commission's allowance for non-network capex;
- (c) an overstatement within the financial model of the Commission's allowance for capex and RAB additions;
- (d) cell reference errors in the CC's calculation of RPEs, which cause the Commission to overstate the aggregate RPE allowance; and
- (e) the mistaken inclusion of an allowance for ongoing pension costs in the period April 2012 to December 2012.

⁴⁹ We note that further corrections may be required in respect of the Commission's detailed calculation of tax. We have not attempted to make these corrections ourselves.

222. On correcting for these errors, NIE T&D's revenue over the 5.5 year period under the Commission's provisional determination is approximately £998m or £11m less than the £1,009m identified in the PD. We are providing the relevant backup spreadsheets⁵⁰ identifying and explaining those errors together with this submission.

Calculation of tariffs

223. We believe that the tariff increase of £5 per year for domestic customers may not be correct due to the base year revenue being understated (because of the deduction of PSO revenues). In our FD we suggested that network charges would remain relatively flat over RP5. Logically, therefore, the smaller projected revenue in the Commission's PD is likely to result in a decrease in network tariffs over RP5.

Licence modifications

224. The Commission's final determination will ultimately need to be transposed into formal modifications to NIE T&D's licences. From this point of view, the various policies outlined by the Commission in the PD appear to be quite complex, especially in relation to opex/capex incentive mechanisms and the in-period pension adjustment mechanism. The formulation of licence conditions is unlikely to be straightforward.

225. We wish to minimise the risk of difficulties arising during our consultation process following the Commission's final determination, and/or during the Commission's review of our proposed licence modifications following that consultation. Therefore, it would be helpful if we could talk to the Commission about how it sees the process for developing the required licence modifications. We also ask, more generally, that the Commission should provide as much detailed guidance as possible on precisely how it sees its proposals being implemented in NIE T&D's licence. We hope that this can be an area of priority during the remainder of this inquiry.

⁵⁰ UR-152 Impact of UR changes on CC PD 5.5 year revenue, UR-152A UR adjustments to CC PD Model, UR-152B Adjusted CC PD cost assessment calculations and UR-152C Adjusted CC RPEs