

Impact of RP5 Electricity Price Control on Northern Ireland Farmers and Land Owners

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1. Background

Northern Ireland Electricity Ltd (NIE T&D) owns the transmission and distribution electricity network in Northern Ireland. This network is comprised of lines and substations, connecting power stations and other generators (including small scale renewable generators) to homes and businesses throughout Northern Ireland.

2. Role of the Utility Regulator

Since NIE T&D are a monopoly provider, there is a statutory need for the Utility Regulator. The Regulator is responsible for protecting electricity consumers by setting what is known as price controls, with the aim ensuring that NIE T&D does not set the prices too high. In equal measure, the Regulator is responsible for making sure that NIE T&D can finance its licensed activities and provide a decent service.

3. Background to Price Controls

Since 1992 there have been 4 Price Controls, starting with RP1, up to the current RP4 which ends on 30 September 2012. Costs covered by Price Control include; Capital Costs, Operating Costs, Pension Costs and other costs. The Utility Regulator has already consulted on the RP5 strategy and NIE T&D responded to this with their Capital Investment Requirements for RP5 in April 2011, with further amendments in January 2012.

This Commodity Watch is in reference to the draft determination recently published by the Utility Regulator in April 2012 and with a closing date for comments 19 July.

4. Impact upon Northern Ireland Farmers and Landowners

This determination since RP5 and its final content will impact upon Northern Ireland farmers and landowners on three counts;

- Farm businesses are direct customers of NIE T&D as their businesses consumes large volumes of electricity
- NI farm land incorporate and facilitate much of NIE T&D's infrastructure and capital equipment (poles, substations etc)
- Farmers and land owners are the main generators of small scale renewable electricity in Northern Ireland, mainly through wind turbines.

In terms of day to day usage, you only need to consider the electricity use on a dairy farm. Table One below shows three different sizes of dairy farms and a range of average electricity usage. A clear example of economies of scale since the usage is less when there are cows in the herd.

Table One – Electrical Energy used on Dairy Farms

Electrical Energy Used Each Year		
Number of dairy cows		Per Head
0-88	Equivalent Kilowatt Hours	340 to 434
89-140	Equivalent Kilowatt Hours	280 to 373
141+	Equivalent Kilowatt Hours	273 to 351

If you consider the fact that the average dairy herd size in Northern Ireland is c. 80 cows you will see that this sector is an intensive consumer of electricity.

In this weeks Commodity Watch we will focus on specifically CAPEX (Capital Expenditure) and OPEX (Operational Expenditure, including proposals for the NIE Powerteam).

5. CAPEX and OPEX

- **CAPEX (Capital Expenditure)** - a business expense incurred to create future benefit i.e. acquisition of assets that will have a useful life beyond the tax year, i.e. expenditure on assets like building, machinery, equipment or upgrading existing facilities so their value as an asset increases.
- **OPEX (Operational Expenditure)** - expenditure required for the day-to-day functioning of the business, i.e. wages, utilities, maintenance and repairs. OPEX is the money the business spends in order to turn inventory into throughput. Also include depreciation of plants and machinery which are used in the production process. OPEX is further broken down into Controllable and Uncontrollable; Controllable OPEX is made up of Payroll/IT and Telecoms/NIE Powerteam/Insurance/Professional Services and Uncontrollable OPEX contains spend such Rates and Wayleave Payments.

6. Review of NIE Powerteam Ltd.

NIE Powerteam Ltd was created within NIE in the early 2000's and is a non regulated entity and not subject to competition from other service providers. It provides engineering services to NIE T&D and no one else. Its revenues are generated from within NIE T&D and income is generated from time-based charge-out rate for providing network services and from managed services contracts. And all costs are recovered from NIE T&D on a "cost-plus" basis.

When reviewing NIE T&D expenditure in RP4, the Regulator assessed the OPEX costs of NIE Powerteam. This was done for 2 reasons; to assess the working relationship between NIE T&D and NIE Powerteam and to assess the relative efficiency of NIE Powerteam as a service provider.

The regulator in their review found that;

- NIE Powerteam salaries were greater than the Northern Ireland average
- Charging between NIE T&D and Powerteam were unnecessarily complex
- Lack of competition
- No clear benefit to local customers

Utility Regulator Proposal – NIE Powerteam should be treated like any other 3rd party supplier. Regulator wants to end the current arrangements and remove any references to NIE Powerteam from NIE T&D’s licence. NIE T&D will have to undertake “demonstrate competitive procurement ensuring better efficiency for consumers under RP5”.

UFU Comment - The UFU are monitoring the NIE Powerteam situation very closely. Farmers and landowners are significant customers of NIE Powerteam due to the reliance of the service (maintenance and breakdown) upon their businesses as well as the numbers of poles and other infrastructure crossing their land.

7. RP5 CAPEX (inc proposed spending on Renewables)

NIE T&D requested a significant increase in CAPEX for RP5. In their submission, they requested an increase in “Business as Usual” CAPEX from £374m in RP4 to £776m.

NIE T&D proposed £291m for renewables and interconnection.

Utility Regulator Proposal - The Regulator responded in their draft determination by allocating £314.7m for Business as Usual CAPEX (significantly less than the £776 proposed by NIE T&D). The Utility Regulator concluded that the costings provided in the NIE T&D submission were heavily based on opinion rather than subjective supporting factual evidence.

In terms of expenditure on renewable generation and interconnection, the Regulator would not set an individual figure, rather they committed to ring-fence funds and consider investment requests on an individual basis as the need is determined in the RP5 period.

UFU response – the UFU will be proposing an alternative proposal in relation to investment in renewables infrastructure and this will be publicised after 20 July 2012.

8. RP5 OPEX

NIE T&D requested £345m, this was 22% higher than the RP4 incurred (£283.5m). Regulator commissioned Cambridge Economic policy Associates to consider NIE T&D’s proposals on Controllable OPEX and their econometric analysis identified a 9% “efficiency gap” with GB DNO counterparts. This means that the Regulator believes there is scope for further efficiencies in RP5.

Utility Regulator Proposal – In light of the “efficiency gap”, the Utility Regulator has allowed total OPEX for NIE T&D of £257m.

9. Treatment of Connections

Utility Regulator has instructed NIE T&D to remove the 40% subsidy for domestic and small business customers. In our response to the earlier consultation, we set out our objections to this move. Regulator justifies their decision saying that the move to remove the subsidy will lead to a transparency of pricing and lead to a reduction in consumer costs.

10. Innovation

In their draft determination, the Regulator has stated that they are not going to continue with either the SMART programme or the Vulnerable Customers Programme. Future investments will be considered in the context of CAPEX. Earlier in the year, the UFU lodged their objection to the decision to not continue with these programmes. Again we will publicise our recommendations in the press after 19 July 2012.

11. Next steps

The UFU will be responding to the draft determination before the deadline of 19 July 2012. Once the closing date has passed, we will publish our recommendations on RP5 including an alternative suggestion on how to integrate small scale renewables onto the low voltage 11kV lines.