Northern Ireland Electricity Limited Price Determination – Provisional Determination

A Submission by SONI Limited

29 November 2013

Introduction

SONI Limited ("SONI") welcomes the opportunity to comment on the Competition Commission's (the Commission's") provisional determination on the Northern Ireland Limited Electricity (NIE) Price Determination. As outlined in our previous submission to the Commission, SONI has a particular interest in this determination as it is, along with NIE, the holder of a Licence to Participate in Transmission of Electricity under Article 10(1)(b) of the Electricity (Northern Ireland) Order, 1992.

The provisional determination is substantial and our response given the time available necessarily brief. SONI has therefore restricted its comments to only those matters most pertinent to it and its licensed functions and where it wishes to see points clarified or amended in the Commission's final determination. Specifically our response comments on:

- The changes as a result of transfer of investment planning from NIE to SONI as set out in Paragraphs 10.256 – 10.261;
- The arrangements in respect of pensions costs and pension deficits – as set out in Section 12;
- The proposed reporting regime set out in Section 17;
- The arrangements in respect of investment in backbone transmission infrastructure as set out in paragraph 5.51; and
- Overall Financeability and financial ratios as set out in Section 16 and paragraphs 16.45 - 16.47 in particular.

SONI would welcome the opportunity to discuss its comments with the Commission as it considers and prepares its final determination.

Transfer of Investment Planning from NIE to SONI

The Utility Regulator is currently consulting on licence changes to both the SONI and NIE licences[1] arising from the European Commission decision on the Certification of SONI as TSO for Northern Ireland[2]. This will give rise to increased responsibilities for SONI and reduced responsibilities for NIE in respect of the planning and identification of the necessary transmission works and progressing such works through the consenting process. There will be additional revenue requirements to enable SONI to fulfil these new functions and no doubt reduced revenue requirements for NIE.

In the provisional determination the Commission sets out its view that it may be beneficial for the Utility Regulator to consult on any adjustment to NIE's costs and suggests the Utility Regulator have

[1] UREGNI Consultation paper - measures for the purposes of IME3 - Sept 2013
[2] European Commission Decision re Certification 2013 059 uk

regard to the Commission's own cost assessment including the use of GB DNO benchmarking in making such adjustment.

SONI knows it is the Commission's intent but SONI would, however, respectfully request that the Commission make clear in its final determination that any recommendations it is making relate solely to an adjustment to NIE's licence and do not relate to any corresponding adjustment under SONI's licence which must itself be assessed against the Utility Regulator's statutory duties, and against the test that SONI, as a business with a very different capital and operating structure, is able to finance the activities for which it is licensed and for which it is taking on additional responsibility[3].

Pension Costs

The Commission's provisional determination provides extensive deliberation and discussion on the treatment of the Defined Benefit element of the NIE pension scheme. The Commission's conclusions – that historic scheme deficits should be funded 100% by customers and 100% of any incremental deficit should be funded by shareholders – are strongly couched in terms of the nature and characteristics of the NIE pension arrangements and indeed the NIE business and balance sheet. The Commission specifically notes the size of the NIE deficit and therefore the impact its ongoing servicing has on consumer prices.

SONI would seek that in its conclusions to the final determination that the Commission make very clear that such principles apply solely to the NIE business and should not be considered transferable to any other business regulated by the Utility Regulator. Contrast for example the position faced by NIE with that of SONI.

- The SONI DB pension deficit has arisen due to a variety of largely enforced circumstances associated with inheriting 'protected persons'.
    - Firstly, SONI inherited a number of such protected persons and associated deficit with the divestment of SONI from the previously vertically integrated undertaking Viridian (also owner of NIE). SONI inherited these liabilities as a result of public policy decisions and public policy arrangements as recently as 2009
    - Secondly, SONI may in 2014 inherit further liabilities associated with the transfer of the investment planning function arising directly from the European Commission's decision on Certification with any such transfers likely to come under the TUPE arrangements.

[3] For example, the proportion of skilled labour costs and therefore the relevant Real Price Effects may be very different for the transferred requirements as opposed to for the NIE business as a whole.

- The SONI DB pension deficit is large relative to the asset light nature of the SONI business and the small Regulatory Asset Base; this is in contrast to the case for NIE. This therefore also means that the risk associated with such transfer on the underlying ability of SONI to finance its licensed activities would be much greater in the case of SONI than in the case of NIE.

- The SONI DB pension deficit is small by reference to its impact on consumer tariffs; this means the impact on consumer tariffs of transferring ongoing deficit risk from consumers to the shareholders of SONI Ltd. is much less than in the case of NIE. The scale of the tariff impact is as outlined above a key consideration in the Commission's conclusion.

The above points demonstrate the type of differences that exist in terms of context and position between pension arrangements and deficits of different organisations. It would be of concern to SONI were the Utility Regulator to any way interpret the Commission's considerations in relation to the treatment of pensions and pension deficits as having wider application outside of the NIE determination. SONI knows this is not the Commission's intent. The Commission should therefore make it very clear in its final determination that this is not the case and that pensions arrangements for other utilities need to be considered on a case by case basis, respecting in the first instance any such practices or arrangements that have heretofore been in place and the basis under which such deficits have arisen.

Proposed Reporting Arrangements

In Section 17 the Commission sets out its views in relation to reporting requirements. SONI commented on the use of a Reporter in its previous submission to the Commission.

SONI notes that it is proposed that the Ofgem RIIGs are adopted by the Utility Regulator in relation to regulatory reporting by NIE. In the limited time available from the notification of this decision to the requirement to provide response SONI has not had the opportunity to fully assess the RIIG requirements. SONI would, however, note that unlike in Great Britain there is a split responsibility, and therefore accountability, in the transmission arrangements (including 110kV) in Northern Ireland and this may mean that in a number of instances it is SONI, not NIE, who is in possession of, and has responsibility for the relevant information.

Whilst SONI is not averse to appropriate regulatory reporting it would ask the Competition Commission again confirm that the arrangements as set out in the Provisional Determination relate solely to NIE and not to SONI and that SONI cannot, does not and will not take on any additional obligations resulting from this determination. Should the Utility Regulator wish to discuss with SONI any additional reporting requirements to facilitate that envisaged by the Commission, including any

costs associated with resourcing their implementation, SONI would be happy to discuss these matters.

Treatment of Investment in the Transmission System

SONI has previously expressed some reservation about the absence of visibility under the proposed mechanism in relation to transmission investment. In the Utility Regulator's determination this was termed Fund 3. Specifically SONI expressed concern that a Catch 22 situation could arise where as a result of the uncertainty on all sides there may be a sub-optimal level of investment in the network[4]. Clearly, following the transfer of investment planning function from NIE to SONI, referenced elsewhere in the Commission's determination, it will be SONI, and not NIE, who is the party responsible for the identification of the necessary transmission investments.

SONI is strongly of the opinion that the Competition Commission's final determination should make clear in Paragraph 5.51 that such responsibility lies with SONI and that the adjustment to the NIE maximum allowed revenues shall be in accordance with the transmission works identified by SONI in accordance with its licence requirements in planning the economic and efficient development of the NIE transmission system.

Overall Financeability and Financial Ratios

SONI notes that in Paragraph 16.46 of the Commission's provisional determination that the Commission identifies the financial ratios within the NIE business in the RP5 period, and the PMICR in particular, of being of some concern.

SONI also notes that these adverse ratios are prior to inclusion of additional network capital spend for '*inter alia*' transmission investment which SONI anticipates is required, and is likely to be identified by SONI as being required, in the period.

It is therefore of some concern and also somewhat surprising that the Commission dismisses so lightly the adverse ratios and suggests that the company (NIE) can somehow off its own bat take measures which will necessarily resolve them.

SONI suggests that the Commission may again wish to consider the overall profile of cashflows between today's consumers and future consumers whether in the NPV neutral adjustment of returns or in alteration to the asset depreciation profile. This is particularly so given that the more adverse ratios are likely to be a resultant impact of the application of a somewhat higher anticipated RPI indexation regime and associated nominal cost of debt with lower real cost of capital (WACC) remunerated through the tariff. Such considerations will not be unique to NIE but a feature requiring wider consideration across the UK regulatory environment and under the UK regulatory model given

[4] SONI response to the Competition Commission Price Determination Review 31.05.2013

the statistical changes which have given rise to higher expected RPI inflation which has in effect rebalanced RPI index linked regulatory regimes such that today's consumers pay less and future consumers more for any given investment profile than was previously the case.

SONI would also note that the original NIE ratios, which were healthier than those now derived from the Commission's provisional determination were themselves such a cause for concern to the Utility Regulator that the utility Regulator suggested moving forward and reprofiling revenues from the RP6 (post 2017) period. This may be something the Commission may also consider and discuss with the Utility Regulator. Certainly SONI would urge the Commission to consider this if the investment in the period, including the as of yet unprovided for transmission investment even though in a number of cases (such as the North South interconnector) its requirement has been clearly identified, is to be delivered.

Conclusion

SONI has raised a number of points in this short response in relation to:

- The changes as a result of transfer of investment planning to SONI
    - Requirement to clarify that recommendations relate specifically to NIE context and are not intended to relate to any corresponding adjustments.
- The arrangements in respect of pensions costs and pension deficits
    - Requirement to clarify that recommendations relate specifically to NIE context and are not intended as recommendations for wider application.
- The proposed reporting regime
    - Requirement to clarify that recommendations relate specifically to NIE context and are not intended as recommendations for wider application.
- The arrangements in respect of investment in transmission infrastructure
    - Requirement to clarify that SONI will be the party responsible for the identification of necessary transmission investments (paragraph 5.51)
- Overall Financeability and financial ratios
    - Request to reconsider determination with regard to the concerning financeability position of NIE and the cash-flow profile anomaly, particularly in light of investment requirements.

SONI has limited its comments to those matters it sees as most material given its unique position in the industry and unique perspective. SONI would therefore request that the Competition Commission consider these comments carefully and reflect them in its final determination.

SONI would welcome the opportunity to discuss the matters raised within this response with the Commission and its staff.