G-TUoS Revenue Allocation

Decision Paper
27 April 2021

About the Utility Regulator

The Utility Regulator (UR) is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.

Our vision

To ensure value and sustainability in energy and water.

Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.

Abstract

Today we publish our decisions regarding the allocation of revenues to the G-TUoS tariff pot. The decision corrects the differences between revenue allocations in Northern Ireland and the Republic of Ireland.

The purpose of this paper is to detail the feedback received to the consultation in August 2020 and set out the rationale for decisions with respect to recovery of TUoS going forward.

Audience

This document will be of interest to SONI, EirGrid, generators and electricity customers.

Consumer impact

The proposals will not impact the overall amount of transmission revenue collected. However, there will be redistributive impacts on all-island generators and NI electricity consumers.

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1. Introduction

Purpose of this document

1.1 Our role is to protect the interests of current and future Northern Ireland (NI) electricity consumers. A crucial way we do this is by ensuring that customers are charged appropriately for the service they receive.

1.2 The purpose of this paper is to align the transmission revenue being allocated to the all-island transmission tariff for generators. Several options have been identified and investigated. A consultation with a preferred methodology was published in August 2020. Five responses were received from stakeholders in October 2020.

Background

1.3 Transmission Use of System (TUoS) tariffs are designed to recover the costs of owning, maintaining and operating the electricity transmission network. In Northern Ireland (NI) this covers the revenue of NIE Networks as the transmission asset owner (TAO) and SONI as the system operator (TSO). In the Republic of Ireland (RoI) the respective companies are ESB Networks (TAO) and EirGrid (TSO).

1.4 In 2011 the Single Electricity Market Committee (SEMC) determined that 25% of transmission *network costs* be recovered from all-island generators (the G-TUoS tariff). The remaining 75% would be collected from suppliers on a separate jurisdictional basis.[1]

1.5 As set out in the G-TUoS revenue allocation consultation paper, a misalignment exists between allocation of costs north and south to the G-TUoS pot. For SONI, 100% of their costs are charged to NI customers through the SSS (System Support Services) tariff. The difference arises due to the fact that a proportion of EirGrid internal revenue is recovered from generators.

1.6 The difference of approach seems to have arisen due to historic differences in TSO activities. A *network cost* adjustment was undertaken for EirGrid as they had responsibilities which historically fell to NIE Networks.

1.7 However, since the transfer of the planning function to SONI in 2014, the TSO responsibilities north and south are now broadly aligned. As such, the cost allocation methodologies are not aligned, resulting in redistributive impacts on generators and consumers alike.

[1] G-TUoS Decision Paper, SEM-11-078, p26-27.

2. Proposals

Potential Options

2.1 In order to resolve the issue, the UR consulted upon four main options as a potential remedy to provide alignment. These included:

1. **Option A** – Do nothing. Maintain existing arrangements.
2. **Option B** – 25% of <u>all</u> TAO and TSO revenues (in RoI and NI) are allocated to the G-TUoS pot.
3. **Option C** – Only TAO costs are considered as network costs, of which 25% are eligible for recovery via G-TUoS (NI methodology).
4. **Option D** – SONI follows EirGrid methodology in allocating a proportion of TSO revenue from the SSS tariff to the G-TUoS tariff (RoI methodology).

2.2 Whilst Options A and B were largely discounted, Options C and D were considered to be viable alternatives. The consultation paper had Option D as the preliminary preferred option on the basis that:

a) It provided the required alignment.

b) It would have the lowest redistributive impact on tariffs.

c) It would reduce the costs borne by NI demand customers.

d) It would align the process in NI to the SEMC decision of 2011.

2.3 The consultation paper sought views on the options listed as well as any other aspects of the paper that were pertinent.

3. Consultation Responses

Preferences

3.1 Five responses to the consultation were received. These included feedback from SONI, EirGrid, the Consumer Council (CCNI), NIE Networks and ESB Generation and Trading (ESB G&T). Responses are published alongside this decision paper.

3.2 Whilst respondents generally agreed that the misalignment should be corrected, both SONI and EirGrid suggested that 'do nothing' should not be discounted. The TSOs view is premised on the issue being of relatively low materiality.

3.3 The majority of respondents (EirGrid, SONI and ESB G&T) consider Option C to be the most practical solution. EirGrid did not however have an objection to Option D if it represented a simple mechanistic calculation.

3.4 CCNI felt Option D to be the most appropriate way forward in terms of tariff impact and reduction of costs to NI electricity consumers. NIE Networks agreed with alignment but did not signal a preferred option. However, they do wish to understand how the change would work alongside the separate proposal to transfer TUoS cash imbalance risk from SONI to NIE Networks.[2]

Views & Responses

3.5 Specific points raised by the respondents are set out in the tables below along with responses from the UR.

Table 1: CCNI Views and UR Responses

Organisation	Comment and Response
CCNI	It is essential that any impact leads to a positive outcome for Northern Ireland consumers both now and in the future.
UR Response	*Alignment should provide a positive outcome as it will ensure the appropriate revenues are collected from the correct customers.*
CCNI	It is essential that consumers throughout Northern Ireland especially those that are more vulnerable are not disadvantaged by the final decision. The Consumer Council would seek reassurances from the UR in its decision document that consumers in Northern Ireland will not be disadvantaged.
UR Response	*Neither Options C nor D would disadvantage NI consumers. Option C would maintain the status quo for NI demand customers whilst Option D would reduce demand tariffs. Not correcting the misalignment would however be unequitable.*
CCNI	The Consumer Council would ask that the UR's decision document presents indicative figures about what this would look like on an end consumer bill.

[2] See SONI Draft Determination, Annex 7, Risk and Return, para 11.5 to 11.12, p57 - p58.

UR Response	The impact on the domestic bill is set out in the next chapter.
CCNI	Consumer Council supports the UR preferred option which is Option D as it will deliver the lowest impact on tariff changes and will reduce the costs incurred by Northern Ireland consumers.
UR Response	UR agrees that this option will reduce costs for NI demand customers.

Table 2: ESB G&T Views and UR Responses

Organisation	Comment and Response
ESB G&T	We support a need for a review of network charging structure in order to address the issue of a potential revenue allocation misalignment.
UR Response	UR agrees with this statement.
ESB G&T	We agree with both TSOs' views that Option C represents the most pragmatic and efficient approach.
UR Response	UR accepts that Option C is a pragmatic approach.
ESB G&T	Option D does not represent an efficient approach to resolving the network revenue misalignment, since it would translate into a more complex and onerous change for the industry. Not only will it require substantial effort from SONI to develop and incorporate all the required modifications, it is also likely to have material commercial implications for generators in the SEM.
UR Response	UR disagrees with this statement. This option should not require substantial effort to develop. As signalled in the consultation paper, it is envisioned that adoption of Option D would be a mechanistic calculation whereby 15% of SONI's internal costs will be allocated to the G-TUoS pot. Furthermore, this should not translate into a more complex change for industry. In fact, industry should not notice any change to current arrangements other than a change in the tariff which naturally occurs each year.
ESB G&T	Option D would lead to an increase in generator G-TUoS charges within a relatively short period. As many generators would have already obtained Capacity Market contracts through a T-4 auction process, they may not be able to recover this additional increase in charges.
UR Response	Whilst ESB G&T raise a legitimate point, this is little different to increases in TUoS which occur at present by NIE or ESB Networks undertaking transmission projects not provided for in their price control. It is assumed that such risks are priced into auction bids accordingly. Analysis also indicates that 15% of SONI costs is not that material in comparison to the G-TUoS pot, so the impact on tariffs is limited. For 2019-20 the G-TUoS tariff pot was €94m across the island. Incorporating 15% of SONI's internal costs (excluding the K-factor and ancillary services) would add a further €4.5m to the total, representing an increase of less than 5%.

Table 3: EirGrid Views and UR Responses

Organisation	Comment and Response
EirGrid	EirGrid believes the current methodology does deliver the desirable outcome, as set out in the regulatory decision. However, EirGrid sees merit in reviewing the current methodology following the transfer of a number of Northern Ireland Electricity's (NIE's) responsibilities and network functions to SONI.
UR Response	UR welcomes the statement that there is merit in a review of the charging methodology. However, it is difficult to understand the view that the current methodology is delivering the outcome as set out in the original SEMC decision. If TSO responsibilities are broadly aligned, it would seem rational that the same method of allocating costs to G-TUoS should be used by SONI and EirGrid.
EirGrid	EirGrid maintains that expenditure associated with network investments and upgrades is best recovered via the associated network charges and that, as part of this, the G-TUoS element should recover expenditure associated with generators' access to the All-Island Networks and to the Single Electricity Market.
UR Response	This view is consistent with the SEMC decision and UR agrees with the principle. However, the original SEMC paper did not specifically define what constitutes network investment. It could certainly be argued that TSO planning activity would fall under this category. If so, Option D would seem to be the appropriate methodology to deliver against the SEMC criteria. However, the level of materiality allocated to network costs (60% of internal costs) would be open to question and would reflect a higher percentage than the current resource SONI allocates to this activity.
EirGrid	EirGrid understands the impact of this misalignment to be relatively immaterial on G-TUoS in general and on NI generation in particular. As a result, EirGrid considers that Option A should not be ruled out at this time.
UR Response	It is accepted that the issue is not that material in the context of the existing G-TUoS pot. However, allocating EirGrid TSO costs on generators without a similar arrangement for SONI will ultimately mean NI customers paying a disproportionate amount. This conclusion is based on generators ultimately recovering their costs from customers on a jurisdictional basis. Furthermore, as the allocation represents a fixed percentage, the materiality will increase over time with growth in TSO costs. As such, UR is of the opinion that the misalignment should be corrected at this time.
EirGrid	If the UR is seeking a relatively straightforward means of removing misalignment then this approach [Option C] may be the most straightforward. It would however require engagement with the RoI regulator, the Commission for Regulation of Utilities, and may require a re-working of the SEM Committee principles and may ultimately be a SEM Committee matter.
UR Response	UR accepts this point.
EirGrid	EirGrid believes that this approach [Option D] is consistent with the philosophy of ascribing network based costs to G-TUoS. Assuming that the underlying collection arrangements in RoI remain unchanged and that the mechanistic calculation set out in UR's consultation paper is applied, EirGrid has no objection to Option D.

UR Response	On the assumption that TSO planning activities constitute network investment, it would seem reasonable that a proportion of TSO costs be allocated to G-TUoS. This would seem consistent with the spirit of the original SEMC decision.

Table 4: NIE Networks Views and UR Responses

Organisation	Comment and Response
NIE Networks	NIE Networks notes from this consultation that there is a misalignment between the costs allocated to generators in the all-island G-TUoS tariff and on that basis, agree that change is required to the revenue allocation to protect the interests of Northern Ireland electricity customers.
UR Response	UR agrees with this statement.
NIE Networks	It is not clear what proportion of the G-TUoS pot is recovered from NI customers, or what is the impact on Northern Ireland customers' retail electricity bills.
UR Response	The impact on the customer bill is set out in the next chapter.
NIE Networks	NIE Networks is content in principle with the proposal to align the cost recovery methodologies used in both jurisdictions; however we are also conscious of the UR's separate consultation which proposes to transfer the risk of TUoS cash imbalances from SONI to NIE Networks. It is not clear to us how both of these proposals interact and therefore how they potentially impact on NIE Networks when taken together.
UR Response	The proposal to transfer the TUoS cash risk to NIE Networks has been postponed. Within the SONI final determination we state, *"However, on further consideration of the points raised by SONI, we recognised that there are some significant practical implementation issues to work through in relation to the de-risking of SONI's revenue collection role. We plan to carry out a separate consultation on specific licence modifications that would de-risk SONI's TUoS role."*[3] TUoS collection risk will therefore remain with SONI in the short term. As such, inclusion of TSO costs in the generator pot should not impact on NIE Networks or existing arrangements. However, there is an expectation that the change will occur in the future. This will however be set out in any future consultation on the transfer of TUoS risk.

[3] See SONI Final Determination, Annex 5, Risk and Return, para 4.13 to 4.14, p83.

Table 5: SONI Views and UR Responses

Organisation	Comment and Response
SONI	Despite this consultation overlapping with the consultation on the UR's Draft Determination of SONI's price control, there is no mention of the proposal to change the allocation of risk associated with TUoS revenue collection that was introduced in that paper or the interaction between these two proposals. If SONI is expected to collect 15% of the revenue related to its internal costs through the G-TUoS tariff, we would expect clear confirmation around how the risks of under recovery will be processed.
UR Response	As above, this is not an immediate issue as the risk transfer has been postponed. However, any prospective changes will be set out in any future consultation on the transfer of TUoS risk.
SONI	How the reallocation of collection agent risk and income apportionment will be reflected in both licences should be set out, to ensure that there are no unintended consequences for our compliance as a result of the changes proposed across the two consultations.
UR Response	Such detail is not necessary in this decision paper as there is no licence change expected. This will however be set out in any future consultation on the transfer of TUoS risk.
SONI	These comments on Option D are premised on the assumption that the change will be a mechanical copy and paste of the percentage split applied in Ireland. A more granular exercise would divert resources away from activities that add value for customers and would therefore be disproportionate for an interim measure. Without further information covering these three issues, SONI is not able to support Option D. We would expect further consultation around the missing information before this proposal could be implemented.
UR Response	UR can confirm that Option D would represent a mechanistic calculation for internal costs. Whilst the licence formula for the 2020-25 price control is not yet agreed upon, it is expected that G-TUoS network costs would constitute 15% of all revenue excluding ancillary services (At), the K-factor and any rewards/penalties from the new performance incentive framework.
SONI	Overall Option C remains SONI's preferred route to resolve this issue. This is the most transparent of the four options, because the revenues recovered under the G-TUoS tariff would be linked solely to the TAO price controls. From SONI's perspective this would be the most straightforward and fastest to implement, with no change required to SONI's current approach. SONI therefore urges the UR to work constructively with the CRU to deliver this outcome.
UR Response	UR accepts that Option C is a pragmatic approach. However, in order to be consistent with the SEMC decision, it would seem that some TSO costs should be recovered via G-TUoS if system planning by the TSO is considered a network investment.
SONI	SONI agrees with the UR that the current situation is imperfect; however because the interjurisdictional inequity is of relatively low materiality, it [Option A] should not be discounted at this stage.

UR Response	As above, UR considers the misalignment to be inappropriate and may become an increasingly material issue should TSO costs grow. As such, UR does not consider that Option A is an appropriate way forward.

Transfer of TUoS Risk

3.6 SONI is responsible for setting tariffs and collecting revenue associated with owning and maintaining the transmission network on NIE Networks behalf. At present, the NIE Networks TUoS requirement is divided by 12 and paid by SONI on a monthly basis. SONI must pay this to NIE Networks regardless of the monies collected.

3.7 As a consequence of this arrangement SONI takes the risk on TUoS under recovery and is remunerated for this service via a percentage margin. In the SONI draft determination UR proposed that this risk should transfer to NIE Networks. Both NIE Networks and SONI raised concerns that the G-TUoS consultation did not address the issue of the TUoS risk transfer.

3.8 As the decision to transfer the risk has been postponed, there should be no impediment to proceeding with the allocation of TSO costs to G-TUoS tariffs. Any future proposal to transfer risk will be subject to a separate consultation.

4. Decision

Summary

4.1 Given the responses received, it does appear that either Option C or D would be viable alternatives. Whilst UR has taken on board the points raised, Option D is considered to be the most appropriate way forward.

4.2 This is due to the fact that it will have the lowest redistributive impact and seems appropriate given that TSO network planning activities would seem to fall under the definition of network costs. Consequently, Option D would be in line with the original SEMC decision.

4.3 From a tariff perspective this will mean 15%[4] of all SONI revenue related to internal costs being allocated to the G-TUoS pot. For the avoidance of doubt, this will exclude ancillary services (At), the K-factor and any rewards/penalties from the new performance incentive framework.

4.4 The residual 85% of TSO internal costs will be recovered from the SSS tariff. No change is expected for S-TUoS tariffs which will remain at 75% of NIE Networks TUoS requirement.

4.5 In terms of the impact on the domestic bill, this will change each year depending on internal costs and domestic consumption. However, the table below gives the indicative impact using 2019 consumption figures and 2019-20 SONI revenues.

Table 6: Impact on NI Domestic Bills[5]

Domestic Connections (No.)	Average Consumption (kWh)	Unit Cost (p/kWh)	Annual Bill (£/year)	Option D Impact [Domestics - £m]	Revised Annual Bill (£/year)
816,055	3,486	17.2	**£600**	-£1.51m	**£598**

4.6 In 2019 the average domestic bill was close to £600 per annum. Allocating 15% of SONI's internal costs for 2019-20 to G-TUoS would remove £4.1m from NI demand tariffs. Based on consumption, domestics would benefit by 37% as a proportion of their total usage. As a consequence, the domestic bill would reduce by £1.85 as a result of the cost reallocation.

4.7 UR considers this to be an equitable outcome and represents the method to be undertaken in tariffs from the first year that they are based on the updated revenue algebra as set out in Annex 1 of SONI's TSO licence.

[4] A 15% allocation will be based on forecasts for some SONI revenue formula licence terms. As all differences will be corrected via the SSS K-factor, the final amount paid by generators may fluctuate slightly above or below the 15% rate.

[5] Figures for domestic connections, average consumption and unit costs are taken from the 2019 Annual Transparency Report, Table 3, p9 and charts on p19.