

RESPONSE BY NORTHERN IRELAND ELECTRICITY plc TO CER'S ELECTRICITY REVENUE REVIEW

Northern Ireland Electricity plc (NIE) is the provider of the transmission and distribution network in Northern Ireland and the public electricity supplier. NIE does not own any power stations and its Power Procurement Business administers the legacy generation contracts.

We are pleased to offer these brief high level comments on CER's review of electricity prices in the Republic of Ireland. We have confined our comments to the transmission, distribution and supply price controls which CER proposes to put in place for ESB's second regulatory period.

Transmission and Distribution Price Controls

NIE's regulated businesses have been operating under price controls since 1992 and our Transmission and Distribution Business is now in the fourth year of its third regulatory period having undergone two price control reviews in 1997 and in 2002. NIE's price control reviews have been significant events. For example, at the 1997 review the second T&D price control was characterised by a one-off reduction of 25% with an X factor reduction of 2% per annum thereafter. At the 2002 review, the X factor reduction was increased to 5% per annum.

NIE's T&D Business has responded to the challenges of these reviews with price reductions that have been delivered through a range of efficiency initiatives driven by both regulatory and shareholder pressure. These initiatives have included a very strong focus on cost reductions, the introduction of new working practices, outsourcing, strategic procurement, strict capital utilisation and new IT systems. Staffing levels have been reduced by around 60% since privatisation. By the end of the third regulatory period in 2007, T&D prices will have been reduced by almost 45% in real terms. At the same time investment in the network has been running at around twice the pre-privatisation level and customer service against the measured standards has improved markedly.

NIE supports incentive-based regulation and we note that this is one of CER's objectives for the price control reviews. We are interested to learn that CER proposes to continue with the scheme which allows costs savings to be retained for five years so that each business remains neutral as to the point in the regulatory cycle at which those efficiencies are attained.

We believe that good regulatory practice takes proper account of relevant regulatory precedent which helps to ensure consistency and predictability within the regulatory framework. These are factors which in our experience are important in shaping investors' perceptions of risk and hence the return that they require on their investment which in turn impacts on the cost of capital. In this regard we note that the proposed price controls are based on

the well-established building block methodology. Within that framework the Commission has proposed that the cost of capital should be determined as 4.92% post tax. We note that this is slightly above the GB precedent of Ofgem's 4.84% figure for the GB distribution network operators and slightly below Ofwat's 5.1% figure for the GB water companies. We also note that a common cost of capital has been applied to both transmission and distribution. This is in line with the precedent which has operated in respect of NIE to date and with Ofgem's precedent for the two Scottish companies which own both regional transmission and distribution assets.

We were interested to check the combined T&D price (transmission asset owner and distribution system operator) under CER's proposals with our own. On the basis of further information supplied to us by CER, we calculate that in 2006 NIE's average T&D price per unit will be 16% lower than ESB's.

PES Price Control

There are a number of interesting insights contained within the PES price control proposals. For example, when expressed on a €/customer basis, the proposed opex allowance looks high relative to a benchmark with NIE and the GB retail businesses (adjusted to reflect similar retail activities).

	Opex/Customer
ESB PES 2006	€ 44
GB ¹ & NIE Benchmark	€ 30

In particular the total allowance for selling and advertising looks high at €21m. It would be inappropriate if this advertising spend was attributable to branding for competitive purposes. As regards call centre costs a benchmark of 1.8 calls per customer for a retailer appears high. A more recognisable ratio for energy retailers would be c1.1 calls per customer.

Finally, based on the projections for growth in both PES GWh sales and customer numbers over the new price control term it would appear that CER has accepted the ESB view that competition in the domestic sector is not likely to occur during the next 5 years and that ESB PES is likely to experience only a modest erosion of its non-domestic customer base. This raises a question about the case for the very substantial Republic of Ireland market opening IT investment, and is very relevant in the context of the choices that Northern Ireland is considering for its approach to IT systems to support domestic market opening here.

¹ Source – IBM Research