

**NIE Energy Limited
Power Procurement Business (PPB)**

**SONI Price Control
2010 - 2015**

Consultation Paper

Response by NIE Energy (PPB)

4 March 2011.



Introduction

NIE Energy – Power Procurement Business (“PPB”) welcomes the opportunity to respond to the consultation paper on the SONI Price Control 2010 – 2015.

Comments

Question 1

PPB agrees that SONI should be incentivised to control predictable operating costs and that any unforeseen costs should be treated as a D_{TSO_t} cost. PPB believes that the proposed regulatory structure is appropriate. PPB would welcome the approval process for costs which fall under D_{TSO_t} , to be expedient in order to optimize the efficiency of operations for both SONI and market participants.

Question 2

There are likely to be significant changes over the next few years as Government policy on renewables is clarified and Interconnection is increased and hence significant variation to opex and capex may be necessary. It may therefore be prudent to adopt a 3.5 year price control. This is further supported given that SONI have less detailed plans for the later years.

Question 3

It is difficult to comment on whether the proposals are adequate from the detail provided. It is clear that additional roles will be required over the period to address such changes as increased wind penetration although it is not possible for us to assess what is appropriate. There are considerable variances between the staffing levels requested by SONI and proposed by UR. A key principle is that resourcing and payroll levels must be set to ensure SONI can deliver the level of service required by market participants and to ensure the TSO is carried out effectively and efficiently. We would note that the proposed growth in the financing team is surprising given what appears to be an already high level of resources and we assume NIAUR has more information available to it to fully appraise the utilisation of existing resources and the expansion requirements.

It is also noted in the paper that SONI are experiencing difficulties in attracting competent graduates. This is a widespread issue in the engineering and technology sector. The Institution of Engineering and Technology (the “IET”) 2010 skills survey indicated that in 2010, 37 per cent of employers were finding it hard to recruit suitable senior engineers and 21 per cent were finding it hard to recruit suitable graduate engineers. If Government strategy is to realise 40% electricity production from renewable resources by 2020 it must be realized that one of the greatest risks in achieving this target is the ability to recruit and retain the brightest minds who will be able to design and manage the system as the topology of the electricity system changes significantly from its original design. The ICT sector in Northern Ireland is attracting many of the top

engineering and technology graduates and it important that the electricity industry is able to recruit its share of the limited pool of graduates.

It is not clear why SONI do not recharge Mutual Energy for its costs of providing an Interconnector Administrator service.

Question 4

PPB cannot comment on the potential to deliver the savings in support costs proposed by NIAUR.

Question 5

The Utility Regulator has made significant reductions to SONI proposed Pensions Allowances. Whilst it is obvious that the Utility Regulator has tried to maintain the actual pension costs from the period 2007-2010. However PPB is unable to comment on whether the increase in costs proposed by SONI is justifiable due to the limited information which has been provided in the report. Contributions are assessed by calculating the cost of future benefit accrual using the same assumptions as for the technical provisions – and without knowledge of the technical provisions it is difficult for PPB to assess the proposed Pension Allowances. It is likely that the SONI Pension Scheme will be more expensive to run per member than the NIE Pension Scheme due to economies of scale – in particular in relation to administration, advisor costs and in providing ill-health and lump sum death benefits under the scheme.

Question 6

PPB strongly believe that a 15 year deficit recovery period is inappropriate for SONI. According to the Pensions Regulator the average recovery plan for 2006,2007,2008 plans was 7.7,7.3 and 8 years respectively. Any plan which is for longer than 10 years receive particular scrutiny from the Pensions Regulator and there must be a demonstration that there are real issues of affordability. PPB do not believe that the Trustees of the SONI Pension Scheme could argue that a relatively small pension deficit of £1.6m could be justified to the Pensions Regulator as being a case which merits an extended deficit recovery period. We are not aware of any discussions the Utility Regulator has had as part of the Joint Regulators Group with the Pensions Regulator and it is concerning that a single case is being cited to justify the Utility Regulators recommendation that a 15 year deficit recovery period is appropriate as it is a requirement that an appropriate recovery plan is put in place which reflects a scheme's unique circumstances. Pensions legislation is built upon flexibility as it is impossible to impose standard deficit recovery periods – however a 15 year deficit recovery period would be inappropriate for the SONI Pension Scheme and the deficit recovery period should be closer to the average recovery plan. In addition a recent publication issued by the Utility Regulator in relation to the NIE plc Price Control indicated a 10 year deficit recovery period would be considered for the

NIE Pension Scheme – a scheme which is significantly larger than the SONI Pension Scheme.

Question 7

PPB agrees that SONI should be able to contract external consultancy for some projects without requiring approval from the Regulator. It is not possible for PPB to provide detailed comment based on the information provided but again the principle must be that the allowance is adequate to enable SONI to deliver a high level of service to stakeholders. Provided these costs are justified and the price control is for a 3.5 year period then PPB agrees with the proposed other opex allowance.

Question 8

The level of capex allowed must reflect what is necessary to deliver the service expected of a prudent TSO.

Question 9

PPB acknowledges that major refurbishment of Castlereagh House is required but we agree with the regulators approach that all options should be considered, including locating some staff (eg SEMO, planning) at alternate locations, before a final decision is reached.

Question 10

NIAUR's proposal of a WACC of 5.45% (pre-tax real) represents a significant decrease from SONI's previous Price Control and in our opinion the Regulator should be mindful that it is essential to set an appropriate level of return to ensure investment is not discouraged.

As this is an extremely complex area it is difficult to comment in greater detail without performing extensive analysis or being able to scrutinise the assumptions and valuation methods used in arriving at the various rates proposed.

Incentives

PPB would welcome more transparency in the area of constraint costs and we agree with the Regulator that SONI should not be rewarded for complying with their licence requirements in relation to publication of documents.

PPB would suggest that SONI should be incentivised on the Accuracy of the Indicative Fuel Runs to the Actual Run as this has implications for market participants in their fuel purchases.

PPB would suggest that the Utility Regulator should consider an incentive for SONI to publish near time and real time system operator notification reports providing system users and market participants with timely system warning

notifications, such as supply / demand margins which will become increasingly important as the level of wind capacity and interconnection increases.

