



Northern Ireland
Assembly

Committee for Enterprise, Trade and
Investment

OFFICIAL REPORT (Hansard)

Pricing, Single Electricity Market, Gas to the
West, NIE Payment Security Policy:
Northern Ireland Authority for Utility Regulation

8 May 2014

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Members present for all or part of the proceedings:

Mr Patsy McGlone (Chairperson)
Mr Phil Flanagan (Deputy Chairperson)
Mr Steven Agnew
Mr Sydney Anderson
Mr Sammy Douglas
Mr Gordon Dunne
Mr Paul Frew
Mr Fearghal McKinney
Mr Mitchel McLaughlin
Mrs Sandra Overend

Witnesses:

Ms Tanya Hedley	Northern Ireland Authority for Utility Regulation
Mr Jody O'Boyle	Northern Ireland Authority for Utility Regulation
Ms Jenny Pyper	Northern Ireland Authority for Utility Regulation

The Chairperson: With us today we have Jenny Pyper, the chief executive of the Utility Regulator's office; Tanya Hedley, the director of networks, water and gas; and Jody O'Boyle, the electricity networks manager. You are very welcome indeed, and thank you for attending. As you know, the procedure here is that you have up to 10 minutes to make a presentation, and we then have a question-and-answer session from members.

Ms Jenny Pyper (Northern Ireland Authority for Utility Regulation): Chairman, thank you very much. Would it be helpful if I went through the issues around the Competition Commission's final determination, and then we take questions on that, and look at the single electricity market (SEM) afterwards? We will do it that way since we are not going to cover the grid connection issues today.

The Chairperson: That is grand. The first section is a wee bit technical in parts.

Ms Pyper: We will try to keep it as non-technical as we can.

The Committee is aware that Northern Ireland Electricity's (NIE) price control, known as RP5, was referred to the Competition Commission. The slide on page 3 is designed to remind the Committee of the timeline. The Utility Regulator put forward a strategy paper proposing the way in which we were going to deal with NIE's price control. That was in July 2010, and NIE rejected our determination on that price control in November 2012. Despite some negotiation with NIE, we were unable to get any agreement, and, therefore, there was a referral to another regulatory organisation, the Competition

Commission, or, as it is now known, the Competition and Markets Authority (CMA). The CC is a regulatory body, as is the Utility Regulator, but is specifically charged with determining disputes and conducting investigations. The determination has now come out. It covers the period from 1 April 2012 to 30 September 2017, and it gives clarity on the funding package that is available to NIE to spend during that period. It was a long process, but we now have clarity on the way forward.

The slide on page 4 is to remind the Committee of the key elements that we look at in any price control. We set a figure for the amount of capital expenditure that NIE can spend. We set a rate of return, or a weighted average cost of capital (WACC), as it is now known. It is the weighted average cost of debt and equity. Essentially, it is the rate of return that the company is entitled to. We set an allowance for operating expenditure, and, in price control, we also looked at NIE pensions, particularly pension deficits. We also looked at capitalisation practices in NIE, and the Competition Commission also looked at all those elements in its review. The final determination set revenues for NIE that were very similar to the provisional determination: it set a rate of return, or a WACC, at 4.1%; it reduced the pension provision for NIE's business; and it allowed around £459 million of capital investment. The overall investment package that the Competition Commission approved ran to about £1 billion. In the provisional determination, it was £1.009 billion, and, in its final determination, it was £1.011 billion. So there was not a great deal of change between those two figures, and there was an investment package of around £1 billion.

The slides on pages 5 and 6 show further elements of what the determination focused on. The determination increased the amount of operating allowance (OPEX) from its provisional determination. Very significantly for us a regulator, it has recommended a system of reporting known as regulatory instructions and guidance (RIGs). It is a very comprehensive basis of reporting to regulators. Ofgem has used it for some years, and it will be a useful tool to allow us to benchmark NIE with other regulated companies. That has now been mandated by the Competition Commission.

The commission proposed a risk-sharing mechanism, which is designed to incentivise the network operator to invest. It looked at capitalisation, which we were concerned about. We were concerned about double charging by NIE, but the Competition Commission felt that there was no need to make any adjustment in the allowance. It inserted a clause relating to a role that we have: if we see actions or activities by NIE that we feel are demonstrably inefficient or wasteful, we have a right to look at and challenge those.

The slide on page 7 shows the figures for NIE's request for funding and the final determination. NIE originally sought £852 million, our determination came out at £446 million of capital investment, and the Competition Commission ended up with an allowance of £459 million.

The slide on page 8 shows you the rate of return. We have included a bit of a historical pattern just to let the Committee see the trend in rates of return or WACCs. You can see the trend from 2005 and the rates of return that Ofgem, the Office of Rail Regulation and Ofwat were setting. You can see where the Utility Regulator proposed to set the rate of return in 2012. You can also see where NIE's request was as an outlier. You can then see where the Competition Commission ended up with 4.1% both in its provisional determination (PD) and its final determination (FD). You can see the trend with regulators over the past few years. The Utility Regulator's determination was broadly in line with where the trend was going, but the Competition Commission has essentially reset the rate of return at 4.1%. Hopefully, that is helpful in letting you see where regulators have been going with rates of return.

The slide on page 9 shows the allowances that have been provided for operating costs. You can see the variation between what NIE was seeking and what the Competition Commission has allowed. Its determination was £283 million. The final element of that — the slide on page 10 — shows you the trend in pensions. I have included that because the Competition Commission changed its position from its provisional determination. At the provisional determination stage, it was going to allow £65 million for pensions, but it changed that and reduced it for the final determination. On an ongoing basis, it has not allowed for any stranded allowance and has moved part of the pension costs to the OPEX element.

There have been some slight changes between the Competition Commission's original position and its final position. The slide on page 11 shows the overall impact. NIE had originally requested £1.288 billion, and the Competition Commission's final determination, as I said, was just over £1 billion. The commission has said publicly that the impact of its final determination will be to reduce domestic customers' annual bill by about £10 by the end of the price control in September 2017. From our perspective, that means that there will be no real change. There will be significant additional

investment by NIE in the network, but there will be no real impact on the networks part of consumers' bills. The slide on page 12 is a summary of the revenue requests that were made by NIE and the final determination.

From the Utility Regulator's perspective, we feel that it is a positive result for consumers. The Competition Commission has ruled broadly in line with what we determined, but it has now given us a new rate of return to set as a benchmark. In our relationship with NIE, it has given us additional regulatory tools through the RIGs in how we move forward and in how NIE reports to us in future. We have some certainty and stability about that aspect of customers' bills on the network piece through to September 2017. We believe that it is a good result for regulation in challenging the company about the justification for its investment and the need for that investment. Those are the key elements of the determination, and I know that the Committee is familiar with the process that we have been through. I am happy to take any questions.

The Chairperson: Thanks very much for that. The figures are pretty much a vindication of the Utility Regulator's initial determination. As a matter of fact, from looking at the figures, it appears that it would have been better accepting that determination rather than running off to the Competition Commission, because it has wound up financially worse off than it would have been. Is it about £70 million worse off? I have read that the cost of NIE taking that action to the Competition Commission was about £1.5 million, or was it more than that?

Ms Pyper: The Competition Commission stated that costs of about £2.8 million could be recovered in total. That was only a fraction of NIE's costs, but it included some of our costs and also its costs. Chairman, I understand why that is a concern for the Committee, but you need to see that £2.8 million in the context of an overall investment package of £1 billion and an overall package that has saved customers about £210 million.

The Chairperson: The word "recoverable" means recoverable from the public and hence from consumers.

Ms Pyper: It does.

The Chairperson: Do you not think that it is a bit daft that in circumstances in which NIE, a private company, took a commercial decision to go to the Competition Commission and wound up worse off than if it had stuck with the initial Utility Regulator's determination, spent a considerable amount of money, including its own money, to fight that case, wound up £70 million worse off than if it had complied with the original determination, and then consumers have had to pay for at least part of that action? That is pretty ludicrous, is it not?

Ms Pyper: To be clear: the Utility Regulator referred the case to the Competition Commission because we could not reach agreement, given that NIE refused to accept our determination. We absolutely would prefer that regulated companies accept what the Northern Ireland regulator determines, but, if we fail to agree, there is a mechanism to refer it to the Competition and Markets Authority. The fact is that NIE requested significantly more in its costs, and the Competition Commission refused to allow around 50% of those costs. Overall, £2.8 million is for the entire cost of referral. That is everyone's costs. Only an element of that is for NIE. If you look at it over the entire period of the price control and over a customer base of about 900,000, it has a negligible impact on anyone's bill. People will not see it reflected in their bills. However, I understand the principle.

The Chairperson: I appreciate that, but it is the principle. People are talking about legal aid and the implications of that for children's courts, and the pressure has been on. This is a private company and a private entity. Why should it have its legal costs paid by consumers at all? It sounds perverse to me.

Ms Pyper: With respect, that decision was made by the CMA. We would much prefer companies to work with the Utility Regulator to try to form an agreement.

The Chairperson: You are pretty much vindicated on this one. It is a pity that NIE did not stand by it in the first instance.

You referred to extra regulatory powers. For the purposes of Hansard and the Committee, please inform us what those extra regulatory powers would be and what areas they would cover.

Ms Pyper: I am thinking specifically about the new reporting requirements on NIE. Obviously, any regulator can make a determination based only on the information that is provided by the regulated utility. One of the difficulties that we always face in any price control with any company is getting good, robust evidence and hard information from companies.

The Competition Commission has now mandated the use of a particular form of reporting that is commonly used in GB. It is a template-based system, so NIE will be required to report in the same way that regulated companies in GB are required to. That will allow us, as a regulatory organisation, to make direct comparisons between NIE, as a network company, and other similar companies. That is always helpful when you are trying to determine the right allowance for a company such as this.

We have struggled to be able to make those comparisons in the past. The fact that the new reporting arrangements — RIGs — have been mandated will be challenging work for NIE to progress. It will be challenging for my team as well, because we have not had this in the past. However, it will give us a more standard form of reporting from NIE, which will allow us to make direct comparisons with other similarly regulated companies. That will help transparency, benchmarking and comparability, and it will be quite a powerful regulatory tool for us to go back and challenge companies with. That is what I meant by additional powers.

The Chairperson: That is grand. Thank you.

Mr Agnew: Thank you for your patience and your presentation. It has been suggested that there has been too much focus in your initial proposals and the Competition Commission's final determination on short-term costs to consumers and not enough on looking at long-term sustainability and security of supply, as well as, of course, cost. What is your response to that?

Ms Pyper: You are quite right. The Utility Regulator has a responsibility not only to today's customers but to future customers. In all that we do, we have to try to strike a balance between the appropriate level of investment for today and for tomorrow. It would be manifestly unfair to ask today's customers to bear all the cost of all possible future network investment that may be required. That is the role that we play in trying to make sure that any investment proposals are economically justified in recovering the cost from today's consumers.

There is no doubt that we need significantly more grid investment to cope with the rising amount of renewable generation. The questions are: how much investment and how soon, how should that be phased, and what is the right amount? That is the regulatory judgement that has to be made. It is how we approach price control, and it is also what the Competition Commission has done. The commission has come down on a figure that is not a million miles from where we were on what the next phase of investment should be, within this price control. We are starting, almost immediately, to look at the next phase of development and the next price control, so it is not as though this is capping investment; it is only for this period of the price control that is recoverable from customers.

The Competition Commission also said that, if NIE can come back to us with economically justified proposals to facilitate further renewable generation, we can look at those again.

Mr Agnew: Is that within the current price control?

Ms Pyper: Yes. If we had had time for the grid connection presentation, that would have come out in one of the later slides. The Utility Regulator has not turned down any request from NIE that has been economically justified to facilitate renewables. We have a track record of facilitating such investment, and we have not turned it down. It is better to think of this as part of a rolling programme. The Competition Commission and the Utility Regulator agree that that is appropriate for this phase of investment to be recovered from customers, but we will start work on the next phase almost immediately. If there are specific case-by-case proposals that NIE can bring forward, we have the right to look at them again. When there is an economic justification, the Competition Commission has given us some flexibility.

Mr Agnew: The price control period lasts until 2017. Obviously, there is a political period, up to 2020, for 40% of electricity to come from renewables. By asking this question, I am asking you to speculate to some extent on the next price control: can we hit the 40% renewables target, given the Competition Commission's decision?

Ms Pyper: It is always challenging, but our belief is that we can, because that was the context in which we viewed the RP5 price control. We are cognisant of the Executive targets. Our perspective was to do with the right phasing and the right amount of expenditure that will help to facilitate us to 2020.

Mr Agnew: As mentioned, your duties are to consumers for security of supply, sustainability and cost. Does the 40% target place a duty on you to facilitate that, or do you take it into account even though it is not your duty because it is not your policy?

Ms Pyper: We are an independent regulatory body, but we do not operate in a vacuum. We operate within the strategic context that has been set for us. You are right: it would be perverse of us to operate in a way that was not designed to move towards the targets that have been set at a political level.

Ms Tanya Hedley (Northern Ireland Authority for Utility Regulation): We have a clear legal duty, which has been set by the Executive, to promote renewables. When it comes to decisions, we have to take that into account as well as our duty to protect consumers.

Mr Agnew: I am trying to get this clear in my mind. It is not for you to make a decision on whether or not the target is in the best interests of consumers; that is a decision for the Executive. However, you take it into account when you are doing your work.

Ms Pyper: Yes. Obviously, we will be involved in the Department of Enterprise, Trade and Investment's (DETI) work on the 40% target, and we will put forward our views.

As a regulatory organisation, we will try to make sure that we have diversity and sustainability in our generation mix. I would hope that we would never find ourselves in a position in which we did not feel that the overall policy that was being set was not in the interests of consumers. If we were unhappy with the direction of policy, we would have been talking to DETI. We will be working, as Tanya said, to facilitate that. It is very much in our mind in how we approach the price control process.

Mr Agnew: I have one final short question.

The Chairperson: Be brief, please, Steven

Mr Agnew: I want to ask about the slide on page 8 on the rate of return. You highlighted graphs in your presentation, and I am suspicious of graphs. I always question statistics that are laid out visually like that. You said that NIE's proposals look way off trend for rates of return. It is fair to say that, if you are making a larger investment, you expect a higher rate of return — for example, if you are being asked to make a £500 million investment as opposed to a £2 million investment. Would the investments that we are looking at have been of a similar magnitude?

Ms Pyper: The key issue is to reflect the fact that neither the Utility Regulator nor the Competition Commission deemed there to be any additional regulatory risk in Northern Ireland. Therefore, the sorts of investment that NIE proposed were no different in nature, never mind the magnitude of the investment. There was no Northern Ireland premium, so there was no additional risk in Northern Ireland and no reason why the rate of return that is applicable in GB should not be applicable here. That is essentially what the Competition Commission has said: there is no Northern Ireland premium when it comes to investment.

The Chairperson: I would like clarity on the 40% renewables target that Steven mentioned. Are you confident that, if we do not meet the 40%, it cannot be attributable to the Competition Commission's RP5 price determination?

Ms Pyper: In order to facilitate that, we will look at more investment in the grid. There is no question about that. I believe that the Competition Commission has determined the right and appropriate level of investment for this period, and, clearly, as Utility Regulator, we will look to facilitate more investment in the future. As always, Chairman, the issue is the balance between how much is too much. We cannot support a gold-plating of the network, and we cannot ask customers to pay for network investment that will not be delivered in or is not needed in that period. It is a matter of trying to match the increasing contribution of renewables with increasing investment in the grid. I believe that we are still on course to achieve that.

The Chairperson: So that is a yes.

Ms Pyper: That is a yes.

Mr Frew: On the question on the graph, which was raised by Steven and the Chair, can the differentials between what NIE wanted, what the Utility Regulator wanted and the final decision be mapped out practically to show where that investment would have gone in?

Ms Pyper: Yes, it can.

Mr Frew: OK. Is it simple? Could we read it?

Ms Pyper: We can write to the Committee, if you would like to see the detailed breakdown. I did not come with that level of detail today, but, if the Committee is interested to know exactly where the differences were, we can do that.

Mr Frew: I think that it would be useful to have that. I am mindful that NIE has been liaising with renewable energy companies on offers, which were always conditional on the level of investment. I know that this is more a question for NIE, but, in your opinion, where do those conditional offers sit, and how does that help, or not help business, to plan?

Ms Pyper: That is a core issue, which, I think, we would have talked about under the section on grid connections, but I am happy to take it now.

Ms Hedley: Under grid connections, which we will come back to, I was going to talk about our role as a disputes body. We have a quasi-legal role. If somebody raises a dispute, we have to make a determination, and that is binding on NIE. Obviously, we have other processes through which we try to resolve issues before it gets to that stage. We also have a group, the renewables grid liaison group, which has met six times in the past year. All renewable interests in Northern Ireland are represented, and people can raise issues, which we can, hopefully, address with NIE before we even get to the complaints stage. We then can deal with complaints, and we try to do so informally. Often, that can resolve issues, but sometimes, unfortunately, we get to the stage of a formal dispute. Unfortunately, the issue that you raised is part of an ongoing dispute, so we are not in a position to comment. However, perhaps by the time that we come back to the Committee, that will have moved on.

Mr Frew: Is the dispute on costs alone, or is it about the timescale?

Ms Hedley: We cannot talk about the dispute because of the nature of it, but I hope —

Mr Frew: In a general sense, would you be able —

Ms Hedley: We have a number of disputes, so I feel uncomfortable.

The Chairperson: We will come back to the grid connection later. Do you have anything further for now, Paul?

Mr Frew: No, I am fine on that section.

Mr Flanagan: Thank you for the presentation. Are we dealing solely with the Competition Commission determination now?

Ms Pyper: I think that the Chair indicated that we would talk about the Competition Commission determination and then progress with the new market.

The Chairperson: I know that Gordon wanted to come in on the Competition Commission.

Mr Flanagan: So do I, but I am seeking clarity. Have you opening remarks to make later on the I-SEM?

Ms Pyper: Yes.

Mr Flanagan: That is OK. I have a couple of questions on the Competition Commission. It is the second determination that has had to go to the Competition Commission, or the Competition and Markets Authority, as it is now, in recent times. First, there was Phoenix, then there was NIE. Serious efforts were made by both organisations to overstate the impact that this would have on investor confidence. In your assessment, have the disputes had a negative impact on the willingness to invest in either company?

Ms Pyper: There has been the very successful sale of Phoenix since the first referral to the Competition Commission. It certainly did not put off the investor, Hastings, which made a very significant investment to purchase Phoenix. I will make two points about the referrals. The Competition Commission did not identify any additional risk for investment — no risk premium in Northern Ireland. We have also seen an assessment by one of the rating agencies, Moody's, of the determination that we made for Phoenix's subsequent price control — GD14 — which was not the subject of a referral. Its assessment at that point was that the Utility Regulator had made a very firm and robust but fair determination that had not impacted on the rating of the company. Moody's independent assessment was that there was no additional regulatory risk in Northern Ireland. Having two referrals has been a challenging time. They are much more common in GB. I hope that there will be some demonstration, particularly from the referral on RP5 on NIE, that the Utility Regulator has been conducting robust and thorough regulatory price controls, and that that will give some stability and certainty.

Mr Flanagan: Are you satisfied that the level of return that NIE gets now is more than enough to attract investment?

Ms Pyper: Part of the reason why I included slide 6 at page 8 is that you can see the trend that, consistently, across water, rail, electricity and gas, the determinations and rates of return have consistently followed that particular trend. We are very much in line with the trend in GB. The Competition and Markets Authority has a much wider remit than we do and looks at much wider financial issues, including investability. That is the determination that it made, and that is the trend. It is not out of keeping with the market trend.

Mr Flanagan: How do you try to stop companies refusing to accept your determinations? Are there any safeguards in place to make sure that they do not refuse sound determinations? If customers incur the cost, they risk nothing by refusing a determination and going to the CMA.

Ms Pyper: The determination, as the Chairman pointed out, has shown that there are considerable risks in what any competition commission might determine. I have been in post for six months and am keen to learn lessons from both referrals to the Competition Commission. Every price control is different. I want to make sure that we learn the lessons, particularly on the level of stakeholder engagement, so that we try to move forward with the companies with a shared understanding of what the art of the possible is here in terms of expectations. From my perspective, we will look at the lessons, our processes and, in particular, engagement with the companies.

NIE has welcomed the new method of companies reporting information to us. It gives NIE greater certainty about what the regulator expects and the standards that will be applied. All that certainty and transparency will be helpful to us. Each process will be different. I just hope that we can learn, improve and raise the bar in our engagement and dialogue. We cannot ever expect companies, however, to be happy with the regulator: we are coming from very different places. Provided that we have a process that the companies feel is robust, transparent and fair so that they can understand where we are coming from and where we are trying to get to, they might not like the end result, but, hopefully, they will feel that they can accept it as being a robust regulatory settlement.

Mr Flanagan: Has NIE's sale of Powerteam had any impact on the determination? Was that a result of the pending determination, or was it a completely isolated business decision?

Ms Hedley: NIE put in place the sale of a group called Powerteam Electrical Services, which does not work in Northern Ireland. A separate group called Powerteam employs the group of staff who work on our network. That has not been sold and is still working in Northern Ireland. I think that there was some confusion in the press because the names are so similar. That sale had absolutely no impact

on the company that was part of the regulatory determination that the Competition and Markets Authority made.

Mr Flanagan: I am confused. What did you just say? What has it sold?

Ms Hedley: There are two companies: one is called Powerteam Electrical Services; the other is called Powerteam.

Mr Flanagan: Right.

Ms Hedley: Powerteam Electrical Services was sold. It did not work in Northern Ireland; it worked for the group outside Northern Ireland. So the sale had no impact.

Mr Flanagan: So the company doing all the grid work and connections here is still owned by NIE.

Ms Hedley: Yes.

Mr Dunne: Thanks very much, folks, and apologies for the delay. On NIE's payment security policy, I see that you have —

The Chairperson: Sorry, Gordon, did you want to come in on the Competition Commission?

Mr Dunne: No.

The Chairperson: Sorry. I had you down twice.

Mr Dunne: No, I have a question on the next section.

The Chairperson: Maybe hang fire until later, if that is OK.

Mr Dunne: Will it be much later, Chairman?

The Chairperson: No. If it is OK with you —

Mr Dunne: I will come back to you. Sorry about that.

The Chairperson: We are working our way down the list, and I had you down for the Competition Commission as well. Phil, you are up next on I-SEM. Do you want to give an overview of that first, ladies?

Ms Pyper: We just have a few slides on that, Chair, if you are —

The Chairperson: Very briefly, please.

Ms Pyper: That is fine. I did not cover that in my initial presentation.

The new regional electricity market in Northern Ireland and the Republic of Ireland is known as the I-SEM. The Committee is very familiar with the single electricity market that was created in 2007. It is a wholesale market, and the Committee will be familiar with the various elements from its review of pricing. A customer's bill has wholesale, network and retail elements. The SEM deals with the wholesale piece, which is where we have a shared market on the island.

Europe has mandated that we need to change the form of the market. It welcomed and was very supportive of the single electricity market in 2007. It felt that it was groundbreaking in Europe and a very welcome way of trying to get a more effective and efficient electricity market. It certainly was in line with the direction of travel of European energy policy, which is trying to harmonise and standardise right across Europe to get the maximum efficiencies and economies. Notwithstanding that welcome, however, Europe has mandated that a new and very different market model be developed. It is aimed at harmonising cross-border trading arrangements in electricity across Europe. It is not simply a requirement to tweak the existing SEM; it represents a significant change.

The SEM Committee, which, as the Committee knows, is the regulatory organisation charged with managing and regulating the single electricity market, had been reviewing its effectiveness, particularly because of the increasing contribution from renewables. We had looked at opportunities to review and improve the single electricity market. The mandate from Europe for a new model means that we now have to try to revise the design of the market, but our objective of trying to get the greatest benefits for consumers, North and South, which was the original intent of the SEM, remains. We are seeking to maximise benefits and security of supply for customers now and in the future. Europe recognised that we had done a good thing in creating the single electricity market and acknowledged the difficulties of unpicking that to create a new one. So it gave Northern Ireland and the Republic of Ireland a two-year derogation. Elsewhere in Europe, everyone has been told to be compliant by 2014, but we have been given an extra two years, and the SEM Committee has been working to try to design a new market model that will comply.

Europe has not told us exactly what the market is to look like, but it has told us what its key features should be. The current market is really a simple, central pool with a single system marginal price. The Committee is familiar with that. The new market must have at least three trading markets: a long-term market, which allows companies to hedge over a longer period; a day-ahead market; and an intraday, or within-day, trading market. That is very different from our single electricity market. The SEM Committee has been consulting on a number of types or models of options that would allow us to move from the single electricity market to what we call an integrated single electricity market or I-SEM.

Slide 13 on page 15 shows in simple terms that what Europe is looking for ideally is similar to what exists in the Baltic and Scandinavian countries, the Nord Pool, which is a very liberalised market. With the SEM, we have a very centralised market with a lot of regulatory intervention and control. There are a number of options on the spectrum, from a very centralised market to a very liberalised one.

So we went out to consultation with three possible models. The consultation closed on 6 April, and we received a total of 95 responses. However, 58 responses were exactly the same, so 37 distinct responses were received. A large number of the wind players put in the same response. I have not gone into detail on the complexities of the different models because I suspect that the Committee might like a briefing on that when our consultation conclusions have been reached.

I will not go through slide 14 in any detail, but we have been using nine principles to assess the possible models. In the new model, we want to try not only to capture some of the benefits of the SEM and comply with the new European model but to address some of the issues, particularly market power, competition, liquidity and so on. The nine principles have been agreed with DETI and the Department in Dublin. Our aim is to encourage competition and maximise efficiency and liquidity in the market. All of that is designed to put downward pressure on the wholesale price.

I have to say, however, that, without the second North/South interconnector, the benefits cannot be maximised. Just as the benefits of the existing market cannot be maximised without the second North/South interconnector, we cannot design a model to get those benefits and be compliant with what Europe wants unless we have further infrastructure. That is because the starting point for a lot of Europe's thinking on electricity markets is to maximise interconnection: they want maximum trading and maximum flows. The new market models that we are looking at cannot design away the absence of further infrastructure. That remains an issue in getting the maximum out of the new market.

Of the 37 distinct responses, 10 were from Northern Ireland, and, of those, the majority supported option 3. The SEM Committee still has quite a lot of work to do on analysing the responses and understanding where people are coming from. We will publish a decision paper with our proposed preferred option, which we aim to do on 6 June. Following our consultation, we will publish a decision paper and then have a further period of consultation to allow those who are unhappy with what we are proposing further chances to have dialogue with us.

Our intention is to finalise, in August, the high-level design for the selected option for the new market. That might present an opportunity for us to come back to brief the Committee in the early autumn and give you the detailed structure of the new market.

I want to mention one thing because I know that the Committee has been very concerned about it. One of the key issues is capacity remuneration. In your report on prices, you expressed concern about the current price-based remuneration scheme, which is, essentially, a pot that is available for every generator. It is one of the challenges that we are looking at and have consulted on, alongside the high-level design. How do we get a more specific and targeted form of capacity remuneration mechanism that is not so broadly based and does not reward generators who are not there to

dispatch? We are looking at a mechanism that will be much more targeted and support generation available for dispatch at any particular time in the market. We want there to be a less open pot of money to bid for. I know that the Committee will want us to come back and talk about that in detail. That is part of the next stage of design that we are looking at.

Mr Flanagan: You are back again, redesigning a single electricity market.

You have talked a lot about the four options. Without going into too much detail, can you tell us what they are?

Ms Pyper: They have different levels of complexity. I did not bring the details, but I could provide to the Committee the non-technical summary available in a document that we published as part of the consultation. Essentially, we have tried to explain the various elements that make up the single electricity market. So we have a long-term hedging element; we have a central pool with only two gate closures; and we have a market that is about the balancing or settlement of the dispatch of the market. The new target model will have a long-term hedging element with physical and financial hedges. The day-ahead market is a new element to us. We have a number of intraday trading markets, auctions, continuous allocation and an EU-wide order book, and we have a more complex balancing and dispatch market. So when I talk about the four options, I am talking about variations in how these different elements of the market would work. That non-technical summary is available on our website, but I can make sure that a copy is provided to the Committee. It will give more detail. I did not think that we would have had enough time to go into the detail today.

Mr Flanagan: It would be helpful if you could give us that. What concerns me is that you are saying that there are four options —

The Chairperson: Members will find some detail on that in their packs.

Mr Flanagan: You say that you are looking at four options, and you will pick one and then assess the impact on customers. Is that not the wrong way round?

Ms Pyper: The four options are very technical, high-level design options. All are based on the principles that I outlined to you. They also have to be compliant with what Europe has mandated. It all depends on the detailed assumptions underlining each of the markets. We have had extensive stakeholder engagement with all the market participants, and there seems to be consensus on what market participants think would work for them and that regulators also believe will offer us maximum opportunities to get the benefits for consumers. The devil is in the detail of the design, and we will get into that in the next stage. We have been consulting only on a high-level design.

A view emerged that option 4 might not even have satisfied the European requirements and that option 1, the most liberalised model, was too big a step and a massive change from what we have at the moment, and, therefore, probably something that we might aspire to in due course. In other words, we could evolve towards that and perhaps — this sounds like the best example of a civil servant sitting in the middle — there might be a middle option that captured the best of the SEM and allowed us to get some of the benefits of moving to a more liberalised market. However, a full cost-benefit analysis will be done on the preferred model. The detailed operational arrangements will allow us to make sure that we get best value for customers in addressing market power and the market rules.

Mr Flanagan: Have you a preferred option at this stage or are you waiting to go through the consultation responses?

Ms Pyper: The regulators have done a lot of work on what we believe the best option would be. That is what we will publish, based on the dialogue that we have also had with stakeholders. That is what we will publish on 6 June.

Mr Flanagan: You do not want to tell us which one it is, no?

Ms Pyper: I do not think that I should pre-empt the decision of the SEM Committee.

Mr Flanagan: OK. Will the impact on prices that customers pay ultimately be what drives the decision or will it be the feedback from those who are involved in the process and whose primary concern is how much money they can make out of a new SEM?

Ms Pyper: The assessment will be on the nine principles on slide 16. We will look to ensure that there is a stable market and that we have guaranteed security of supply and that it is efficient and effective at the least cost. We are minimising the cost of implementation and so on. It is important to link the design of the market with the capacity remuneration mechanism because, as the committee is well aware, the capacity remuneration mechanism accounted for about 16% of costs in the SEM last year, if I remember correctly. We are looking to try to drive down costs. If we have a more focused capacity remuneration mechanism, rather than a wide pot, which is what we have at present, there is an immediate area where we believe we can get efficiencies.

Mr Flanagan: One of the issues —

The Chairperson: Please, Phil. We are running out of time.

Mr Flanagan: One of the issues that we flagged up in previous phases of the inquiry was the lack of political oversight in the single electricity market. How involved have the two energy Ministers in Ireland been in that process?

Ms Pyper: As I said, the principles against which we, as regulators, are required to assess the new market design have been agreed with DETI and the Department of Communications, Energy and Natural Resources (DCENR). Both Departments will have a role to play in facilitating the legislation. The SEM Committee is the regulatory body charged with addressing the new market. You are aware that there is a joint steering group between the two Departments, North and South. That is where they come together with the two regulators to ensure that there is transparency and clarity on what needs to be done and certainty about how things move forward. I am not in a position to speak about the level of dialogue between Ministers, I am afraid.

Mr Flanagan: As regards the policy preferences of the regulator in the North and the Commission for Energy Regulation in the South, is there much difference on how you want to go or are you both singing off the same hymn sheet?

Ms Pyper: The SEM Committee comprises representatives from the Utility Regulator, the Commission for Energy Regulation in the South and two independent members; one who has experience of the Nord Pool and one with considerable experience in the GB market. The consensus that will emerge, I hope, on 6 June will be between all the regulators about what is best for consumers North and South. That is what we are charged with. That is the SEM Committee's duty. We are required to consider and weigh the interests of consumers now and in the future in Northern Ireland and in the Republic of Ireland.

Mr Dunne: Thanks, folks. I see that the Utility Regulator has great concern about the lack of consultation by NIE on its payment security policy. How do you address that lack of consultation?

Ms Pyper: I will let Jody speak on that, as it is his area.

Mr Jody O'Boyle (Northern Ireland Authority for Utility Regulation): NIE has a licence condition whereby it has to have a payment security policy, which we then have to approve if there are any changes to it. In 2013, NIE came to us requesting to make changes to the current policy. We asked it to put forward some options for changes and the impact of those options. We asked NIE to consult on its website. NIE put out a consultation in 2013. We put up a news item stating that it was on NIE's website. We asked NIE to put together a recommendation report and come to us with a summary of responses. Unfortunately, only two suppliers responded to NIE's consultation —

Mr Dunne: Which was poor, obviously.

Mr O'Boyle: — which we felt was poor. We also felt that there was no customer interaction or feedback from any customer groups, for example the Consumer Council or any other representative bodies, so we decided to reissue the consultation. We drafted our own consultation and attached NIE's consultation to it. Hopefully, we will get a better response for us to pull them together to make a consideration.

Mr Dunne: In relation to the security policy, surely that is a charge that large consumers and manufacturers could do without. You are, in effect, de-risking NIE at the cost of consumers. Is that fair?

Mr O'Boyle: It is, in effect, an insurance policy in case a supplier defaults. There is a level at which you can pay for an insurance policy. We are trying to strike a balance at what the right level is.

Mr Dunne: We have been lobbied by many. Manufacturing NI has been in touch with us. We have had evidence from Michelin, and I am sure you are fully aware of Michelin. They said last week that Northern Ireland now has the most expensive energy in the world. This adds to their costs rather than trying to address the problem. Are you getting to grips with the cost of energy overall? People find this type of thing most disappointing, you de-risking the risk and liability for NIE and passing it on to consumers, some of them huge consumers.

Mr O'Boyle: One option was for no change. We would like to hear from representatives such as Manufacturing NI about which option is most suitable for them as well as hearing from suppliers.

Mr Dunne: Are you doing enough, especially for the big manufacturers and consumers in Northern Ireland?

Ms Pyper: This is only a small element of it, and I know —

Mr Dunne: Still, it is all accumulative, isn't it?

Ms Pyper: Of course it is. We need to look at this cost alongside others and assess the cost of this payment security policy in comparison with the cost and risk to consumers of bad debt should a supplier default on payment. It is in consumers' interests as well. The issue is the level that they should pay, and that is why we are consulting on four options. The challenge is right across the piece on prices. This Committee has been very clear. We found its work on the review of prices extremely helpful, and we will be coming back to talk to you about what we can do.

However, you are aware of the areas where the Utility Regulator can challenge. A good example of that is the work that we did on the Competition Commission and the price control there, where the difference between what NIE was seeking and the final determination was about £210 million, which resulted in a pretty much neutral impact on that part of the bill for customers. That is the sort of robust regulation that we believe is needed.

We went out with this consultation precisely because we were concerned that customers had not had enough engagement or sufficient opportunity. We are trying to make sure that we are engaging with them on this issue as fully as we can. As you might imagine, I meet Manufacturing Northern Ireland regularly to understand the issues. Tanya has been out to talk to Michelin and other big manufacturing companies to understand where their problems and issues are.

Mr Dunne: Thanks very much.

Mr McKinney: I want to move on to another subject, but just to finish that off, the four options that you are looking at and making considerations on strike me as a balance between price and process. There are different revenue streams for the different pots. Will you end up with a process that is ultimately more expensive, although it is better for the process, or what will take priority?

Mr O'Boyle: Once we get the feedback and responses, we will review each response and assess each option. We will look at everything.

Mr McKinney: On the issue of price, are there substantial margins between the revenue for different options?

Mr O'Boyle: Depending on which option is chosen, there will be different impacts on different customers, such as domestic and higher-end users. There will be different impacts for different options.

Ms Pyper: By the way, the consultation closes on the 27 May. Given the Committee's interest, we would be happy to brief you on the outcome.

Mr McKinney: That is welcome.

May I move on to something that is not in your presentation? We are focusing on gas to the west at the moment. Can we get an update on how things are proceeding?

Ms Pyper: The Committee will be aware that we have launched a competitive licence application process to extend the network to Strabane, Omagh, Enniskillen, Derrylin, Dungannon, Coalisland, Cookstown and Magherafelt. The intention is to award two exclusive gas conveyance licences: one for high-pressure assets; and another for low-pressure assets.

As with our existing gas network, the successful operator has to consider all projects and all possible connections on the gas pipeline route, but they must be economically viable. That test will remain.

The tender application process closed earlier this week on 6 May. We had an extensive engagement before the tenders closed to allow any possible applicants to ask questions for clarification. We had a forum whereby any applicants could seek clarification on the process and the detail and on how we would assess the process. That was open to all, and it has now closed. I am glad to say that we have received applications, and we are now working through a process to assess them. We will then go out to consultation on the preferred applicant and probably a reserve applicant. We hope to do that in early July.

An evaluation committee has been set up in the office of the Utility Regulator to work through all the applications for high-pressure and low-pressure assets. We are on target. There is nothing that we have seen in the process so far to suggest that we will not be able to get to a preferred applicant by early July. The intention is to have full licences granted by October. That process is up and running, and we are into the evaluation stage. I really cannot say anything more than that at this stage because I am on the evaluation committee. That is a process that we are now working through. However, I am glad to say that we are on schedule.

Mr McKinney: On track. This is not unlinked. Some big energy providers are considering going off the electricity grid. Will that have an impact on your consideration?

Ms Pyper: For gas to the west?

Mr McKinney: Yes.

Ms Pyper: No. It will not be an issue for us in the gas to the west process. There is a wider grid issue, which, again, we might pick up on when we look at connections.

The Chairperson: Steven, do you have a final point?

Mr Agnew: Yes. Thank you, Chair. I want to come back to the different options for the I-SEM. I think that you said that it was either aspiration or ambition to get to — I am bringing the options up again. Was it option — ?

Ms Pyper: The more liberalised option? Option 1?

Mr Agnew: Yes, basically the most liberalised option.

Ms Pyper: That is certainly what Europe wants everyone to aspire to.

Mr Agnew: I suppose that that is where I am coming from. That may be what Europe wants for mainland Europe. However, some question whether Europe's drive to break up our market would be to the benefit of our consumers. What would be the benefits for consumers, particularly those on this island, of that aspiration to greater liberalisation?

Ms Pyper: Europe is trying to get as much competition into the markets and to make sure that they are as liquid and as efficient as possible. Those who favour markets and market-based competition

argue that the best way to get that is to have markets that are as liberalised as possible. Regulators, on the other hand, particularly in a small market or small markets such as Northern Ireland and the Republic of Ireland, have the sense that the risk of market power and dominance is still a concern and that regulation still has a role to play. The question is where do you go.

I take your point about mainland Europe: much more competition is already there. There are bigger markets, and that encourages competition, which is where Europe wants us to go. However, the assumption underlying everything that Europe is doing on harmonisation and liberalisation is based on greater interconnection so that it does not matter where you are, the electricity can flow and trading can take place. We are quite limited here in the trading opportunities that are available, so I think that, in that sense, we have tried to look at a spectrum from the very liberalised to the very centralised.

Mr Agnew: I think that it has been discussed before, but we are heading towards an all-islands market, these two islands. Is the direction of travel ultimately for a single European market? Is that what is envisaged?

Ms Pyper: Yes, at a high level, a single energy market is what Europe is looking for so that there is free trade as with other goods and services.

Mr Agnew: So this may be seen as a short-term thing that may not benefit consumers now, but, in the long term, if we have an integrated market —

Ms Pyper: I think that the SEM Committee would argue that there are benefits to be had now from moving towards the European model. The question for us is how far we should go and how fast and how we keep some of the benefits and certainties provided by strong regulation and central markets. How do we move in the right direction without giving up all the advantages? It is clear that protecting the interests of consumers is still a significant driver, along with ensuring security of supply. If we did not think that we would get benefits now and we did not think that opportunity existed, I think that we would have challenged Europe and told them that this is really not going to work for us. We feel that it is challenging, but there are opportunities to get a more liquid, competitive and efficient market now.

Mr Agnew: Briefly, without going into the detail, with option 1, how liberal are we talking? Are we talking you out of a job? *[Laughter.]*

Ms Pyper: That might be one indicator of success. *[Laughter.]*

The Chairperson: I do not know. We still need regulation.

Ms Pyper: I think that it would allow an awful lot more control by the companies and a very light touch on regulation. That seems to work extremely well in Nord Pool Spot, and Tanya has been over to see how that market works. There may be something in the Scandinavian psyche that inclines them to be very collaborative and cooperative in their market. However, they have a very different generation mix: they have significant hydro-reserves. There is great certainty of power generation there. We have to balance the type of generation mix that we have here with the fact that we are at the end of the gas pipeline. However, we have the opportunity for increasing renewables, so at least Europe has not mandated a market so specific that it will not be appropriate for our situation. That is why we have looked at different models to get the one most suitable and most tailored to what we have here.

The Chairperson: Thanks very much indeed for that, today, Jenny.

Mr Flanagan: Most of us have been briefed here about energy storage proposals. Can you give us a quick update on where the assessment of that is?

Ms Pyper: That is not with the Utility Regulator. The proposals that have come forward from AES Corporation are with the System Operator for Northern Ireland (SONI) at the moment. The Utility Regulator is interested in seeing all options, and if there are economically viable options for storage, they have to be factored into our mix.

Mr Flanagan: So, you have no update for us?

Ms Pyper: I do not; it is not a decision for us, I am afraid.

Mr Flanagan: OK.

The Chairperson: OK. Again, thanks very much for your time. We look forward to seeing you again to talk about the grid stuff, which will prove very interesting, I am sure.

Ms Pyper: Thank you for that and thank you for the opportunity. What I will say on the grid issues, because we do not want to hold up your work in any way, is that if it is of help to your researcher or Clerk, we are happy to meet and give briefings to the researcher if there is any information that we have that could help with that work, as we did with PricewaterhouseCoopers. We are more than happy to facilitate that. These are important issues, and we welcome the Committee's attention to them.

The Chairperson: Great. Thanks very much indeed.