

Maximising Customer Value

Options for Northern Ireland Energy Holdings

1 Summary

- 1.1 Northern Ireland Energy Holdings (“NIEH”) continues to develop proposals for the best use of its resources so as to maximise long term value to the energy customers of Northern Ireland. The company intends to maintain and build on its track record of contributing to lower energy prices in Northern Ireland, achieving the proper balance of short, medium and long term considerations and plans. NIEH looks forward to the input of the wider community to its development of these plans through the responses to the Authority’s consultation.
- 1.2 NIEH has used the operating surpluses of Moyle Interconnector Limited (“Moyle”) to contribute to the reduction of electricity prices in Northern Ireland, as the need has arisen and the company’s circumstances permitted. Contributions totalling £14.7m will have been made in the period 2003-07, despite major adverse changes in Moyle’s trading conditions and the uncertainty as to its position under the Single Electricity Market (“SEM”) rules from 2007-08 onwards. Under the draft rules, Moyle would not be paid for the capacity benefit it actually provides. If the rules are not modified so as to rectify this, the company will incur significant deficits, which will have to be funded by the electricity customers of Northern Ireland. Moyle has imposed no burden on customers to date and aims to continue to avoid doing so. Consequently, until Moyle’s revenue uncertainty is resolved, NIEH believes it must take an extremely prudent approach to further commitments to contribute to lower energy costs in the short to medium term or to longer term investment.
- 1.3 NIEH greatly appreciates the Authority’s approval of its £10m investment as founding investor in the renewable energy investment fund which it is now setting up as a joint venture with Northern Renewables Limited. NIEH is confident that its investment in the fund will not only contribute to the implementation of government policies on renewable energy and the environment but will provide a good return to the energy customers of Northern Ireland.
- 1.4 Investing the capital refund in a partial buy back of Moyle’s bonds would provide a very low return on the funds, so the company will continue to seek alternative means of earning greater returns.
- 1.5 NIEH is in agreement with the principles which the Authority has set out to underlie decisions on the investment of the funds at NIEH’s disposal. In addition, NIEH believes that its plans should be matched to and build on its existing strengths. The company’s preliminary assessment of each of the listed options against these principles, but making no assumptions as to the intentions of any other party who would require to be involved, is set out in Section 6 of this response.

2 Introduction

- 2.1 Northern Ireland Energy Holdings (“NIEH”) welcomes the Authority’s consultation on the options for the company in the future and how the resources it has available can best be used for the energy customers of Northern Ireland, in whose long term interest the company is run. As for any other company, NIEH’s directors carry the responsibility for managing its resources in the interests of the company and maximising value for its stakeholders. Being a mutual company with no shareholders, NIEH’s principal stakeholders are the energy customers of Northern Ireland, who are represented in the corporate governance arrangements of the company by its members, to whom the directors are accountable. As NIEH develops proposals for the best use of its resources and continues its dialogue with the Authority under its regulatory arrangements, the opportunity to have the thinking of the company and the Authority informed by the views of the wider community is welcome.
- 2.2 The Authority’s paper notes the successful track record to date of NIEH in maximising value for the electricity and gas customers of Northern Ireland. In the context of the present consultation, the paper notes particularly the record of NIEH’s subsidiary, Moyle Interconnector Limited (“Moyle”), in relation to its contribution to electricity prices. NIEH intends to maintain and build on this track record into the future. In addition to the efficient running of its present businesses, NIEH aims to further benefit customers through the effective use of the additional resources at its disposal, achieving the proper balance of short, medium and long term considerations and plans.
- 2.3 In relation to short to medium term customer benefits, the company has to date used the surpluses Moyle has built up from earlier years’ trading to directly contribute to electricity prices in Northern Ireland, keeping those prices lower than they would otherwise have been. Looking to the future, it is an important objective of the company to maintain its ability to contribute in this way. Moyle has in the past faced calls for all of its available resources to be used for the immediate relief of electricity tariffs. However, NIEH believes that it would not be properly discharging its responsibilities towards the company or the long term interests of customers if it were to respond to such calls in a way that would provide a short term benefit but result in Moyle having to seek support from customers in subsequent years in order to meet the costs of running its business.
- 2.4 In the course of the re-negotiation of its connection and use of system arrangements in Great Britain, necessary for the implementation of the new electricity trading arrangements there (“BETTA”), Moyle was very pleased to have obtained the capital refund of £30.1m on behalf of its stakeholders. As the Authority’s paper notes, this amounted to the return of funds which had originally been borrowed as part of Moyle’s bond financing. In NIEH’s view, these considerations define the BETTA Rebate as capital funds which must therefore be put to use with a view to the long term customer interest.

3 The Moyle Interconnector Business

- 3.1 As the resources of NIEH which are the subject of the present consultation derive from the Interconnector Business operated by Moyle, any consideration of the best use of the funds must be in the context of that business. The policy of NIEH is that it is in principle prepared to use its operating surpluses to contribute to the reduction of electricity prices in Northern Ireland, as the need arises and the company's circumstances permit. The Authority has noted Moyle's direct contribution of £2.3m from its operating surpluses to the reduction of electricity tariffs in 2004-05, and the further contribution of £12.4m being made in 2006-07 principally from accumulated operating surpluses, backed by the funds from the BETTA Rebate. The latter contribution is being made despite the major change in Moyle's economic environment from the beginning of 2005-06 and the uncertainty as to Moyle's trading conditions in the Single Electricity Market (SEM) from 2007-08 onwards.
- 3.2 The uncertainty as to Moyle's revenue from 2007-08, noted in the Authority's paper, derives from the market rules as now published. The Authority, together with the Commission for Energy Regulation in the Republic, has decided that in the SEM the providers of generation capacity to the all-Ireland electricity system should receive capacity payments dependent on the extent to which their capacity is made available to the system. Moyle's capacity contribution has been demonstrated by the experience of the last four years and has been recognised by both the system operator and the Authority in their respective published documents. Nevertheless, the SEM rules do not so far provide for the capacity payments to be made to interconnector owners based on the availability of their assets to the system. If the SEM rules are not modified so as to pay Moyle for the capacity benefit it actually provides to the system in the whole of Ireland, the company's revenue will continue to be very uncertain and will most likely be at a level which will result in significant deficits. As the Authority's paper notes, any such deficits will have to be funded by the electricity customers of Northern Ireland alone. The paper further identifies this issue as one for resolution in the context of the SEM.
- 3.3 In these circumstances of continuing uncertainty as to whether Moyle will be paid by the market for the service it provides and will consequently earn adequate revenue, NIEH does not believe it would be prudent to commit all of its available resources either to contributing to lower energy costs in the short term or to longer term investment. Moyle has imposed no burden on customers to date and, to continue to avoid doing so, NIEH believes it should take an extremely prudent approach to further commitment of its available resources until its revenue uncertainty is resolved.

4 The Renewable Energy Investment Fund

- 4.1 The Authority's paper describes the proposal which NIEH made to the Authority for the setting up of a renewable energy investment fund. The paper outlines the rationale for and modus operandi of the proposed fund. NIEH greatly appreciates the Authority's approval of its £10m investment as founding investor in the fund ("The

Irish Renewable and Sustainable Energy Fund”), which NIEH is now setting up as a joint venture with Northern Renewables Limited. NIEH believes that the time is now right for such a fund in view of the government policies in favour of renewable energy in both parts of Ireland and the availability both of investment capital and of sound large scale renewable projects seeking investment. The company is confident that its investment in the fund will not only contribute to the implementation of government policies on renewable energy and the environment but will provide a good return to the energy customers of Northern Ireland.

5 Bond Buy Back

- 5.1 The Authority’s paper describes the possible use of the £30m capital refund for the cancellation of part of Moyle’s debt by buying back some of its bonds as the Base Case against which other options for use of the funds should be measured.
- 5.2 Investing the capital refund in this way would avoid any mismatch with Moyle’s long term liabilities and would, as the Authority notes, be equitable as between present and future customers. However, as the Authority also notes, this option would provide a very low return on the funds so invested. Consequently, while NIEH will keep this option under review as market conditions change from time to time, the company will continue to seek alternative means of earning greater returns.

6 Investment Options

- 6.1 The Authority’s paper has set out its views as to the principles which should underlie decisions on the investment of the funds at the disposal of NIEH:
- the ongoing viability of the company, meeting all of its legal, regulatory and governance obligations;
 - the company meeting its obligations to all its stakeholders, particularly its financiers;
 - matching the investment of the funds with the long term liabilities from which they derive;
 - maximising long term customer value;
 - developing tax efficient investment plans; and
 - achieving equity in the returns to present and future customers over the remaining life of Moyle’s bond financing.

The company is in agreement with these principles. In addition, NIEH believes that its plans should be matched to and build on its existing strengths.

- 6.2 The following paragraphs set out NIEH’s preliminary comments on the options which the Authority has set out in its paper for the purpose of stimulating debate. They are

based on NIEH's present understanding of the options as outlined and are subject to development and modification in the light of further information. NIEH notes that some of these options relate to the assets of other companies and agrees with the Authority's remark that the co-operation of those companies (and, in some cases, other authorities) would be required. NIEH's comments are on the Authority's proposals as made and the company makes no assumption as to the intentions of any other company or authority.

- 6.3 In relation to a partial buyout of part of NIE's asset base, NIEH understands the Authority's rationale for this proposal. However, the idea would need considerable further development and clarification, particularly against the ongoing viability criterion, which would require NIEH to obtain full value for any investment made in this way.
- 6.4 NIEH agrees that further investment in North-South electricity interconnection is needed to enable the full benefits of the SEM to be delivered to customers throughout Ireland. The company understands that it is currently proposed that this investment will be undertaken by the relevant transmission licensees in each jurisdiction. However, NIEH would be willing to consider playing a part in such developments if required. It should be possible to identify a role which would match the company's strengths and meet the other investment criteria.
- 6.5 As noted by the Authority, the mutual model has been shown to work well for Northern Ireland's electricity and gas interconnectors with Great Britain. It is also clear that interconnectors, while generally recognised to be in the interest of the customers of a small isolated electricity system such as that of the island of Ireland, are difficult to have constructed as merchant projects since some form of customer underwriting is usually required. The mutual model may therefore have a contribution to make in the development of the proposed East-West Interconnector and, if so, NIEH would be willing to play a part in this development in a way that would match the company's strengths and meet the other investment criteria.
- 6.6 If mutualisation of any of the other gas transmission assets in Northern Ireland is on the agenda between the Authority and the respective asset owners, NIEH would be willing to play its part in such further mutualisation. The company believes that there is significant potential for reducing the cost base of the industry in this way, with corresponding cost savings for both gas and electricity customers.
- 6.7 The need for an independent Transmission System Operator for Northern Ireland is recognised. NIEH accepts that it could play a part in bringing this about in the interest of customers. On the assumption that any such transaction would be done in such a way that the company would obtain the appropriate value for any investment made, NIEH would be willing to explore this option further.
- 6.8 In relation to the costs of the systems which will facilitate the introduction of the competitive retail market in Northern Ireland, it is not clear that this would have a particularly good fit with the strengths of NIEH. Nevertheless, if an arrangement is envisaged whereby the systems could be developed by those with the relevant expertise and financed by NIEH at a cost commensurate with its low cost of capital,

there appears to be potential for delivering customer benefits. Again, this is an option which could be explored further.

- 6.9 It is not immediately clear to NIEH that the proposed energy efficiency programme would be well matched to the company's strengths or would contribute to meeting the investment criteria from the company's perspective. Nevertheless, NIEH would be willing to explore the idea further with the Authority and other interested parties.