SONI price control 2020-2025

Final Determination

21 December 2020

About the Utility Regulator

The Utility Regulator 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 final determination for our 2020-2025 SONI price control. SONI is the electricity transmission system operator for Northern Ireland. Our final determination follows an extensive review of SONI's business plan submission, engagement with stakeholders, including feedback from our Stakeholder Expert Challenge Group (SECG). We have also taken account of stakeholder responses to our July 2020 draft determination.

During this price control period, we will support SONI during the energy transition to deliver an electricity system that promotes whole system outcomes that matter to consumers, such as greater decarbonisation, grid security and lower energy bills.

As it delivers whole system outcomes, we encourage SONI to take an open, flexible and collaborative approach to the consideration of new ideas and technologies that could have the potential to support the energy transition process.

This final determination sets out a price control framework to support SONI as it provides real value for consumers through high quality service, during a time of significant change. At the heart of our approach, is our desire to build on our existing price control framework to support SONI in delivering whole system outcomes.

Our key price control final determinations include:

- Outcomes focused evaluative performance framework to incentivise performance, with financial rewards and penalties, and reputational incentives
- Adapting our approach to cost remuneration to incentivise delivery of whole system outcomes.
- Cost allowance of £88m for SONI to run its business with a flexible framework to manage and consider future costs which are uncertain, in a timely way.
- Allowed return on SONI's Regulatory Asset Base (RAB) of 4.03%. We have provided an allowed margin on revenue collection activity costs, an adjustment to allowed return for asymmetric risk, and remuneration for a Parent Company Guarantee (PCG).

Audience

This document will be of interest to SONI, its customers, consumers and other stakeholders.

Consumer impact

SONI's TSO costs of running its business are typically around 2% of the NI consumers' electricity bill. How it chooses to deploy the costs of running its business and performs its role has a larger impact on outcomes such decarbonisation, grid security and wider system costs (for example, system service, wholesale and transmission investment costs which make up part of the electricity bill for NI consumers); given the influence it has across the system. We incentivise SONI through the price control to deliver high quality service to contribute to these good outcomes.

Contents page

Executive Summary

SONI is the Electricity Transmission System Operator (TSO) in Northern Ireland (NI), undertaking TSO activity for NI consumers. SONI also has a separate licence to operate the electricity market in conjunction with the Republic of Ireland TSO, EirGrid, on an all island basis.

The UR sets a SONI price control in Northern Ireland to provide SONI with an allowance and framework to support it in providing great TSO service for NI consumers. In March 2019 we set out our price control regulatory approach for 2020 to 2025. Having reviewed SONI's business plan, and engaged with stakeholders, we set our draft determination in July 2020. We thank stakeholders for their responses. We have taken account of these in coming to our final determination.

Supporting good outcomes for consumers during the energy transition

Change envisaged during the 2020 to 2025 period presents significant opportunities for consumers as we plan for the energy transition. The energy transition will change the way energy is produced, transported and consumed across the whole energy system.

SONI already plays a leading role as the TSO for Northern Ireland. The way it performs its role can lead to great benefits for energy consumers, as it can positively influence whole system outcomes such as greater decarbonisation, grid security and lower energy bills (particularly wider system costs beyond those from running its business).

We will support SONI during the 2020 to 2025 period as it branches out to play a lead whole system collaboration and coordination role. Our framework is aimed at encouraging SONI to take an open, flexible and collaborative approach to the consideration of new ideas and technologies that have the potential to support the transition process.

We remain strongly committed to funding further cost allowances for strategic, innovative initiatives during the price control period which provide additional value for money, beyond those provided as part of this final determination. We set out our strategic expectations relating to areas that we would like SONI to further focus on in Chapter 3: we call these our service priorities

Evaluative Performance Framework

For our final determination, we have decided to introduce a modified version of the outcomes based evaluative performance framework that we had proposed in our draft determination. Overall, we did not consider that SONI or other stakeholders provided reasons against the introduction of an evaluative performance framework that we had not already considered. Furthermore, we considered that there remained a good basis for some of the key features of the approach that we had proposed, which in turn had built on Ofgem's evaluative framework for the GB electricity system operator.

We did, however, consider it appropriate to make modifications to the draft determination proposals, in the light of stakeholder feedback, to promote further predictability and simplicity in the framework design. We have also decided, after considering stakeholder feedback, that the evaluative performance framework should be calibrated to have a maximum financial reward of £1.25m and a maximum financial penalty of £0.75m per year (instead of £1m per year reward and/or penalty proposed at draft determination). On reflection, we recognise that this will help incentivise and reward good customer service as we strongly believe that this benefits consumers. We welcome feedback on our guidance that we are consulting on today.

Cost remuneration

Our approach to cost remuneration is generally aligned with our draft determination. We have made some relatively minor modifications and further clarifications. Compared to the 2015-20 price control framework, our final determination adapts the way that SONI can recover the costs of its activities. We also adapt the way that the framework exposes SONI to financial incentives and financial risk around its costs. At the heart of our proposals is our desire that the regulatory framework better supports improved whole system outcomes.

For some of SONI's costs, the current regulatory approach risks SONI having direct financial incentives to minimise these costs, without sufficient regard to how this may affect whole system outcomes. We will retain financial incentives on these costs, to encourage SONI to operate efficiently, but with some adaptations. First, our position is to reduce the scale of financial incentives on these costs. Second, our position is that the incentives involve a safeguard arrangement so that the regulatory framework does not reward cost reduction that comes at the expense of quality and performance. Furthermore, our approach would give SONI greater opportunity to be remunerated for higher costs where it can show that this improves whole system outcomes. We refer to this adapted approach as conditional cost-sharing incentives.

We retain the existing approach where SONI can recover transmission network pre-construction project (TNPP) costs up to an approved cap, subject to them not being demonstrably wasteful or inefficient. This approach was upheld by the 2017 CMA appeal process. We will extend the scope of qualifying costs for this arrangement to cover project scoping and feasibility activities. This will bring greater consistency in the treatment of SONI's network planning costs. It will also enhance the positive role that SONI can play at the early stages of project development.

We also retain the approach which allows SONI to recover its full costs in purchasing system services and the amounts it pays in respect of transmission use of system charges. No price control cap is applicable to these costs.[1]

We will take account of SONI's performance in relation to the level of external system services and market operation costs as part of our Evaluative Performance Framework.

We will also require greater cost transparency to support our proposals on cost allowances, remuneration and performance.

Managing uncertainty

[1] Expenditure for system services is approved outside of this price control and we note that no new capital expenditure has been approved.

Our approach to managing cost uncertainty is closely aligned with the approach we proposed in our draft determinations but with further clarification. Compared to the 2015-20 price control framework, our final determination will bring more consistency to our use of uncertainty mechanisms and the above approach to cost remuneration. It also allows greater flexibility for the regulatory framework to accommodate new initiatives and new developments during the price control period.

We will retain the existing TNPP.

For funding other additional cost allowances for new initiatives that can provide benefits to the wider electricity system, we will make use of one of the following types of approaches:

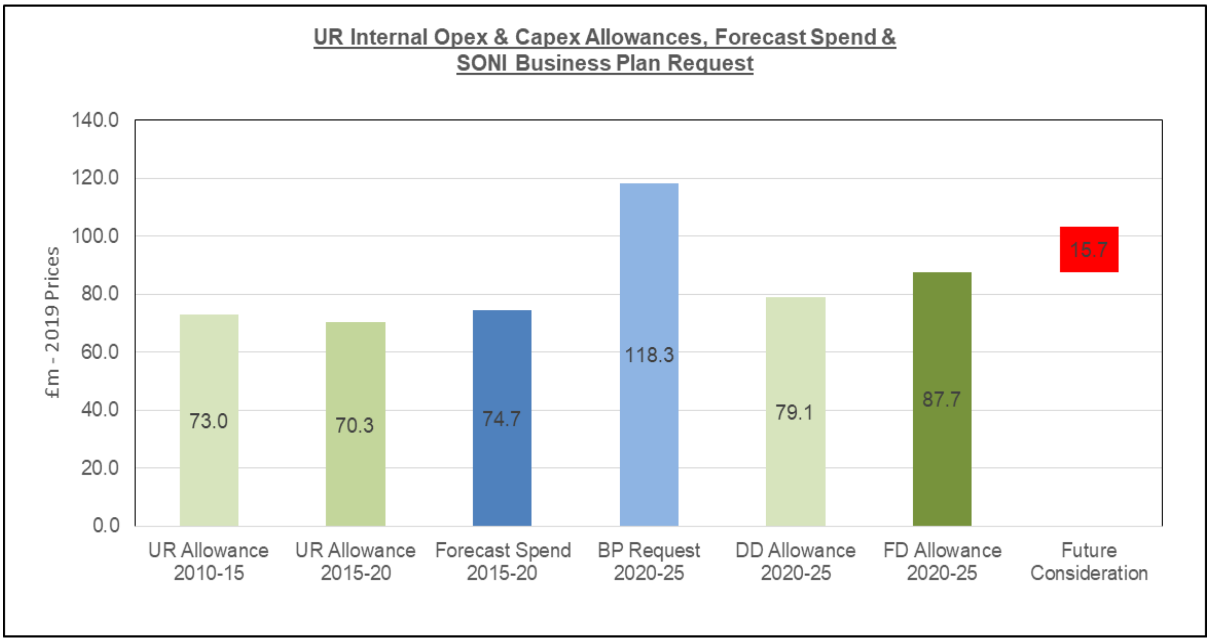
- Set an incremental cost allowance based on an estimate of the efficient level of the new/additional costs, with the costs incurred by SONI being subject to mechanistic cost-sharing incentives.
- Allow for remuneration of the costs incurred subject to an approved cap.

We expect to make most use of the first of these but see value in having the flexibility to use both.

Cost allowances

SONI requested £118m for the 2020 to 2025 period, following slight amendments that it made in response to our draft determination. SONI's request is a significant increase compared to previous business plan submissions.

We will allow £88m for our final determination. This represents a 25% increase from the allowance that we set for the 2015 to 2020 period. In coming to our final determination we have taken account our assessment of business plan quality. Since the draft determination, we have further increased SONI's allowance where SONI has provided more evidence and justification that we asked for at draft determination. Around £16m of SONI's cost request is not justified at this point, and so we can reconsider these initiatives during the price control period.



Risk and return

We carried out considerable amount of further analysis and assessment for the purposes of our final determinations. This included developments to our approach, and refinements to our assessment, in the light of stakeholder feedback. We updated our assessment to take some account of the CMA's provisional findings in the water company redeterminations. We also changed our approach to estimation of the cost of debt for a notional TSO. This was as a consequence of further information provided by SONI on its debt financing arrangements. Our key positions for remunerating equity and debt financing are as follows:

- Our position is a pre-tax WACC of 4.03% on a CPIH stripped basis, compared to our draft determination position of 3.79%. This compares to SONI's request of a pre-tax WACC on a CPIH stripped basis of 5.08%. Our assessment of the pre-tax WACC reflects a detailed review of SONI's proposals and other evidence. A large part of the difference arises because SONI's proposed WACC is calculated using an asset beta assumption that we considered excessive, and because SONI assumes a greater proportion of higher-cost debt finance than we consider reasonable.

- We now retain the regulatory obligations on SONI to procure a Parent Company Guarantee (PCG) from its parent company EirGrid in relation to TSO activities. This compares to our draft determination which proposed removal of the PCG. We now consider that a £10m PCG which is remunerated at a rate of 0.175% nominal is appropriate, in line with the 2017 CMA determination.

- We retain the margin of 0.5% for revenue collection activities (from the 2017 CMA determination) and apply this to the same set of revenues as under the CMA remedies. We still consider that it is in consumers' interests that the TUoS revenue collection element is transferred to NIE Networks. However, we now plan to pursue this through separate licence modifications during the 2020 to 2025 price control period instead of at this final determination. On this basis, the TUoS allowance would subsequently be removed during the price control period as it is de-risked.

- We accept SONI's proposal for an additional profit allowance of 3% on certain categories of costs for which SONI's remuneration is subject to approved caps, in line with our draft determination proposal. This is in recognition of potential for SONI to face asymmetric risk exposure in relation to these costs, and the CMA's determination of an adjustment for asymmetric risks in the 2017 appeal.

As part of our final determination we have carried out further analysis to check the robustness and internal consistency of our proposals for draft determinations. We are satisfied that these detailed checks support the robustness and internal consistency of our proposals for final determinations and align with the CMA principles applied in recent determinations. Our overall package of proposals is financeable.

Interaction between the price control and the review of SONI governance

Following a Call for Evidence, the UR is separately developing a consultation paper on proposals for changes to SONI's governance arrangements. The governance review complements our price control work as good governance supports the delivery of service and efficiency expectations by helping to drive appropriate behaviours by a regulated monopoly company which is remunerated by customers. In this final determination our proposals for cost allowances and risk and return do not take account of any future governance changes we may propose. To the extent that our governance proposals do affect these areas, we will set this impact out in the consultation on governance. Also, if required, we will provide for a re-opener for these costs as part of any future licence modifications related to governance.

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 providing SONI with a price control framework to align its interests with those of its customers and consumers.[2]

1.2 This final determination is a decision that is subject to statutory consultation for the purposes of an Article 14 (Electricity Order) modification. Decisions in relation to it are to be made by the application of the principal objective and general duties at Article 12 of the Energy Order. We have applied our principle objective and general duties to shape all of the proposals that are set out in this document.

Background

1.3 SONI is an asset light provider of TSO services which can benefit Northern Ireland (NI) electricity customers and consumers. As a monopoly business, SONI does not face the same pressures to continuously drive efficiency and improve service and innovate, as a normal business might. We set a price control framework as a proxy for supporting SONI to perform as if it were operating in a well-functioning market.

1.4 We agreed fixed objectives with SONI and other stakeholders as part of this review, which are grounded in our statutory principal objective and general duties. These were set out in our March 2019 regulatory approach document.[3]

- **SONI's service meets customer expectations and is aligned with system wide interests**. We signalled that SONI should take a customer focused approach and that it could play a collaborative role in enabling system wide change during the energy transition.

- **SONI is providing high quality service and performance which improves over time**.

- **Costs should be reasonable and efficient.** Consumers should be protected from inefficiency arising from SONI's internal costs of running the business, and should demonstrably benefit from wider system cost reduction which SONI can influence.

- **SONI service and cost should be transparent**

- **Framework should provide SONI investors with a fair package of remuneration and risk**

---

[2] We see customers as the direct users of its services who use the electricity system. This is distinct from end consumers (e.g. domestic or business electricity consumers).

[3] https://www.uregni.gov.uk/publications/soni-price-control-final-approach

1.5 As part of our March 2019 approach we also set out a range of approach proposals. These included how we would encourage business plan quality, incentivise whole system performance through an evaluative performance framework, adapt our approach to cost remuneration to make it more aligned with whole system outcomes, and align risk and return.

1.6 We published our draft determination in July 2020. This followed engagement with Stakeholders through Stakeholder Expert Challenge Group (SECG) and also with SONI. We engaged with SONI through our query process to better understand its business plan, and then bi-laterals to further clarify its cost allowances. We also presented SONI with our draft determination 'minded-to' position across all the proposals in March 2020 a few months before draft determination publication.

1.7 Since the draft determination we held a session with SECG to get its views on our draft determination. We also held a number of bi-lateral meetings with other stakeholders. We have accounted for these views within our draft determination. We again thank SECG for taking the time to input into the process.

1.8 We have also engaged with SONI through numerous workshops and meetings, and our query process to further understand its draft determination response. In particular, we have shared, and given SONI an opportunity to respond to many aspects of our further thinking on the Evaluative Performance Framework. We also gave SONI a further opportunity to respond to our proposed allowances to allow it to implement new aspects of our regulatory framework.

1.9 We also carried out a site visit to SONI in October 2020 to review confidential information on SONI grid security initiatives. This helpful engagement allowed us to provide further cost allowance for some initiatives, but did not provide sufficient evidence or justification for others.

1.10 We have also sought SONI's views on further refining its draft deliverable information, including those relating to our proposal for SONI to develop a whole system strategy and digitalisation strategy. We did not receive any feedback from SONI on the content or detailed aspects of our request and will seek further development from SONI on certain aspects over time.

Structure of remainder of this document and annexes

1.11 The main body of this document is structured as set out in the table below.

Table 1: Final Determination document structure

Main Body Section	Contents
2. UR strategic priorities for SONI performance	This section set out our priorities for where SONI should be focusing on in developing service in the context of the forward look of this price control period.
3. Business plan assessment	This section summarises our final position on business plan assessment view in light of stakeholder responses

4. Evaluative performance framework	This section sets out an overview of our final determinations for an evaluative framework to incentivise SONI performance
5. Cost remuneration and managing uncertainty	This section provides an overview of the arrangements that apply to the SONI's costs, or to specific categories of SONI's costs, which determine how SONI is remunerated for those costs. It also sets out how uncertain costs are remunerated.
6. Cost allowances	This section provides an overview our capex and opex allowances for the cost of SONI to run its business (we call these internal costs).
7. Risk and return	This section sets out our final determinations for remunerating equity capital and debt finance
8. SONI RAB	This section summarises our final determinations on the historical SONI RAB up to and including the financial year 2019/20, for the purposes of setting the 2020 to 2025 SONI price control, and how we have made other estimates and forecasts of the RAB for the purposes of our modelling analysis. It also sets out the related rules we intend to apply.
9. Revenues and consumer bill	This section provides an overview of the revenues we propose for SONI and their impact on consumer bills

1.12 We set out detailed technical analysis in our annexes, including more detailed responses to stakeholders. We also set out guidance related to evaluative performance framework and cost remuneration and uncertainty mechanisms. We also publish two reports by consultants assisting our assessment of the SONI submission.

Table 2: Supporting final determination documentation and guidance

Technical Annexes, Guidance and other materials	Content and relationship to main body content
Annex 1: Business plan assessment	Annex 1 set out a reminder of our DD position, approach, and our detailed response to stakeholder comments. This annexes largely expands on the main body section 3 (business plan assessment)
Annex 2: Service and outcomes	Annex 2 sets out more detailed views on stakeholder responses and our final determination position on the evaluative performance framework and other issues related to service and outcomes. It expands further main body section 4.

Annex 3: Cost remuneration and uncertainty	Annex 3 sets out more detailed views on stakeholder responses and our final determination position on cost remuneration and managing uncertainty. It expands further on our main body section 5.
Annex 4: Cost allowances	Annex 4 sets out sets out more detailed views on stakeholder responses and our final determination position on SONIs' internal costs of running its business. It expands on the main body section 6.
Annex 5: Risk and Return	Annex 5 sets out more detailed views on stakeholder responses and our final determination position on risk and return. It expands on the main body section 7. It also contains our final determinations on SONI's RAB.
SONI Deliverables	This sets out SONI deliverables that we have updated since the version published at DD.
Guidance: Evaluative performance framework	This sets out our guidance on the evaluative performance framework
Guidance: Conditional cost sharing	This sets out our guidance on the conditional cost sharing approach.
Guidance: uncertainty mechanisms (excluding TNPP)	This sets out our guidance on uncertainty mechanisms (excluding TNPP)
GHD cost assessment	We asked consultants GHD to review SONI's expenditure on the service initiative allowances. Their report is set out in this annex. This sets out whether SONI has responded to GHD's concerns as part of its assessment published alongside out July 2020 DD.
GAD pensions report	We asked GAD to review SONI's updated actuarial pension report that SONI submitted alongside its DD response. This sets out GADs view.

Interlinkages with other UR work

1.13 Our 2019 to 2024 corporate strategy sets out three strategic objectives which the SONI price control cuts across:

- Promoting markets that deliver effective competition, informed choice and fair outcomes.
- Enabling 21st century networks.
- Enabling security of supply and low carbon future

1.14 We are also undertaking work within a number of other areas which have interdependencies with this price control. Within this document we account for:

- Review of SONI governance.
- System services. We have commenced a project with CRU reviewing the approach to system services. UR published an approach document in July 2020.
- Work supporting DFE energy strategy.

Interaction between the price control and the review of SONI governance

1.15 Following a Call for Evidence, the UR is separately developing a consultation paper on proposals for changes to SONI's governance arrangements. The governance review complements our price control work. This is because good governance supports the delivery of service and efficiency expectations by helping to drive appropriate behaviours by a regulated monopoly company which is remunerated by customers. In particular, it helps build and maintain collaborative relationships with a wide range of stakeholders. For a public interest company, these relationships can only be successful and enduring if they are based on trust, confidence and mutual benefit, as well as appropriate accountability. Furthermore, good governance is the keystone for effective arm's length regulation of a monopoly regulated enterprise.

1.16 The UR wishes to ensure that SONI TSO's governance is appropriately designed and implemented so as to:

- Secure the protection of the interests of consumers and other stakeholders, including generators and suppliers, in Northern Ireland (NI);
- Allow for the implementation of UR regulatory policy, including the requirements of the SONI TSO licence;
- Enable SONI to play its role in the implementation of the policy of the UK Government and/or Northern Ireland Executive, and in particular to facilitate the industry's energy transition based on NI priorities; and
- Maintain cross-jurisdictional relationships necessary to facilitate the SEM;

while also:

- To the extent compatible with the above requirements, permitting appropriate synergies and efficiencies that stem from SONI's position as part of the EirGrid group.

1.17 In this final determination our proposals for cost allowances and risk and return do not take account of any future governance changes we may propose. To the extent that our governance proposals do have an impact in these areas, we will set this impact out in the consultation on governance. Also, if required, we will provide for a re-opener for these costs as part of any future licence modifications related to governance.

Next steps and timelines

1.18 The timelines for the next steps on the price control are set out below. We publish our guidance for consultation today alongside our final determination. We will consult on our licence modifications in mid-January 2021.

Table 3: Price control process timeline

Activity	Timing
Publication of statutory licence modification consultation	18 January 2021
Statutory licence modification consultation and guidance consultation close	15 February 2021
Statutory licence modification statement and guidance decision	19 March 2021

1.19 The price control timetable has been delayed by approximately 7 months. We agreed to a request from SONI for an additional 3 months to submit its business plan. We have also published the draft determination 3 months later than expected due to the impact of COVID 19. We have already agreed arrangements with SONI to roll-over the price control for 3 months, as is consistent with the SONI licence, to account for SONI's request for additional time to submit the business plan. In keeping with SONI's licence, we apply a similar approach to implement the remainder of the delay.

2. UR strategic priorities for SONI performance

2.1 We started to engage SONI and other stakeholders in summer 2018 on our strategic approach and proposals for change. Following this nine month period of significant engagement and consultation we set out our regulatory approach in March 2019. We were clear that the existing price control framework needed to adapt to support this change, in light of the important role SONI plays across the system. We set out a range of proposals to support SONI during this change.

2.2 The energy transition is expected to bring rapid and uncertain change during the forward look of this review. It is expected that there will be significant opportunities to unlock value for consumers. Our framework changes are aimed at encouraging SONI to take an open, flexible and collaborative approach to the consideration of new ideas and technologies that could have the potential to support the energy transition.

2.3 Given the expected opportunities for consumers, a key part of our approach has been to provide clearer expectations, than perhaps we have in the past, of what we think good may look like to support SONI in delivering value.

2.4 In setting out these expectations, we have been careful to take account of stakeholder, customer and consumer views, noting where we agree or disagree. While we recognise different stakeholder views and interests, we are encouraged that stakeholders agree that SONI will play an important coordination and collaboration role to benefit consumers.

2.5 One area that we will be assessing SONI against is how it meets our expectations of service: we call these service priorities. We have integrated these as a criterion as part of our Evaluative Performance Framework. SONI will have financial and reputational incentivises to demonstrate that its proposals are aligned with these expectations; alongside with other criteria such as ambition of performance, stakeholder satisfaction and accountability for deliverables and timing.

2.6 Many of these service priorities reflect the idea that not everything SONI does can be easily measured or is simple, but can be potentially highly value adding. However, this is to be expected given the nature of service SONI offers and we have seen no good reason why these expectations are unreasonable and cannot be embraced as positively as possible.

2.7 We recognise that achievement may take time. We feel that if there is confidence that SONI is performing well against these then there is potentially strong scope for material benefits to consumers.

2.8 The service priorities are intended to be flexible to give SONI space in how it meets them whilst being meaningful and instructive. In keeping with this thinking, we will update them, where necessary, during the price control period to capture change. We look forward to SONI working with us and its customers, and other stakeholders, to deliver further value for consumers.

Effective engagement and collaboration

2.9 SONI undertakes a great deal of engagement already. This will undoubtedly have led to benefits for consumers, and we hope for this to continue. Some stakeholders have spoken of the need for SONI to continue to educate and engage to allow SONI to bring networks project ideas through development to infrastructure build. We recognise that there are aspects of SONI's day to day role that do require explanation from expert staff to support further network development. So we do not necessarily disagree with these points.

2.10 However, where we take a different view relates to the fact that SONI has already developed a reasonable level of maturity and experience in this area over the last five years. This means that we are more confident that SONI can continue to play a positive role in this area and is funded to do so. The energy transition will, however, bring up new opportunities during 2020 to 2025 and beyond, that require adaptation in culture and approach. We consider that a prudent approach would to be start demonstrably planning for these changes now.

2.11 We, therefore, agree with stakeholders who have encouraged SONI to ensure that a more collaborative style of engagement is foundational in everything that SONI does; and that this should be embedded into organisational culture rather than simply as an engagement process to be followed. We also agree with the need for SONI to listen and actively collaborate with stakeholders and customers, rather than taking a more educational or one-way style engagement. Stakeholders also conveyed the need for SONI to better engage and collaborate with non-traditional actors and technologies.

2.12 We are pleased that SONI has begun to take on board some of this feedback. We have provided SONI with additional allowance, beyond that proposed in the draft determination, to support these aims. We are open to further allowance during the period to support new, value adding engagement initiatives which support the energy transition.

Open and collaborative innovation

2.13 We recognise the benefits that SONI's service proposition has brought to consumers to date and the ambition to move beyond the status quo. This is clear from SONI's tangible business plan statement to support a higher renewable electricity consumption target. We note that is being proposed by DfE and received stakeholder backing. We also welcome the positive actions it has taken over time in areas like development of system services and control centre tools. There is strong stakeholder support for further development in these areas. Some stakeholders, including SONI, have also asked for more allowance now to meet challenges set out in SONI's business plan.

2.14 We see significant opportunities for SONI to innovate and are prepared to provide further funding for certain value for money business plan initiatives relating to control centre tools and system services. This is subject to receiving more appropriate justification and evidence than we have received to date.

2.15 While the business plan contains initiatives have the potential to bring net benefits to the system, some of which may be innovative, many seem under-developed at this point. We are particularly concerned that a material amount of activity that SONI is proposing risks being within the remit of other 3rd parties in the future.

2.16 Accepting such an approach now invites risks to consumers that may outweigh any benefits from approving such expenditure at this point. This is particularly so if it effectively forecloses future opportunities that may have greater benefit to consumers than those being put forward by SONI. We have incorporated sufficient flexibility within our framework for SONI to develop its case in an appropriate and timely way. We have also provided allowances at this point to allow SONI to develop its case appropriately.

2.17 Looking ahead, we, therefore, agree with stakeholders who have spoken of the importance of SONI innovation not just being essential for SONI, but also to help a variety of types of third parties to learn how they can best help SONI to develop new services. Some stakeholders also considered there is scope for improvement in terms of how new ideas are developed and how a culture of open and collaborative innovation will be embedded within the organisation.

Agility and responsiveness in meeting policy, regulatory and market development.

2.18 Some stakeholder feedback suggests that the nature of the energy transition may require consideration of use of practical projects and learning practical lessons through collaboration with 3rd parties. We agree that this is likely to be the case where SONI considers such an approach can add value.

2.19 Stakeholders also gave tangible and persuasive examples of how SONI could be learning approaches, processes and methodologies from other jurisdictions in areas such as system service, control centre design and system planning. At the same time they encouraged SONI to learn about and solve bespoke local issues, noting unique circumstances in Northern Ireland. Stakeholders drew on consumer opportunities and asked that SON's organisational governance and people planning and recruitment culture stands ready to take advantage of them

2.20 We expect SONI to work effectively with us to support us as we carry out our regulatory duties. For example, SONI should be clearly providing accurate information which we require, as is proportionate and appropriate, within the timescales agreed. This will support us in our work to further the consumer interest. This will also help build confidence that SONI is demonstrating its independent expert role that it seeks to continue to play.

Whole system collaboration and coordination with 3rd parties, including NIE Networks, across its various TO, DNO

and DSO roles

2.21 To date the main energy using sectors have operated in a relatively independent way. A key feature of the energy transition is that energy (and other) systems are becoming increasingly interlinked so that decisions taken in one part of the energy system have implications elsewhere in the system(s). Going forward, it will be important to have an integrated whole systems approach.

2.22 Regulators, government and other stakeholders, including SONI, are working together to support good outcomes for consumers as part of the transition. Department for the Economy (DfE) has recognised the need for an integrated whole systems approach in its December 2019 call for evidence. DfE published its call for evidence in December 2019.[4] We are inputting into this.

2.23 We also note that NIE Networks has been collaborating, partnering and learning with GB DNOs and the GB TSO National Grid, through the Energy Networks Association (Open Networks project). One of the aims of this is to consider how NIE Networks role may evolve to DSO to support whole system grid flexibility.

Figure 1: Whole system approach

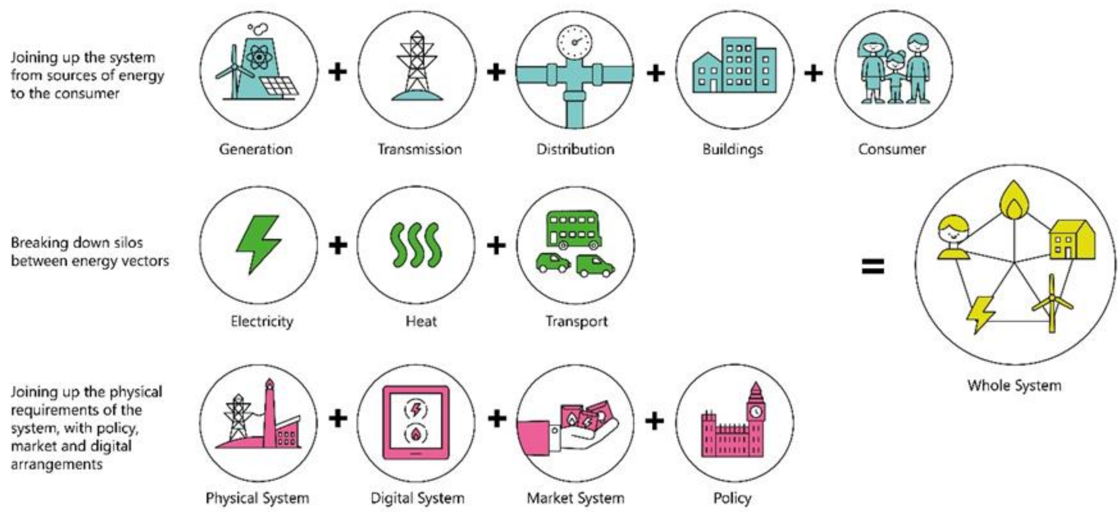


Image credit: Energy Systems Catapult

2.24 SONI should be comprehensive, ambitious and collaborative in undertaking a whole system role. It should be reflecting on how its role can influence good outcomes, across the a) electricity transmission to distribution interface, b) across the wider

[4] https://www.economy-ni.gov.uk/energy-strategy-call-for-evidence

electricity value chain and c) on a cross-sector basis.

2.25 While SONI maintains in its response that's it strategy embraces a whole system vision, we did not feel this came across enough strategically, conceptually or through its activity proposition. We have some concerns which we consider risk creating a conflict with aspects of whole system thinking. Our business plan guidance was provided in this area back in March 2019 and cited that it would be important to consider 3rd party options where appropriate.

2.26 We recognise uncertainty that is inherent within the energy transition, and that market developments and aspects of role evolution (like that of the DSO) are still being considered. But SONI should be demonstrably planning for this now and taking account of the direction of travel appropriately. We expect that SONI will need to work closely with NIE Networks, and other relevant 3rd parties, to develop its whole system strategy and role further.

2.27 In terms of its role in coordinating and collaborating across the distribution and transmission interface, SONI will need to be careful to build a common understanding of where actions taken by one system/network operator could have cross-network impacts. It will also need to identify and implement actions (innovative and/or other) that optimise synergies and develop processes with NIE Networks that ensure optimal resource utilisation. Given our concerns about the clarity of SONI's proposals in terms of the DSO and TSO interface, we expect SONI to work with NIE Networks to ensure that there is clear delineation of responsibility between the TSO and the DSO functions. We will engage further with parties on this in early 2021.

2.28 We anticipate that there are many 'least regrets' opportunities, actions and business planning decisions that SONI can take for consumers now so that it can add value despite uncertainty.

2.29 For example, there is further scope for SONI to consider how non-network options can be further integrated into its service activity like other TSO's are doing within other jurisdictions to promote flexibility at least cost to the consumer (for example, in terms of improving its system planning 'communicating and assessing system needs'). This may reduce the need for network reinforcement whilst meeting other outcomes, such as decarbonisation aims. We also seek greater transparency in the SONI's assessments and decisions for system planning / network planning purposes (e.g. options considered, rationale for proposed approach) and (ii) greater transparency and continued improvements in the methodologies and tools used for system planning / network planning purposes.

2.30 This broad whole system expectation is likely to cut across many of SONI's TSO services but may be particularly value adding in areas such as:

a) Dispatch and scheduling

b) Ensuring system adequacy and market development

c) Assessing and communication of system needs

d) Project scoping and feasibility

e) Connection access rights activity.

Collaborating and coordinating to promote a holistic, customer based service approach to digitalisation

2.31 SONI should take an ambitious and appropriate role in this area given its level of system influence. This will require not only basic transparency from SONI in terms of openly sharing its relevant data, and making its TSO actions transparent to enable market participants make efficient operational and investment decisions where it is largely funded to do so today; but to also embrace a broader, more holistic digitalisation role and culture that enables SONI to reach out to 3rd parties, to listen to and learn from them.

2.32 While SONI maintains that its data strategy is very similar to the above notion, we understand that its proposed approach is different to what is being envisaged and developed in certain other jurisdictions. While this is a relatively new area related to future energy outcomes, not just for SONI but many stakeholders (including us), we do expect SONI to effectively consider lessons learned from 'digitalisation' practice, that is being developed in other jurisdictions. It should also engage with experts and 3rd parties to consider what works in NI, and to start evolving a digitalisation culture and mind-set. This broader role should, therefore, not simply be aimed at enhancing internal TSO processes but instead support customer facing SONI service design.

2.33 This will be relevant to a range of SONI service activity, for example:

a) Dispatch and scheduling (e.g. energy forecasting)" and

b) "Ensuring system adequacy and market development (e.g. system service design)" and

c) "Assessing and communication of system needs".

Developing markets through competition and stakeholder engagement and collaboration.

2.34 The way SONI designs and procures system services and its approach to dispatch and scheduling can affect providers' ability to compete and revenue available, and affect price signals and cost in wholesale market.

2.35 SONI should be actively and swiftly addressing barriers that may prevent non-traditional technologies and actors from participating in the market. SONI should be ensuring the rules and processes for procuring system services (and/or dispatch and scheduling) maximise competition where possible (e.g. continue to move to more market based approaches where in consumer interests), and are fair (e.g. design facilitates existing and new providers to compete on a level playing field irrespective of size or type) and transparent.

2.36 SONI should be actively partnering, innovating and collaborating with industry and other 3rd parties, including new actors, in preparing and implementing future projects and programmes of work where it can see benefit for consumers.

Other priorities

2.37 These are other specific service priorities largely relating to wholesales markets activity. We set these out within the Annex of our draft guidance on our Evaluative Performance Framework. For the most part, we consider that good performance in these areas is activity that we would expect as part of the every-day job of an efficient TSO.

3. Business plan assessment

Context

3.1 This section discusses stakeholder responses to our assessment of SONI's business plan assessment, and our final determination. More information on our methodology for business plan assessment, our reasoning for each test area score, and detailed response to stakeholder views across each test area is set out in Annex 1, Business plan assessment.

3.2 As part of our March 2019 regulatory approach we set out a framework to improve the level of business plan quality. We set out our expectations across the different areas that we proposed to test SONI's performance (test areas), the categories we would apply for assessment of SONI's business plan, and we proposed a reputational incentive for SONI. We explained that this gave SONI an opportunity for reduced regulatory intervention, and that it would support SONI in taking more ownership to deliver a high quality business plan.

3.3 We examined the business plan across eight test areas. These test areas were built up from SONI's response to various test questions within each of the test areas published as part of our March 2019 regulatory approach. We then carried out an 'in-the-round' categorisation of the business plan on the merits of what was submitted on 31 October 2019.

3.4 As part of the July 2020 draft determination, we highlighted areas of SONI's plan which demonstrated good practice and areas where we felt there is scope for further improvement. Our view on business plan quality also provided important context for proposals and interventions that we proposed across key framework areas.

3.5 We explained that while we welcomed the effort SONI has put into the plan, there were a number of material areas where the proposed price control proposals were skewed too far in SONI's favour. We said that some material areas were also insufficiently supported or developed to translate directly into the proposals without our significant intervention. We recognised this is the first time that we and SONI have undertaken such an approach, and there is an element of judgement required.

Stakeholder views

3.6 CCNI commissioned an economic consultancy, SLG Economics, to review our proposals from the consumer perspective. It said our interventions represented a significant improvement on SONI's business plan proposals, and that our regulatory framework proposals are generally in the consumer interest.

3.7 CCNI was concerned about the quality of SONI's business planning function but cautioned that we risk 'second guessing' SONI's business planning process. It said that explicit recognition and incentivisation of business planning in the regulatory framework may be more appropriate (such as use of licence conditions), noting potential limitations from using stakeholder feedback.

3.8 SONI made the following points on our business plan assessment:

- SONI welcomed SECG feedback but implied that we have relied too heavily on SECG views given certain limitations (e.g. some members had not responded to questions/some did not respond at all).
- UR guidance is too subjective (guidance on what good looks like should be measurable), is not tailored to SONI, and is better suited to where multiple companies are being assessed;
- We haven't taken account of the volume of engagement SONI undertakes; price control timelines were too tight to allow SONI to develop the desired level of engagement; and its was underfunded 2015 to 2020 period;
- SONI has been unfairly penalised for not sharing its opinion on subjective matters where individual regulators also adopt different approaches.

FD position

3.9 We have taken account of SONI and other stakeholder views, here and in Annex 1. After doing so, we consider that our draft determination score remains appropriate.

3.10 We recognise the amount of engagement that SONI undertakes. However, much of our scoring assessment was based on evidence of quality. As we set out in the draft determination, we found a range of material issues in this regard. We have not seen any reasoning from SONI to change our view.

3.11 We do not consider that the price control timelines were an issue. While SONI was afforded an atypical, three month extension to submit its plan, the level of business plan quality should not be determined by the timings of our price control process. It is for SONI to proactively, continuously and effectively plan its business to ensure its engagement is up-to-date.

3.12 SONI and CCNI both made points about our reliance on stakeholder SECG feedback and/or UR assessment, albeit in the context of differing concerns. We set up SECG with various safeguards to mitigate limitations,[5] but we recognise that there are factors[6] which mean other framework tools are necessary. However, this does not mean that SECG feedback that we put weight on had little value, was not factual in many instances, or that we used it inappropriately. We have been even-handed and clear in taking account of SECG feedback, flagging where we agree or disagree. We have considered clearly where in the framework feedback is best used, and have applied weight appropriately using judgement, experience and observations, in line with our strategic objectives. We have also acknowledged this

[5] For example, invitation request to a range of interests, non-disclosure agreements signed to promote the free flow of information exchange etc.

[6] We recognise there were circumstances such as time constraints on who were kindly giving up their free time to contribute. We also recognized, as did the group, there were certain areas like risk and return which were the group had less interest/experience.

is the first time we have used such an approach. We provide some examples below to illustrate these points.

3.13 The strength of similar views made by different interest groupings as part of the test area of stakeholder engagement, and the fact they were well-placed to take a view given customer experience, strongly influenced our scoring in this test area. However, we explicitly tempered our score for an aspect of this area, in SONI's favour. For example, we recognised that SECG was the clearest source of evidence that SONI had used within its business plan. We also recognised that it was the first time SONI had used this approach set up by another party (UR).

3.14 We also gave weight to plausible views from a participant experienced in understanding newer technology actors and participant views. This was not only because these reflect some important issues that may affect consumers, but also because it was clear from the factual examples of practice given that the issues are cross-cutting and so directly applicable to SONI.

3.15 We agree that SONI does have different attributes to certain other monopolies we regulate. However, none of those mentioned by SONI mean that it should not be benchmarked against progress being made by utility companies within other jurisdictions. It is important that we acknowledge any genuine mitigating factors or different circumstances and we account for these where necessary.

3.16 Where we have used SECG views to shape our wider interventions, for example service priorities as part of our Evaluative Performance Framework, we have done so in a mostly non-prescriptive way. We have also used the expertise of the group appropriately.

3.17 We agree with CCNI that other remedies may be more appropriate depending on the issue. We have tried to reflect this within the framework, given the business planning concerns we have. We have proposed a licence condition to improve cost transparency given our significant concerns within an area that stakeholder engagement may not address. We have also highlighted[7] the need for provision of timely regulatory information within service priorities so there is explicit recognition and incentivisation of this within the evaluative performance framework. We have the ability to update these service priorities during the period where we need to. We have also drawn on SONI proposals where we can as part of our interventions. Overall, we consider that our package of proposals puts the onus on SONI to take control of its performance rather than us 'second guessing', whilst encouraging SONI to improve performance in certain areas.

3.18 SONI was also concerned that we penalised it in areas which are subject to interpretation. SONI gave some of examples and so we respond to these in Annex 1. We recognise that some of the examples given by SONI are matters of regulatory judgement. While this does not mean that we cannot take a view on them, we would point out that our score was determined 'in the round'. Looking across the guidance, we considered there was firm evidence to suggest our grading was not overly

[7] We had included this within our service expectations at draft determination but have kept this within our refined service priorities.

harsh. We feel these were clearly brought out at draft determination, but clarify again in Annex 1.

3.19 Finally, SONI was concerned about subjectivity of assessment. There is a subjective element to the exercise, but we considered that going further than this risks distracting from our and SONI's aims. It may also risk introducing a 'box-tick' approach to developing a business plan. We do recognise that as part of the process for this review that it is fair for stakeholders to have an opportunity to respond to our scorings and reasoning before we take a final position. We have responded to any detailed stakeholder points relating to each test area within Annex 1, as well as across this final determination where relevant.

4. Evaluative Performance Framework

4.1 This section provides an introduction to the new Evaluative Performance Framework that we have developed for the SONI price control. This is a key element of our final determination, to improve SONI's service quality and ensure accountability for SONI's performance.

4.2 We provide our detailed position on the Evaluative Performance Framework in Annex 2, along with other price control arrangements, to ensure that SONI is accountable for its performance and its delivery. We are also consulting today on our Evaluative Performance Framework guidance

Context

4.3 In our draft determination we said that it would be useful to establish a set of outcomes from our regulation of SONI that we want to influence through the Evaluative Performance Framework.

4.4 Drawing on material from SONI's business plan, and our own further consideration, we proposed to define four high-level outcomes:

- **Decarbonisation**. The Northern Ireland electricity system supports government decarbonisation policy and targets.
- **Grid security**. Northern Ireland electricity customers receive secure and reliable electricity supplies.
- **System-wide costs**. Northern Ireland electricity consumers get good value for money which reflects efficiency within, and across, different parts of the Northern Ireland electricity system, over the short term and the longer term.
- **SONI service quality**. SONI provides an appropriate range and quality of services to participants in the Northern Ireland electricity system and other stakeholders.

4.5 SONI and other stakeholders supported these four outcomes. We have adopted them for our final determination of the Evaluative Performance Framework.

4.6 Our draft determination proposed the introduction of a new annual evaluative performance framework which is intended to encourage SONI to improve its performance, and to take better account of customer and stakeholder views, across the full range of its activities. This built on the proposals from our March 2019 regulatory approach, where we said there should be a stronger role for the regulatory framework to offer incentives to SONI to deliver high quality service.

4.7 Our draft determination set out detailed proposals for the design of the Evaluative Performance Framework. We proposed that:

- SONI's performance would be assessed annually by an independent evaluation panel, which would determine scores in 16 individual areas of performance.

- The scores would be used to calculate a potential financial reward or penalty for SONI. The formal decision on the size of the financial incentive would be a matter for our board.

- We proposed a maximum financial incentive reward of £1m per year and a maximum financial penalty of £1m per year. This maximum and minimum would apply to the net position on the Evaluative Performance Framework and the financial incentives on SONI in relation to over-spend or under-spend against ex ante cost allowances set at the price control review.

- We would prepare detailed guidance to support the framework, covering a number of areas including: the desirable outcomes that SONI is intended to help achieve and influence; upfront expectations of what good performance from SONI would involve across a number of its roles and services; the nature of the annual forward plan required from SONI; and the evidence to be provided by SONI relating to its performance each year; and the approach for the panel's scoring of performance.

4.8 In proposing this type of Evaluative Performance Framework, we proposed not to adopt SONI's proposed benefits sharing mechanism from its business plan. This was not well aligned with our proposals from our March 2019 regulatory approach. SONI's proposal placed emphasis on mechanistic financial incentives and did not seem suitable for the 2020-25 SONI price control. Nonetheless, we drew on some aspects of SONI's work on its benefits sharing mechanism in developing some of the details of the Evaluative Performance Framework.

4.9 We also proposed additional arrangements to ensure that SONI would be accountable for its delivery and performance in relation to specific projects or initiatives explicitly funded through price control allowances. For instance, we proposed arrangements which would make financial adjustments to price control allowances if there is no delivery, or only partial delivery, for these projects or initiatives. In addition, we said the performance against the price control deliverables would be taken into account as part of the Evaluative Performance Framework.

Key changes from DD to FD

4.10 For our final determination, we have decided to introduce a modified version of the Evaluative Performance Framework that we proposed in our draft determination.

4.11 Overall, we did not consider that SONI or other stakeholders provided reasons against the introduction of an Evaluative Performance Framework that we had not already considered when proposing such a framework in our draft determination or March 2019 regulatory approach. Furthermore, we considered that there remained a good basis for some of the key features of the approach we had proposed, which in turn had built on Ofgem's evaluative framework for the GB electricity system operator.

4.12 We did, however, consider it appropriate to make a series of significant modifications to the framework, in the light of stakeholder feedback. We highlight a few examples of key modifications below, and provide full information in Annex 2.

Stakeholder views

4.13 There was general support across stakeholders for a price control framework that focuses incentives more on wider outcomes and performance than the SONI's internal costs.

4.14 Some stakeholders directly supported the introduction of an evaluative performance framework that we had proposed.

4.15 SONI did not object to the introduction of an evaluative performance framework but raised concerns with what we had proposed in our draft determination. SONI considered that there needed to be significant changes to this and further guidance on the application of the framework. SONI, and some other stakeholders, considered that our approach should place more emphasis on financial incentives against quantitative metrics rather than a subjective evaluation process. Some stakeholders provided views on the types of performance information that could be useful.

4.16 We engaged further with SONI in the period since publication of our draft determination to better understand its concerns and to explore how these might be addressed.

Main FD modifications to the framework

4.17 The general balance of stakeholder feedback, on our draft determination for a maximum upside and downside of £1m, was in favour of greater financial upside than financial downside. This was in light of the perceived opportunities to improve performance and outcomes, and concerns about loss aversion bias.

4.18 We have now considered that, on balance, the framework should have somewhat greater financial upside than downside. We have decided that the evaluative performance framework should be calibrated to have a maximum financial reward of £1.25m and a maximum financial penalty of £0.75m. We have maintained the approach from our draft determinations that these caps would apply to the net position of financial incentives across the evaluative framework and the cost-sharing incentives. In other words, the caps would apply to the total financial incentive from the combination of any financial reward or penalty from the performance evaluation, and any financial reward or penalty that SONI faces in respect of over- and under-spend against ex ante allowances for its costs (under the cost-sharing incentive).

4.19 Furthermore, SONI's response emphasised concerns about regulatory uncertainty and subjectivity under an evaluative framework and the lack of predictability.

Following our draft determination, we identified ways to reduce the degree of regulatory uncertainty and subjectivity and to improve predictability. This involved for example:

- A greater role for an annual forward plan produced by SONI, which can then provide a reference point for assessment of its performance during the financial year.
- providing greater clarity on expected performance baselines (e.g. taking 2019/20 performance levels as a reference point where applicable).
- The development of detailed (draft) guidance on the application of the evaluative performance framework, including on the evaluation criteria that the panel should use and how the assessment under each criterion translates into an overall grade.

4.20 We have also made changes to reduce the potential complexity of aspects of the framework. Our draft determination proposed that the panel would determine a score in 16 separate areas made up of scores for each of four SONI roles across the four SONI outcomes. We decided that, for any assessment phase by the panel, the panel should determine a score for each of four separate SONI roles without seeking to decompose scores by separate outcomes.

4.21 We recognise that, even with these changes, there would be residual uncertainty and subjectivity in the determination of financial incentives, relative to a mechanistic incentive approach. But we also recognise that it is not possible, or always desirable, for us to seek to minimise this. We consider that an evaluative approach is worthwhile, given the benefits it allows to hold SONI accountable for its performance and encourage it to make improvements to the benefits of consumers and desired outcomes.

Performance information (including metrics)

4.22 We welcome the useful stakeholder feedback requesting certain types of metric and areas for incentivisation. We agree that, in certain instances, metrics or other types of performance information will be useful for measuring performance. The information provided by SONI will need to be clear, simple, stretching and relevant. SONI will also need to provide accompanying explanation on how its actions have led to desired outcomes.

4.23 We have drawn on the specific stakeholder feedback as well as SONI's proposals. While we consider that it is SONI's responsibility to create and develop performance information, we have integrated specific types of performance information within our draft guidance where we think they could add value. This, therefore, explicitly recognises the role that they can play within the framework.

4.24 We ask stakeholders to review our Annex on 'Performance Information' within the draft Evaluative Performance Framework guidance that we are consulting on today. We recognise this performance information as well as other information SONI identifies will require further development. This should be done with stakeholders.

We also encourage SONI to take the opportunity to capture any lessons from National Grid ESO; given that Ofgem has worked with the ESO to refine performance information.

How the evaluative framework will operate

4.25 We will establish an evaluation panel comprising individuals with a range of relevant knowledge and perspectives. Our current plan is to establish a panel of five members. The panel will be chaired by an independent member. The UR will provide secretariat support.

4.26 In relation to each financial year in which the Evaluative Performance Framework is operational, there will be two phases of assessment by the panel:

- After the publication of SONI's annual forward plan, the panel will make an evaluation of the plan against a set of evaluation criteria for the plan.
- After the end of each financial year, the panel will make an evaluation of the SONI's performance within that year, against the evaluation criteria concerning the SONI's plan delivery and wider performance.

4.27 For each of these two phases of assessment, the panel will determine a grade (from one to five) for each of four SONI roles. These four roles are:

- System operation and adequacy.
- Independent expert.
- System planning.
- Commercial interface.

4.28 The individual members of the evaluation panel will be required to feed into the evaluation process by drawing on their own knowledge, experience, perspective and insight. They should not act as representatives of any organisation or group that they are affiliated with.

4.29 The panel is not intended to play the role of stakeholder representation directly. The panel should draw on evidence and views provided by stakeholders (or stakeholder groups) in making its evaluation. We may establish one or more stakeholder groups to help inform the panel's assessment, and to help guide SONI's planning and performance.

4.30 The panel does not have any decision-making powers. Instead, its evaluation forms a recommendation that goes to us, which will make the decision on any financial reward or penalty. We will either accept the grade determined by the panel or determine a grade itself, in which case it will set out its reasoning for differing from the panel.

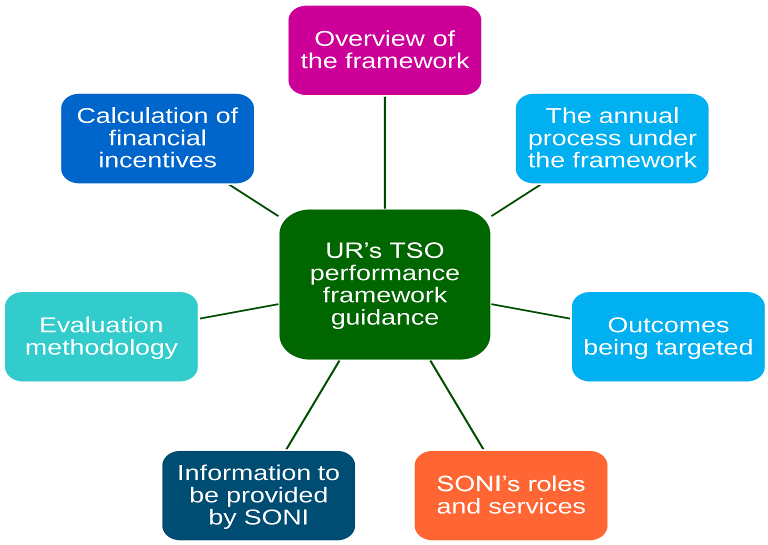
4.31 The financial reward or penalty will be based on the weighted average grade across the four SONI roles and calculated in accordance with the incentive calculation methodology set out in the guidance document. We will engage with SONI on our draft position before the decision.

Draft guidance on the Evaluative Performance Framework

4.32 Alongside our final determination, we are consulting on draft guidance for the application of the evaluative performance framework. We invite stakeholder feedback on this. The draft guidance builds on proposals from our draft determinations and a number of significant modifications as highlighted above. The guidance is intended, in particular, to provide guidance to the evaluation panel (and SONI) on how the panel should perform its assessment role, and to SONI on the information and evidence required from it.

4.33 As part of our final determination, we have decided on the key features of the approach that should apply for the 2020-25 price control period. We also decided that there should be some scope for refinement during this period, in terms of the details of the guidance on individual assessment criteria. We expect that the guidance will evolve over time, drawing on insight and lessons from the practical application of the evaluative performance framework.

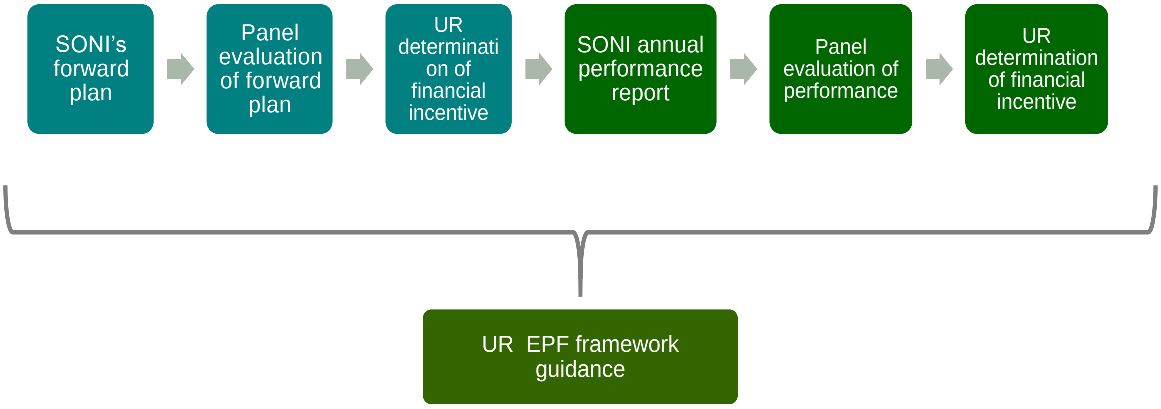
Figure 2: Key features of the Evaluative Performance framework (EPF)



The annual process and implementation date

4.34 The annual performance review process will be governed by the regulatory guidance set referred to above. In broad terms, we envisage that, for each price control financial year (i.e. running 1 October to 30 September). The key steps are set out in the figure below.

Figure 3: Key EPF steps



4.35 The key steps in the process are as follows:

- **SONI's forward plan**. The first step in the annual process is the forward plan produced by SONI. SONI would provide a strategy and plans, explaining how it will meet expectations and contribute to desired outcomes in each of the four SONI roles. The plan is expected to build on stakeholder engagement.

- **Panel's evaluation of the forward plan.** The panel will evaluate the forward plan according to the criteria and approach set out in the guidance document. The panel will draw on feedback from stakeholders. The panel will produce a report on the evaluation, with a recommended grade for each SONI role.

- **Determination of forward plan incentive amount**. We will then determine a financial incentive (e.g. reward or penalty) in light of the grades recommended in the panel's report, and based on the approach to calculation of the incentive amount specified in the guidance.

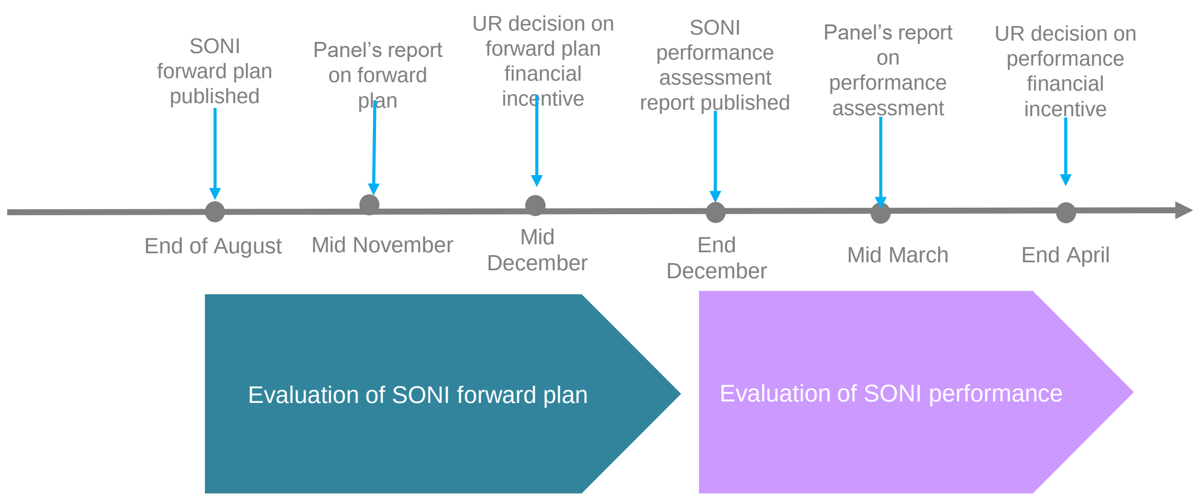
- **SONI's annual performance report**. Following the end of the financial year, SONI would produce its annual performance assessment for the UR and other stakeholders. This would set out SONI's assessment of outturn performance. SONI will report on delivery against its forward plan and price control deliverables, and will provide other evidence on performance as specified in the guidance document.

- **Panel's evaluation of performance.** The panel will evaluate SONI's performance during the financial year, according to the criteria and approach set out in the guidance document. The panel will draw on feedback from stakeholders. The panel will produce a report on the evaluation, with a recommended grade for each SONI role.

- **Determination of performance incentive amount**. We will determine a financial incentive (e.g. reward or penalty) in light of the grades recommended in the panel's report, and based on the approach to calculation of the incentive amount specified in the guidance.

4.36 Figure 4 provides an overview of the timetable we envisage for the annual process.

Figure 4: Overview of proposed timetable for annual process



Timescale for implementation

4.37 Given the extra emphasis that we decided to place on SONI's annual forward plan as part of our modifications to the framework, and the timing of our final determination, we decided that it was not practical to apply the framework for the year from October 2020 to September 2021. We also continue to see value in a transition year in which the framework would apply but without the application of financial incentives (as envisaged in our draft determination).

4.38 We have decided as follows:

- The framework should not apply at all in respect of the financial year 2020/21.
- The framework should apply in respect of the financial year 2021/22 on a transitional basis as follows: all aspects of the framework apply except that the panel's grading of the forward plan and performance would not be translated into the application of financial incentives on SONI.
- The framework should apply in full, including financial incentives, in respect of the financial years 2022/23, 2023/24 and 2024/25

5. Cost remuneration and managing uncertainty

5.1 In this section we briefly summarise our final determination in three related areas:

- The cost remuneration approach under the price control
- Enhanced cost transparency.
- Uncertainty mechanisms.

5.2 We provide full details of our final determination in these areas in Annex 3. This section presents a recap of our draft determinations, and a summary of our final determination, in relation to the cost remuneration approach to be applied to different categories of SONI's costs under the price control framework.

5.3 The cost remuneration approach refers to the price control arrangements that apply to SONI's costs, or to specific categories of SONI costs, and determine how SONI is remunerated for those costs. This leaves aside the specific cost allowances that we set, which is set out in the next chapter.

5.4 The cost remuneration approach concerns a range of interrelated regulatory policy questions for the design of the price control framework, such as:

- How does the price control remunerate SONI for the (efficient) costs of its services and activities?
- What is the role for financial incentives within the price control framework to encourage efficiency in the costs incurred by SONI?
- How does the price control framework protect customers from the costs of any inefficiency on the part of SONI?
- How does the price control framework protect SONI and customers from uncertainty, at the time of the price control review, about the efficient level of costs for SONI's services and activities over the price control period?

Context for cost remuneration

5.5 SONI's operating environment is experiencing rapid change. This means there is need for SONI to respond to these changes swiftly and more ambitiously. We have concerns with aspects of the existing cost remuneration approach for the SONI price control, especially given the importance we are attaching to SONI's role in contributing to desired outcomes across the Northern Ireland electricity system. At the same time, there remains a need for arrangements which provide for an appropriate and proportionate amount of pressure on SONI's cost efficiency.

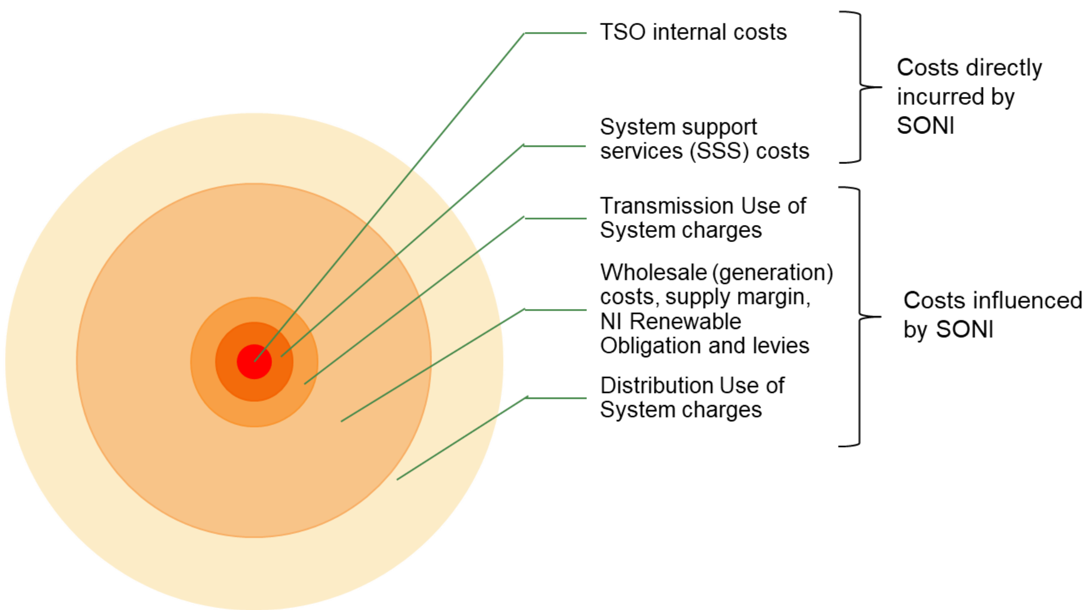
5.6 A significant element of the costs incurred by SONI are currently subject to conventional mechanistic financial incentive arrangements. By this we mean that we set an ex-ante allowance based on our assessment of the efficient level of costs during the price control period, and any differences between the actual costs incurred by the regulated company and the ex-ante allowance is shared in a fixed proportion between customers and the company (and its investors). The current sharing is on a 50:50 basis.

5.7 This means that the regulated company gets a fixed share of the benefits from spending less than this amount (as a financial reward) and bears a fixed share of the costs from spending more than this amount (as a financial penalty). While this is a familiar approach within the context of UK RAB-based price control regulation, there are reasons to think that it may not be appropriate for SONI.

5.8 The SONI costs which have been the subject of "conventional" mechanistic financial incentives represent around 2% of the NI consumer electricity bill, but how SONI performs and delivers services can influence a much greater element of the total electricity bill (wider system costs), given its system wide influence. This is illustrated by the figure below.

5.9 By SONI internal costs, we mean costs incurred by SONI in its TSO role which are not system support services and excluding transmission/interconnector revenues collected by SONI on behalf of NIE Networks and Moyle. This distinction is useful because the current price control treatment of these internal costs is very different to that for other SONI costs.

Figure 5: Costs incurred by SONI and other costs it influences



5.10 There is a serious risk that applying conventional price control cost incentives to SONI's internal costs could lead to small savings in these costs, at the expense of higher costs elsewhere in the system (e.g. increases in future transmission infrastructure costs due to worse quality network planning by SONI) and at the expense of desired outcomes besides costs (e.g. decarbonisation and service quality to SONI customers and other stakeholders). This risk is exacerbated by the lack of an established and effective regulatory framework for encouraging good performance from SONI in terms of the costs it influences in the system and in relation to desired outcomes beyond that of managing costs.

5.11 A further concern with the use of conventional mechanistic financial incentives for SONI's costs is that this places weight on our ex-ante assessment of the efficient costs of SONI activities over the price control period. In some UK regulated sectors (e.g. electricity distribution and water supply), regulators can draw heavily on cost benchmarking analysis across companies to support cost assessment. This helps supports the effectiveness of the financial incentives on costs and gives the regulator more information on the efficient costs of regulated activities to use when setting ex ante allowances. However, due to the relatively idiosyncratic nature of SONI, for example, in terms of structure, role and size, there is a lack of close comparators for benchmarking its costs, which will tend to limit the power of mechanistic financial incentives as more reliance is placed on SONI's own costs.

5.12 Over time, the SONI price control framework has moved some way from conventional price control cost incentives. For instance, under the 2015-20 price control, there are special arrangements for transmission network pre-construction costs.

5.13 Furthermore, under the 2015-20 price control framework (and preceding price controls) a large proportion of the costs that SONI incurs in its TSO role are treated as pass-through costs, with SONI remunerated under the licence for the level of costs it actually incurs (e.g. costs of purchasing system support services). While the costs subject to conventional price control incentives have tended to get the most attention at price control review, these costs represent a minority of the total costs incurred by SONI each year.

Overview of draft determination on cost remuneration

5.14 In the context summarised above, we identified a fundamental question of whether the range of different cost remuneration approaches applied to different categories of SONI costs was logical and appropriate for the 2020-25 price control period. This was an area that we had marked out for further development in our SONI price control approach decision in March 2019.

5.15 For our draft determination we carried out a detailed review of options for the cost remuneration approach for the SONI price control framework over the 2020-25 period. We considered a range of potential approaches that could be applied across the various SONI cost categories.

5.16 The outcome of this process was a set of proposals which would involve modifications to the existing arrangements. Our proposals would continue to apply different approaches to different areas of SONI's costs.

5.17 We briefly summarise below our proposals for a number of key categories of SONI costs. We take the following in turn:

- SONI's internal costs currently subject to cost-sharing

- Transmission network planning costs.
- External costs (such as system support costs).

Internal costs currently subject to cost-sharing

5.18 The majority of SONI's internal costs are subject to mechanistic financial incentives, under the 2015-20 price control framework, with 50:50 sharing of any over-spend or under-spend between SONI's investors and consumers. These internal costs include, for example, staff and facilities costs for core system operation activities and support function costs (e.g. HR, IT, legal).

5.19 In our draft determination, we proposed to adapt this approach, so that the financial incentives that apply to under or over-spend against ex-ante baselines are conditional on a targeted regulatory evaluation of evidence provided by SONI. This targeted regulatory evaluation would concern the interactions between the costs it incurred and its wider performance. We called this new approach "conditional cost sharing" incentives.

5.20 This approach represented an intermediate position between the existing cost-sharing approach and a more radical approach of removing any form of direct cost incentive on SONI and remunerating SONI on the basis of the costs it incurs (potentially up to a cap). That more radical approach would place more reliance on the evaluative performance framework as a means to ensure SONI's cost control and efficiency. This reliance did not seem appropriate, at least for the 2020-25 price control period in which the evaluative performance framework is introduced for the first time.

5.21 We said that the move away from mechanistic cost-sharing incentives to conditional cost-sharing incentives was intended, in particular, to help protect against a certain risk to consumers. This is the risk that the price control framework provides SONI with financial incentives to reduce or limit its own internal costs at the expense of higher costs or worse outcomes across the wider electricity system.

5.22 The conditional cost-sharing approach can be seen to start from the perspective of a mechanistic cost-sharing incentive arrangement with significant modifications. The modifications that we proposed had the following key features:

- In the case of an under-spend, SONI would only qualify for a financial reward from the cost-sharing rate if it can provide good evidence to us that the under-spend was not due to a reduction in costs that came at the expense of worse performance against the desired outcomes.
- In the case of an over-spend, if SONI can provide good evidence to us to show that this was due to the efficient costs of justified improvements in performance against outcomes, it would be remunerated in full for those additional costs, rather than facing a penalty under the cost-sharing rate.
- A reduction in the cost-sharing incentive rate, where applicable, to 25% (so that, as a minimum 75% of any under-spend or over-spend would be passed

through to consumers).

5.23 As an exception, we also proposed that the cost-sharing incentives would work in conventional, mechanistic way in the case of ex ante cost allowances for specific projects or initiatives where we have set price control deliverables/outputs that can be used to hold SONI accountable.

5.24 We also proposed that any financial incentive from these costs would be subject to an overall cap on the net financial reward or penalty from both cost-sharing incentives and the evaluative performance framework. We proposed a maximum financial penalty of £1m and a maximum financial reward of £1m.

5.25 We recognised the potential for additional regulatory and administrative burden under our proposed approach compared to the current approach. However, to a large extent this arises from the need for the regulated company to better understand, and demonstrate, how changes in its costs have affected its performance; and how changes in its performance have affected its costs. Understanding these things is a feature of a well-run system operator, and we said that we would expect this to contribute to our desired outcomes.

Transmission network planning costs

5.26 Our proposed approach for transmission network planning costs built on the existing uncertainty mechanism approach for transmission network planning project costs under the 2015-20 price control. We proposed that:

- SONI can recover the costs it incurs up to caps approved by us, and subject to potential disallowance of costs that are demonstrably inefficient or wasteful (DIWE)
- These arrangements would apply to all transmission planning costs (including early project scoping costs) for greater internal consistency.
- These network planning costs would be taken into account as part of evaluative performance framework, with potential for financial reward or penalty for its performance in relation to these costs.

External costs (such as system support costs)

5.27 A large part of the total costs that SONI incurs each year are currently subject to a full pass-through approach under the 2015-20 price control framework, with SONI entitled to recover through the SONI price control the amount of costs that it incurs.

5.28 This applies, for example to:

- The costs of purchasing system support services (ancillary services).
- Certain market operation costs that SONI incurs (e.g. imperfections costs).
- Payments to NIE Networks for transmission use of system services.

5.29 We proposed that SONI could continue to recover the costs it incurs in these areas.

5.30 We also proposed that, with the exception of costs SONI incurs in purchasing transmission use of system services (and payments for the Moyle interconnector), the costs, SONI performance in relation to these external costs would be taken into account as part of evaluative performance framework.

Stakeholder views

5.31 In general, where we received stakeholder comments, these concerned either the details of the arrangements proposed in specific areas (e.g. the details of the conditional cost-sharing) or requests for clarification or guidance on how specific aspects would work in practice.

5.32 No stakeholders provided targeted comments on the overall process that we had proposed, or identified major alternative options that we should have considered.

5.33 SONI's response to our draft determination welcomed our recognition that it was appropriate to reduce the incentive rate on its internal costs. Furthermore, SONI's response did not seem to object to the principle of a move away from mechanistic cost-sharing incentives.

5.34 However, SONI said that there were fundamental problems with the conditional cost sharing mechanism proposed in the draft determination, which could result in very asymmetric outcomes and increased uncertainty; as the parameters of cost sharing can change ex post providing no clear framework up front. SONI proposed modifications to the approach to address the specific problems that it had identified. It said that it would expect that, in order to secure symmetric outcomes, the burden of proof for any claw back of out-performance or under-spend against ex ante allowances would lie with us, to evidence and demonstrate that any variance was to customer detriment against clear principles specified ex ante.

5.35 SONI's response also covered a number of other aspects of the overall cost remuneration approach. SONI's raised specific concerns about the potential for ex post regulatory review on its strategic initiatives. It said that the approach could encourage risk averse behaviour and undermine financeability. SONI's generally supported the proposals we had made in relation to cost remuneration for transmission network planning costs and system support costs.

5.36 The Consumer Council said that it appeared that we had ended up with a reasonable balance of high-level incentives on SONI, while also making a more detailed comments on the design of the conditional cost-sharing approach.

FD position on cost remuneration

5.37 Our final determination on the cost remuneration approach is generally aligned with our draft determination.

5.38 We considered the operation of the conditional cost-sharing approach in detail, in the light of stakeholder comments.

5.39 We did not agree with SONI's proposal for changes that would alter the burden of proof in the event of an under-spend (this was also an aspect of our draft determinations that the Consumer Council had queried).

5.40 We recognised a need to provide additional information on how the conditional cost-sharing would work in practice:

- We decided on a number of simplifications and clarifications, for the purposes of implementing the approach, including a materiality threshold (below which more conventional mechanistic cost-sharing would apply).

- We produced a draft guidance document for the application of the conditional cost sharing approach, which we are publishing today for consultation alongside our final determination.

5.41 In the interests of clarity and reduced complexity, we have also decided that where we set ex ante allowances for specific new initiatives or projects as part of our final determinations, SONI's costs for these initiatives will be subject to mechanistic cost-sharing incentives with a 25% incentive rate, without the need for regulatory assessment of the reasons for any under- or over-spend. We recognise that the conditional cost-sharing approach is unnecessary for these types of allowances as we are specifying associated price control deliverables that can be used to hold SONI to account for the price control funding. However, the conditional cost sharing approach will instead apply to the base cost allowances for SONI.

5.42 We decided that, at least for the 2020-25 period, we would not implement the proposal from our draft determinations that SONI's performance in relation to the network planning costs it incurs (which are to be remunerated based on costs incurred up to a cap) would form part of the panel's assessment under the evaluative performance framework. Our revised position now reflects further consideration of the scope of the panel's assessment, especially for our initial introduction of the evaluative performance framework. We considered that other safeguards in the price control framework, including the caps we set and enhanced transparency provided sufficient safeguards on costs, and that the panel's attention and assessment would be better directed at other areas of performance.

5.43 Our final determinations also provide additional clarification of the cost remuneration approach for pension deficit repair costs, which reflect our pre-existing policy on the treatment of pension deficits across different price controls.

Context on role for enhanced cost transparency

5.44 In addition to the cost remuneration approach summarised in the previous section, we proposed enhanced transparency in relation to SONI's costs. We said that enhanced cost transparency and cost reporting initiatives can support cost efficiency in a number of ways:

- They can help harness reputational incentives to encourage efficiency and avoid wasteful expenditure (e.g. excessive remuneration of senior staff).

- They can help allow stakeholders to identify potential opportunities for SONI to operate more efficiently.

- The can provide information that is useful to the assessment required for the purposes of the evaluative performance framework for SONI or for assessments for the conditional cost-sharing incentives.

- They can improve opportunities for benchmarking between SONI and other organisations.

- They can provide a more detailed evidence base to use when setting ex-ante cost baselines, and when making approvals of expenditure caps for price control purposes.

5.45 We provided further details on our proposals for enhanced cost reporting in an annex to our draft determinations, and invited stakeholder feedback on these proposals.

5.46 We also said that, as far as possible, while recognising the potential need for some redactions where justified on grounds of commercial confidentiality, we would envisage SONI publishing the data for the benefit of stakeholders rather than just providing it to the regulator.

Stakeholder views

5.47 The Consumer Council said that it supported cost transparency as a way to allow closer monitoring of trends in SONI's performance and to highlight adverse movements. It also said that it is important for consumers that the information provided is as accessible and consistent as possible, so as to facilitate stakeholders engaging with the information provided.

5.48 We did not identify in SONI's draft determinations response any comments targeted at the cost transparency proposals in our draft determinations.

FD position on cost transparency

5.49 We have decided to adopt the full range of enhanced cost transparency measures proposed in our draft determinations. We agreed with feedback from the Consumer Council that it is important that information is presented in a way that enables stakeholders to engage with this information.

Context on uncertainty mechanisms

5.50 In this sub-section section we set out an overview of our approach to price control uncertainty mechanisms. The approach is intended to help deal with uncertainty, at the time of the price control review, about SONI's efficient level of costs over the five-year price control period. This includes uncertainty mechanisms to deal with uncertainty about the projects and initiatives that it would be desirable or efficient for SONI to carry out during the 2020-25 period.

5.51 We proposed to keep the current uncertainty mechanism for transmission network planning projects, with the addition of a materiality threshold of £40,000. This mechanism was subject to detailed consideration as part of SONI's appeal to the CMA in 2017.

5.52 In addition, and in light of SONI's business plan submission in this area, we proposed to make changes to the treatment of transmission network project scoping and feasibility costs, to provide greater flexibility for price control funding of these costs. We agreed with SONI's view that there might be a funding gap in the current process which could affect the quality of early stage network planning work or which may lead to delays in network planning processes.

5.53 We also considered the arrangements that should apply for areas of costs that do not form part of transmission network planning. Key aspects of our proposed approach are summarised below.

5.54 We envisaged a price control framework for SONI where we would be carrying out regulatory assessments for new initiatives proposed by SONI not just at the price control review, but also during the price control period. There is already a major role for within-period determinations under the current price control framework (e.g. pre-construction projects, DS3 and I-SEM implementation costs, other Dt items).

5.55 We said that a clear role for within-period cost assessment seemed well-suited in the context of SONI's business plan for the 2020-25 period. The plan contained a variety of initiatives that might bring net-benefits to the system or customers, but which seem under-developed in areas such as the clarity on benefits/outputs and confidence on costing. In some cases, SONI has not provided good enough evidence, but in other cases the lack of evidence also reflected the early stage in the development of an initiative.

5.56 In that context, we did not identify good reasons to move away from a price control framework that allows us considerable flexibility for us to approve additional allowances during the price control period. This currently works through the Dt and Zt provisions of the SONI price control licence conditions.

5.57 We proposed to bring more consistency between the types of cost remuneration approach used for approvals made during the price control and the approach used for cost allowances set at the price control review. Drawing on our wider proposals for cost remuneration set out earlier in this section, we proposed that approvals during the price control period would primarily involve one of two regulatory approaches for additional cost allowances:

- Approving funding by setting an ex ante baseline for the efficient costs during price control period (which would be added to existing ex ante baselines), with these costs being subject to the conditional cost-sharing arrangements.

- Approving funding on the basis of remuneration of costs incurred, subject to an approved cap, with potential to take account of the costs incurred in this area as part of the wider evaluative performance incentive framework.

5.58 We proposed that cost recovery would be via adjustment to operating expenditure allowances and/or adjustment to the RAB (and in turn depreciation and rate of return allowances), depending on the mix of operating expenditure and capital expenditure in the relevant costs.

5.59 We proposed that, where we approve additional cost allowances during the period, we would generally determine the outputs or deliverables that SONI would be accountable for achieving or delivering in exchange for the additional funding.

Stakeholder views

5.60 Stakeholder feedback on our draft determinations concerned two main areas.

- The scope and design of the proposed uncertainty mechanisms.
- The overall balance between providing upfront funding for new initiatives at the price control review and providing funding for new initiatives during the price control period via uncertainty mechanisms.

5.61 On the first area, the Consumer Council made some specific proposals for how uncertainty mechanisms should be used in practice. These concerned a proposal for the arrangements to allow reductions to SONIs allowances as well as increases. The Consumer Council also proposed that SONI and the UR consider if there is a need for a specific focused re-opener relating to Covid-19 and/or Brexit.

5.62 SONI's feedback on the first area was mainly focused on the arrangements in relation to funding what it called strategic initiatives, and requests for further clarification. For instance, SONI referred to the uncertainty mechanism arrangements for the 2015-20 price control and said there is a need for additional protections given risks associated with these projects as initial cost estimates are subject to change, and the timings for and scope of these initiatives could change in the course of the price control. SONI also sought clarification on interactions between the uncertainty mechanisms and other price control arrangements (e.g. the conditional cost-sharing approach).

5.63 On the second area above, SONI's response argued that our draft determination provided too little upfront funding for new initiatives, relying too much on uncertainty mechanisms during the price control period. It said that is consumers who are harmed by delays to approval for new initiatives. SONI raised concerns about the use of uncertainty mechanisms impairing planning and management through optimisation, risking inefficiencies (e.g. through stop start on projects) and impeding comprehensive economic appraisals.

5.64 Some other stakeholders (e.g. renewable generators) also raised concerns about too little funding for new initiatives provided upfront in the draft determinations and the emphasis on uncertainty mechanisms.

FD position on design of uncertainty mechanisms

5.65 Our final determinations on the design and scope of uncertainty mechanisms are generally aligned with our draft determinations.

5.66 One consequential refinement reflects our broader approach to cost remuneration summarised above. This refinement is that where we provide additional ex ante allowances for new initiatives, and set associated price control deliverables for SONI, then conventional and mechanistic cost-sharing (with 25% incentive rate) will apply rather than the conditional cost-sharing approach.

5.67 We did not identify a need for a specific reopener for Covid-19 and/or Brexit. The other price control uncertainty mechanisms included in our final determinations are sufficiently flexible to be able to allow for potential increases in costs that relate to Covid-19 and/or Brexit. In addition, there is also the change of law adjustment provision in the SONI price control licence conditions, which we were retaining.

FD position on balance of upfront funding

5.68 To a large extent the stakeholder feedback on the balance between upfront funding for new initiatives proposed by SONI and the use of uncertainty mechanisms concerns the specific funding decisions that we make in our final determinations in relation to SONI's proposed new initiatives.

5.69 We did not have a policy position on what proportion of the costs of new initiatives should be allowed upfront rather than (expected to be) funded during the price control period. This will reflect the wider circumstances in which SONI operates, the nature of the opportunities available to it at a given point in time, the outcome of our cost assessment process and the quality of SONI's business plan and further submissions.

5.70 Further to this, we make some broader points of principle below in paragraphs 6.19 to 6.21 of cost allowances section which we consider to be relevant to our overall approach to the final determinations to managing uncertainty. We do not repeat these considerations again here, but note that, on balance, across these considerations, we considered it was appropriate to adopt an approach which is likely to involve a significant role for approval processes for price control funding for new initiatives during the price control period.

6. Cost allowances

Context

6.1 While SONI's costs of running its business do not represent a large part of the electricity bill that consumers that pay, they are still significant. This means that we expect them to be clear, reasonable and efficient. While justification for the level of internal cost is important, we are particularly interested in understanding the choices SONI makes in deploying its costs, and that the initiatives are well planned and specified. These factors affect how SONI can positively influence whole system outcomes and bring resulting benefits for consumers.

6.2 There are a number of key components, or building blocks, which make up SONI's cost allowance which we explain further below. These are Baseline, Service initiatives (mostly service type enhancements), Productivity, RPEs, Salary and Pensions. As part of our approach to assessment we apply more scrutiny based on materiality (increase and size of costs) and where there is weaker justification and evidence.

6.3 In line with our March 2019 business plan quality guidance on assessment we assessed SONI's Business Plan on how well evidenced and explained its costs are. We also assessed how ambitious and challenging the proposals are in terms of securing cost efficiency for the benefit of NI consumers. Finally, we assessed how well SONI has demonstrated innovation that contributes to cost efficiency.

6.4 We understood that SONI requested £121m as part of its October 2019 business for this 2020 to 2025 period. We proposed to allow £79m at draft determination. We welcomed improvements in the structure and presentation of SONI's analysis and recognised some good justification and evidence in certain areas. However, we were also concerned about the overall quality of evidence and strength of justification, in light of the materiality and increase of the costs requested. Historic allowances and SONI requests against SONI's 2020 to 2025 request, as we set out at draft determination, are illustrated below.

Table 4: BP request and allowance at draft determination

	UR Allowance[8] 2015-20 £000s	SONI Spend[9] 2015-20 £000s	BP Request 2020-25 £000s	Proportional Increase %
Opex	62,591	70,473	94,791	**51%**
Capex	7,703	5,739	26,007	**238%**

6.5 We had particular concerns around justification for the strategic initiatives building

[8] Allowances reflect those following CMA referral and decisions.
[9] It should be noted that this refers to projected spend.

block (or service enhancements), which is the most material driver of SONI internal cost. We were very concerned that many initiatives were not sufficiently well scoped or specified or planned and/or many were not additional and/or SONI was proposing to undertake the work of 3rd parties now and in the future without justification. We gave SONI a further opportunity to make its case by setting actions on SONI to provide further evidence for us to consider as part of our final determination.

Key changes from DD to FD

6.6 Since the draft determination we have engaged with SONI across all areas of the cost allowances through stakeholder workshops and our query process. We have also taken account of further information provided by SONI in its response and stakeholder views.

6.7 As part of its response to the draft determination, SONI revised the business plan to remove some uncertain projects. It has also responded to stakeholder feedback on stakeholder engagement related to strategic initiative service enhancements. It has also flagged a business plan error it made relating to staff allowance which had been omitted. The net-effect is a slight reduction in the amount of revenue requested.

6.8 After taking account of the further evidence and stakeholder views, we have increased our allowance from £79.1m to £87.7m. We are pleased that SONI has met some actions, but would note that in many cases it has not been able to.

Table 5: Final determination allowance and costs for future consideration

	Revised BP Request 2020-25 £000s	DD Allowance 2020-2025 £000s	FD Allowance 2020-25 £000s	FD % Increase from DD	Costs for Future Consideration £000s
Opex	92,852	70,154	77,998	11.2%	5,038
Capex	25,442	8,955	9,725	8.6%	10,623

Stakeholder views

6.9 SONI was very concerned that we have provided too little upfront funding for its new service initiatives. It said that we are relying too much on uncertainty mechanisms, and that consumers will be harmed by delays to approval for new initiatives. It said that our proposals would prevent it from developing a whole system vision, collaborating and engaging as part of DfE's energy strategy, risk grid security in NI, and prevent it from procuring staff and expertise with Eirgrid.

6.10 Stakeholders with renewable generation interests also raised concerns about too little funding for new service activity relating to the dispatch and balancing and system services, the risk of relying on uncertainty mechanisms, and that the proposed costs are small given the potential level of value these could deliver. The Business Alliance had similar concerns. It was also concerned about a lack of funding for stakeholder engagement activity. Mutual Energy, while not disagreeing with our assessment on costs, urged us to agree on what activity is required before any future regulatory approval. SSE also said SONI and UR should work together to ensure SONI is resourced. Some stakeholders were also concerned that is co-ordinated approach in both NI and RoI jurisdictions in relation to the funding.

6.11 SONI raised various concerns that the draft determination underestimated base line costs by c. £2.3m per annum, across areas such as ISEM costs, re-charges, and in-direct staff costs.

6.12 SONI and CCNI both commented on salary levels. SONI maintained that the UR provide the slightly higher salary level assumed in its business plan than we proposed at DD, citing various reasons for its request largely similar to those made in its business plan. CCNI, on the other hand, said our proposal was too high and should be benchmarked to a lower level.

6.13 SONI and CCNI both commented on RPEs and Productivity proposals. SONI's main contention on RPEs is that we have put too much weight on one source of evidence for non-labour costs (SPPI index); and that for productivity, the challenge we set is unachievable and not in line with current economic trends. CCNI questioned whether some SONI RPE forecasts were realistic.

6.14 NIE Networks, SONI and CCNI commented on pensions. The main focus was on the issue of the deficit recovery period. SONI and NIE Networks considered a shorter recovery period than our 10 year proposal was more appropriate, whereas CCNI agreed with our proposed 10 year period.

6.15 Manufacturing NI made a general comment that the overall level of funding proposed by the UR strikes the balance required. It considered we had forensically reviewed SONI's plans and that sufficient funding is provided to operate safe, secure and affordable services whilst providing supporting to manage the transition in the market

FD position

Baseline

6.16 SONI has clarified that the business plan information it submitted on staff numbers was incorrect and failed to account for additional members employed post I-SEM introduction. SONI also made other representations with respect to recharged staff and salary expenses. As a consequence of the evidence submitted, we have made various changes to base allowances from our draft determination position, including the following:

- Provision for 4 additional internal FTEs related to I-SEM activity.
- Provision for 2.5 external FTEs related to I-SEM.
- Increase in IT support costs by £0.6m per annum following new market

requirements.

- Inclusion of additional £100k per annum in professional fees for mandatory annual schedule and dispatch audit.
- Adjustment to recharged staff to average levels in the 2015-20 price control period.
- Re-instatement of overtime and standby allowances.
- Adjustment to non-labour costs where material increases are unsupported.

6.17 The impact of the final determination decisions is to increase base costs to £13.5m compared to our draft determination position of £12m against the SONI estimated request of £14m. Our revised position largely accounts for the error SONI made in its business plan concerning ISEM costs. The principle reasons for the difference between SONI's draft response position and our final determination is the salary allowance variance. It also reflects the reduction to recharged staff costs which we do not consider to be fully justified.

6.18 Besides the allowances and disallowances above, we have made four other adjustments to our allowances in line with draft determination position. This includes the following:

- We have provided a provisional allowance of £1.25m (includes contingency) within baseline opex for network planning feasibility studies. This is equivalent to £250k per year split by £200k for external specialist support and £50k contingency.

- Certain relatively predictable costs such as licence fees, ENTSO-E[10] and CORESO[11] membership have been provided for as part of base costs as opposed to being subject to an uncertainty mechanism request each year.

- We have provided three additional FTEs to cover the resource required to enable SONI to undertake the relevant proposals, monitoring, analysis and reporting associated with the new regulatory framework. This represents an additional FTE on top of what was provided at draft determination. SONI considered our draft determination may not provide sufficient allowance but did not provide evidence for further allowance (this remains the case). However, while we have simplified aspects of the regulatory framework since draft determination, we have further reviewed what we think will be required. We consider an additional FTE to that we proposed at draft determination to be appropriate. We have uplifted our allowance accordingly using our regulatory judgement of the work required to account for the changes being new and material.

- We have provided SONI with an allowance to further scope out one of its strategic initiatives for grid security (Alternate Disaster Recovery Site).

[10] ENTSO-E = European Network of Transmission System Operators for Electricity
[11] CORESO = Co-Ordination of Electricity System Operators.

Strategic initiatives (service enhancements)

6.19 Stakeholders were concerned about the balance between upfront funding and use of uncertainty mechanisms. We have reached a balanced position on what specific initiatives to allow funding for rather than leaving to uncertainty mechanisms during the period. We have recognised that there could be potential harm to consumers from factors such as: (a) delays to new initiatives that could benefit consumers; and (b) potential inefficiencies in delivery from not approving as much funding upfront. We have considered any evidence provided by SONI on these matters and the risks.

6.20 It is also important that we take account of the benefits of leaving approval for some initiatives to a point during the price control period, especially in a context of uncertainty and evolving opportunities. In particular:

- Even after the refinements and further submissions SONI made following our draft determinations, a number of SONI's proposals seemed insufficiently well-developed and thought out. Not only can further development of proposals improve the reliability of SONI's costings but, perhaps more importantly, it can help improve the extent to which the project is planned in a way that reaps the full opportunities available for consumers and is well-aligned with stakeholder requirements.

- We expect that, during the price control period, the Evaluative Performance Framework that we are introducing for the 2020-25 period will bring benefits by better aligning SONIs proposals for new initiatives with the desired outcomes and stakeholder expectations. The funding decisions under uncertainty mechanisms will be a matter for us to decide on. However, SONI will have a potential financial reward under the Evaluative Performance Framework if, during the period, it gains approval for projects that the evaluation panel consider to be ambitious and well-aligned with our strategic priorities and stakeholder views.

- Over the longer term, we consider that it is in consumers' interests for the regulatory framework to encourage regulated monopolies such as SONI, when seeking additional funding from customers, to provide good evidence and supporting analysis as part of their submissions. The incentives for SONI to do so would be reduced if we meet SONI's funding requests despite the poor-quality submissions it has provided to us.

6.21 On balance across these considerations, we considered that it was appropriate to adopt an approach which is likely to involve a significant role for approval processes for price control funding for new initiatives during the price control period.

6.22 We note specific concerns that the costs of SONI's control centre tools and system services initiatives are likely to be small in the context of the overall size of the electricity bill, compared to the potential value. Many of our concerns do not necessarily relate to size of cost or that there may be a lack of value in these areas. Instead, we are concerned that the project(s) have not been scoped sufficiently and that a sizeable proportion of the activity risks being within the remit of 3rd parties (DSO and/or the market). We asked SONI to clarify its position on this. We have provided an allowance for SONI to identify needs and mitigate any 'stop start' timing risk. We look forward to receiving appropriate justification.

6.23 Our regulatory concerns are not unreasonable as they are in line with the consumer interest. If we were to provide funding for certain areas, in the way requested by SONI, in relation to its system service and control centre tools request, we risk not optimally supporting all technologies. We also risk not fully supporting investment in renewable generation in the most appropriate manner.

6.24 Stakeholders were concerned about the need for all-island coordination. We have taken account of the regulatory direction of travel on matters which may be considered all-island. We and CRU operate under two different jurisdictions, with two different legislative frameworks and two different price control approaches. So what is decided upon in one jurisdiction may not be appropriate for the other jurisdiction. That being said, we do co-ordinate, particularly where such aspects of SONI TSO activity may have an all-island impact, and where we are working strategically with CRU. We will continue to do so as SONI further develops its service scope in these areas.

6.25 Stakeholders were concerned about engaging and working with SONI on its requirements. We have engaged with SONI significantly throughout the process. It is ultimately for SONI to consider its requirements and we strongly urge it to consider our concerns as it further develops its scope. Since the draft determination we have engaged further with SONI to refine deliverables and timescales. We have also proactively engaged with SONI to review sensitive information relating to its grid security initiatives. We have since provided a full allowance for one initiative in light of the strength of evidence and justification provided by SONI. We have also uplifted its baseline to scope out work relating to another complex grid security initiative. We have also now accepted a revised SONI request for an allowance to understand what stakeholders need and to enable it to learn from other jurisdictions.

6.26 We have also set out deliverables for SONI to further develop whole system strategy to reflect our concerns that SONI needs to clearly set out how it will coordinate with the DSO; and also to reflect the need for digitalisation strategy development. We have further engaged SONI on these and taken account of its response since the draft determination was published. We intend to engage further with both SONI and NIE Networks on this work in 2021.

6.27 We have split our allowances into three areas, and we summarise out our final determination position below for these.

Full allowances (£5.5m)

6.28 We have provided full allowance where are content with the rationale for consideration, need, proposed option, costs and are confident that the benefits are likely to outweigh costs. We propose to allow most of the additional IT over and above SONI's existing baseline, and also some proposed enhancements elsewhere such as 'Transition to Cloud' 'Smarter Outage Management', 'System Planning'. Since the DD, we have also provided the full allowance for 'Enhanced Cyber Security' following the review of appropriate evidence.

<u>Partial or non-additional allowance where further justification to support further allowance is required (£16.1m out of £36.5m)</u>

6.29 These include projects for which a partial allowance has been provided but where we consider there is a strong case for future consideration of costs during the price control.

6.30 We have made partial allowances expenditure where the basic rationale for consideration, need for action is established, and options are appropriate, and the benefits are likely to outweigh the costs. We illustrate this in the context of those initiatives that stakeholders had concerns with:

- SONI requested 5 FTEs to research, develop and implement activity as part of its 'Renewable Strategy' and 'Control Centre Tools' initiatives. We recognise there is a strong overall rationale for consideration for these particular initiatives, and there are potential net-benefits. So we have provided for the opex allowance.

- SONI also requested capex for a DSO-TSO interface as part of its 'Renewable Strategy' initiatives. We have funded SONI's full request to develop a DSO-TSO interface, as we recognise the value from effective coordination between SONI and NIE Networks from this activity now. We understand that it may be the case that the DSO views it as appropriate that the SONI has sight of certain DSO information. As such the DSO should lead on this development rather than the TSO. This is because the distribution network is the responsibility of the DSO and tools relating to small scale renewables should be within the remit of the DSO. We intend to carry out further engagement with both SONI and NIE Networks in this area

- SONI revised its stakeholder engagement business case in light of ours and SECG feedback. We have provided an allowance for work related to better understand stakeholder needs and to develop an engagement portal/update its website to collaborate stakeholders.

6.31 There are also aspects of initiatives where we have not provided any allowance at this point. However, we expect there to be a strong case for future consideration of costs during this price control period. This is because the optionality and/or scope of design and quality of planning and/or cost case has not yet been fully justified. In particular:

- We have disallowed the remaining capex for SONI's 'Renewable Strategy' and 'Control centre tool' initiatives. The components are largely at conceptual design stage and it was unclear what services and tools are required for most items.

- We also remain concerned that some components, particularly under the renewables strategy initiative, could be undertaken by 3rd parties such as the DSO. SONI will need to engage effectively with stakeholders to ensure the needs of its diverse customer base are prioritised. It will also need to engage with NIE Networks as part of its potential DSO role. It will be important to ensure that there is a clear de-lineation of responsibility between TSO and DSO roles, in terms of how it plans to operate across the TSO / DSO boundary. SONI will need to ensure that its proposals are not within the remit of the DSO.

- Grid security initiatives where there is a clear rationale for consideration but further work is required to scope. We have disallowed the 'Alternate Disaster Recovery (ADR) Site' request. However, we have uplifted SONI's baseline to enable it further scope this work as we recognise this is a new task. We have also set a deliverable with timings so SONI is clear what it needs to scope by when. We have also set a deliverable for SONI to further scope 'Physical Security' outputs as part of its existing allowance, as the same rationale as applies for the ADR does not hold. UR sought expert opinion for these areas and we provided SONI with the opportunity to respond to this review. These steps will help mitigate any risks to consumers from not meeting SONI's request at this final determination point.

- There were some aspects of the revised stakeholder engagement business case which are likely to be additional and have strong potential to add value for consumers. However, SONI has not specified what these are yet and it was unclear what exactly it was seeking allowances for. SONI does not propose to undertake this activity until after year 1. However, it has said that its year 1 focus will be learning/researching from other jurisdictions and understanding stakeholder needs, which we have funded in full. There is, therefore, an opportunity for SONI to seek further funding following completion of the year 1 funded tasks. This approach should aid SONI in providing further clarity on its future needs.

No allowance (£0m out of £5.5m)

6.32 These reflect projects where, for the most part, we disagree that there is a rationale for further consideration. For example, where it is unlikely that the benefits will outweigh the costs, or where initiatives are already reasonably covered under existing or other initiative allowances. A good example is some of the activity under SONI's revised stakeholder engagement business case, which is aimed at educating stakeholders and customers on the need for further infrastructure. However, we note that there are some initiatives which seem necessary and should be delivered if SONI so chooses within its existing allowance.

Service initiative deliverables and performance accountability

6.33 We propose an approach for the SONI price control which means that where we approve funding for new initiatives we would establish deliverables (and/or performance commitments). These deliverables (including success measures) can be used to hold SONI to account for delivery or for the achievement of the proposed benefits of the initiative.

6.34 We have published these alongside our final determination. Where SONI deliverables had shortcomings or limitations in terms of accountability for an initiative, as there is a lack of detail on what would be delivered and by when, we should ensure that SONI does not benefit unduly from any resultant ambiguity when it comes to the assessment against the delivery for that initiative. For instance, where the plan gives rise to a range of reasonable interpretations of what is required for full delivery we should try to strike a balance across those interpretations rather than holding SONI accountable for the least challenging interpretation. We will require SONI to further develop these over time. We expect development to be accounted for within our Evaluative Performance Framework.

Salary, Pension, RPE's and Productivity

6.35 The main difference between SONI's business plan and our draft determination proposals on salary relates to staff based on a regional price adjustment. We have maintained our draft determination position of £51k base salary provision on this basis. This was based on actual costs, benchmarking and relevant precedent from other comparators. We note SONI arguments for an increase given limitations and use of benchmarking data, and CCNI arguments for a downwards adjustment. However, we have not seen a good reason or evidence to move away for our draft determination position.

6.36 We have only made two changes to the pension allowance since draft determination after reviewing SONI's updated actuary report. We have uplifted the Defined Benefit contribution rate to 52% in line with SONI's request. We have retained the 10 year deficit recovery period that we proposed at draft determination but re-profiled in line with the SONI request until the next actuarial report is complete. Otherwise the defined contribution rate and the administration expenses remain the same as at draft determination.

6.37 We note mixed views from stakeholders on our proposal for a 10-year pension deficit recovery period. We drew on specialist advice to review SONI's updated actuarial report. The expert was unconvinced by SONI's arguments against a 10 year pension deficit recovery period and for a shorter, 7 year recovery period. The detailed report is published alongside this final determination. It summarises that given the strength of the covenant and the desire to create fairness for different generations of consumer, the recovery plan of 10 years proposed by the UR does not seem unreasonable. It went on to say that it does not appear to be out of line with the recovery plan lengths of other regulated companies. We have maintained this position for final determination.

6.38 We have retained our draft determination position concerning Real Price Effects and Productivity where we made slight amendments at draft determination to the assessment SONI made within its business plan. SONI and CCNI made comments on our draft determination proposals. We did not see any further evidence or justification to merit a change in our draft determination position.

7. Risk and Return

7.1 In this section we summarise our final determinations on the remuneration of equity capital and debt finance under the 2020-25 price control. This includes our proposed WACC allowance and proposals for other elements of the overall allowed return. We provide a more detailed explanation of our proposals in Annex 5, Risk and return.

Context

7.2 Our broader approach to the price control put more accountability on SONI for the quality of its price control business plan than has been the case in the past. In line with this approach, our starting point for our draft determinations was SONI's business plan proposals for different components of the overall remuneration of equity capital and debt finance, and the evidence and justification provided in support of these.

7.3 For the purposes of our draft determinations, we considered which specific aspects of SONI's proposals for the remuneration of equity capital and debt finance we should use, and which aspects we should "intervene" on, to adopt an alternative approach or alternative figures. In this context, a proposal not to intervene on a particular aspect of SONI's business plan proposals was not necessarily a full endorsement of the approach used by SONI, or the figure it had proposed. Our view may reflect other considerations such as the need for proportionality and prioritisation across different parts of our determinations, taking account of SONI's proposals, the materiality of the issue and the availability of other sources of information.

7.4 In our March 2019 regulatory approach, we summarised the main aspects of our proposed approach for the remuneration of equity capital and debt finance as part of the price control. This, in turn, drew on the outcome of SONI's appeal to the CMA in 2017. For the most part, SONI's business plan was well-aligned with the high-level approach we envisaged.

7.5 SONI's business plan endorsed the approach we set out in March 2019. This was that the remuneration for its equity capital and debt finance under the price control should be determined for a notional TSO licensee, which may have a different capital structure to SONI. This approach is consistent with wider UK regulatory precedent.

7.6 In our draft determination we decomposed the overall allowed return sought by SONI into four main components, leaving aside the return to investors achieved through inflation-linked indexation of the RAB. The overall remuneration can be seen as the sum of allowances from four potential remuneration channels:

- **Allowed return on the RAB**. The allowed return on the RAB (regulatory asset base) is determined by applying an allowed weighted average cost of capital (WACC) to the value of SONI's RAB. The WACC is intended to cover remuneration for equity capital (i.e. providing a reasonable return for equity investors) and to cover the costs of efficient debt finance, and its calculation reflects the balance, or weighting, between these two elements. For the price control, we determine the allowed WACC on a pre-tax basis, which includes an allowance for the corporation tax liabilities arising on the profit expected to be generated by SONI over the price control period.

- **Allowed return on parent company guarantee (PCG)**. Historically SONI's parent company EirGrid has been required to provide a parent company guarantee in support of SONI's TSO activities. This represents an additional form of equity investor capital beyond equity captured in the SONI RAB. We identify a separate remuneration channel to provide for a rate of return on any parent company guarantee required from the notional TSO licensee.

- **Allowed margin on revenue collection activities**. Some of the activities covered by the revenue control can be seen to involve a revenue collection role, with SONI collecting substantial amounts of money from participants in the Northern Ireland electricity system. Following precedent from the CMA's determination in the 2017 SONI appeal, we provide a separate remuneration channel to allow for a margin on revenue collection revenues for which the notional TSO licensee would bear material risk.

- **Adjustment to allowed return for asymmetric risk**. The allowed return on RAB channel above involves an allowed WACC which is based, in part, on estimates of the cost of equity using the capital asset pricing model (CAPM). These estimates of the cost of equity are most relevant in cases where the regulated company in question faces a reasonably balanced profile between upside and downside financial risk. Following precedent from the CMA's determination in the 2017 SONI appeal, we provide a separate remuneration channel to provide an additional return if the notional TSO licensee would face significantly asymmetric risk under the price control framework, to the detriment of SONI equity investors. By the same token, if there is significant asymmetry in favour of SONI equity investors, and to the detriment of customers, this channel could involve a negative adjustment applied in the calculation of the overall allowed return.

7.7 Figure 6 provides a high-level illustration of how the total allowed return is to be derived from these four remuneration channels. It shows, for instance, that the allowed return on the RAB is to be calculated by applying an allowed WACC (%) to the prevailing value of the SONI RAB. It also recognises that the total forecast return to investors under the price control framework will reflect not just the total allowed return used to calculate price control revenue allowances, but also a forecast of the net effects of any financial out-performance or under-performance by SONI under the price control framework (e.g. out-performance from positive net rewards under price control incentive schemes, or under-performance from exposure to costs in excess of allowances).

Figure 6: Overview of remuneration channels for debt and equity

Key changes from DD to FD

7.8 We carried out considerable amount of further analysis and assessment for the purposes of our final determinations, after considering responses. This included developments to our approach, and refinements to our assessment, in the light of stakeholder feedback. We updated our assessment to take some account of the CMA's provisional findings in the water company redeterminations. We also changed our approach to estimation of the cost of debt for a notional TSO, as a consequence of further information provided by SONI on its debt financing arrangements.

7.9 In the table below we present a summary of our final determination for each of the four remuneration channels introduced above, and place this in the context of SONI's business plan proposals and our draft determinations. We then provide a more detailed summary in relation to each of the four remuneration channels.

Table 6: Final determination for cost of capital components

Element of allowed return	SONI business plan	DD proposal	FD position
Allowed return on RAB	Pre-tax WACC of 5.08% Estimated allowance of £2.0m based on forecast RAB of £40m on average over period.	Pre-tax WACC of 3.79% Based on DD forecast average RAB of £35 million this would imply average annual allowance of £1.34m	Pre-tax WACC of 4.03% Based on FD forecast average RAB of £34m [April 2019 prices) this would imply average annual allowance of

			£1.36m
Allowed return on PCG	PCG of £10m remunerated at rate of 0.175% nominal Implies £175,000 (nominal) per year.	No allowance and revisions to regulatory obligations on SONI to regarding PCG for TSO activities	Keep requirement for £10m PCG and remunerate at rate of 0.175% nominal (as per CMA) Average allowance of £163k per year (April 2019 prices).
Allowed margin on revenue collection activities	Margin of 0.6% applied to revenue collection revenues for DBC/imperfections charges; TUoS revenues; and system support costs. Based on SONI's forecast average annual revenues of £173m, this implies a margin allowance of £0.9m per year.	Allow margin of 0.5% on qualifying revenues No margin allowed on TUoS with proposed change SONI's role in relation to TUoS revenue collection, so that any risk lies with NIE rather than SONI, enabling customers to avoid the need to fund TSO margin on this Applying a margin rate of 0.5% to our forecast of annual average qualifying revenue £97m gave a forecast remuneration of £0.5 million per year.	We still see value for consumers in de-risking SONI's TUoS revenue collection role, but plan to pursue this through separate licence modifications after our FD On this basis, FD would allow for margin of 0.5% on revenue collection revenues including TUoS, which we forecast to provide for approximately £688k per year The TUoS allowance may subsequently be removed if SONI is de-risked
Adjustment to allowed return for asymmetric risk	3% margin applied to qualifying costs. Estimated at £220k per year.	A 3% margin applied to the forecast amount of qualifying costs subject to remuneration up to approved cap Forecast of the costs subject to remuneration up to approved cap of £4.4 million per year on average (2020- 25) and, on this basis we proposed an allowance for asymmetric risk of £132k per year. No other adjustment for asymmetric risk	3% margin applied to upfront estimate of qualifying costs subject to remuneration up to approved cap Forecast of the costs subject to remuneration up to approved cap of £4.5 million per year on average (2020- 25) and, on this basis we proposed an allowance for asymmetric risk of £136k per year. No other adjustment for asymmetric risk
Total allowed return (forecast)	£3.3m per year.	£1.99m - £2.04m per year.	£2.35m

Stakeholder views

7.10 In its response to our draft determination, SONI said that it would not be financeable based on the financial projections implied by the draft determination, given the company's characteristics, business activities and risk exposure. SONI provided a detailed response from SONI across many (but not all) aspects of the proposals from our draft determinations on risk and return.

7.11 SONI was particularly critical of the approach we had taken towards the notional gearing assumptions, the TSO asset beta, the cost of debt, the PCG, the margin for revenue collection and overall financeability.

7.12 These was some additional comments from other stakeholders in specific areas, but these were generally quite limited. CCNI said that in general it agreed with the UR's approach to risk and return as being in consumers' interests, and also made specific comments on the PCG remuneration. Business Alliance also commented on the PCG and wider debt financeability.

FD position on pre-tax WACC for notional efficient TSO

7.13 One preliminary issue, which affects the assessment of the pre-tax WACC for the SONI price control, is the choice of inflation index for the SONI RAB. We confirm our decision to switch from RPI indexation to CPIH indexation of the SONI RAB and revenue control for the 2020-25 period.

7.14 Our final determination is for a pre-tax WACC of 4.03%. Table 7 lists the main components (parameters) feeding into the estimation of the pre-tax. We present the figures we have used for each component and put this in context against the corresponding figures from our draft determinations and SONI's business plan proposals. SONI's response to our draft determination did not propose an updated set of WACC parameters or updated WACC calculation, and SONI generally sought to defend its business plan position.

7.15 Table 7 provides comparisons for both pre-tax WACC, where relevant, and also the vanilla WACC. The vanilla WACC does not include remuneration for corporation tax and is used for the WACC determinations for some other UK price controls (which involve a more complex approach to setting separate allowances for corporation tax liabilities).

Table 7: Final determinations on pre-tax WACC (CPIH-real basis)

WACC component	SONI business plan proposals	Draft determination assumption	Final determination assumption
Notional gearing assumption	55%	30%	40%
Total market return	6.50% (6.00% to 7.00%)	6.50%	6.70%
Risk-free rate	-0.60%	-0.60%	-1.0%
Equity risk premium	7.10% (6.60% to 7.60%)	7.10%	-7.7%
TSO asset beta	0.57 (0.54 to 0.61)	0.50	0.50
TSO debt beta	0.15	0.125	0.075
Corporation tax allowance	17%	17%(subject to adjustment mechanism)	19%(subject to adjustment mechanism)
Cost of debt	2.14%	1.14%	0.75%

Pre-tax WACC	5.08%	3.79%	4.03%
Vanilla WACC	4.42%	3.21%	3.32%

7.16 We briefly highlight some of the key aspects of our determination below.

Notional gearing assumption

7.17 SONI heavily criticised our proposal for 30% notional gearing. We remained of the view that SONI's proposal for 55% notional gearing lacked sufficient justification, and did not seem consistent with the higher risk nature of the TSO versus the network infrastructure companies such as water companies for which notional gearing is around 60%. Furthermore, SONI's actual gearing seemed well below its notional gearing.

7.18 However, in the light of some relevant points made in SONI's draft determinations response, and other changes for our final determinations (e.g. allowance for parent company guarantee), we considered that a notional gearing assumption of 40% was more appropriate than 30%.

Total market return and risk-free rate

7.19 Our draft determination was aligned with SONI's business plan proposals on the total market return and risk-free rate, although we noted that we may look to update these parameters. For our final determination, we used updated assumptions for these parameters, which draw on estimates from the CMA's provisional findings in the water company redeterminations (and SONI's views on those estimates).

TSO asset beta

7.20 The TSO asset beta was one of the areas that we gave most attention in our draft determinations. We considered a range of evidence, including: updates to an operational gearing adjustment method for estimating asset beta which has been used in the past by the CMA; comparisons of the implied cost of equity (at 30% notional gearing) for the TSO against the cost of equity for regulated water companies (at 60% notional gearing); and consideration of wider regulatory precedent (e.g. asset beta for NERL).

7.21 SONI's response to our draft determination argued for a higher asset beta and was critical of our approach to the assessment of the TSO asset beta. We considered SONI's arguments in detail. We also carried out updates to the analysis from our draft determinations and made refinements to our approach and assessment.

7.22 We decided that, overall, there were not good grounds to move away from the asset beta assumption of 0.50 from our draft determinations.

TSO debt beta

7.23 SONI's response to our draft determinations highlighted, rightly, that the debt beta would be expected to be lower at lower levels of notional gearing. Given our notional gearing assumption of 40%, SONI's submissions and regulatory precedent, we considered that 0.075 was a reasonable assumption for the TSO debt beta parameter.

Corporation tax allowance

7.24 Our draft determinations proposed an uncertainty mechanism which would adjust the corporation tax allowances for any changes to the statutory corporation tax rate. The Consumer Council endorsed this proposal. We have adopted this approach for our final determinations and updated our central forecast of the corporation tax rate from 17% to 19%.

Cost of debt

7.25 Our draft determinations on the cost of debt were based primarily on a review of SONI's business plan proposals for the cost of debt, supplemented with a review of relevant regulatory precedent. SONI's approach had been to start with a benchmark derived from yields on long-term corporate bonds (1.14% CPIH-real) and then add a small company premium (0.40%) and a premium for transaction costs (0.60%). In our draft determinations, we adopted the benchmark rate but considered that SONI had not provided sufficient evidence to justify the premiums it proposed.

7.26 SONI's response to our draft determinations provided good evidence that a notional TSO would face a significant premium on the cost of debt, relative to a large, regulated network infrastructure company (all else equal). It also provided evidence on transaction costs, albeit on a smaller scale than proposed in its business plan.

7.27 However, in light of further information provided by SONI on its actual debt finance arrangements, we considered it misleading to start from a benchmark derived from long-term corporate bonds and then apply upwards adjustments. SONI does not raise finance through long-term corporate bonds, but rather through shorter-term (e.g. five-year) bank finance with floating or variable interest rates. We considered that this form of bank finance was also more relevant for a notional efficient TSO.

7.28 Rather than using benchmark derived from long-term corporate bonds (which reflect interest rates a number of years ago) we decided to make a more direct estimate of the cost of debt for a notional TSO, drawing on evidence from SONI's bank finance arrangements and other relevant information.

7.29 In light of this evidence, we decided on an assumption for the cost of debt of 0.75% on CPIH-stripped basis. This is intended to cover a notional TSO's debt finance costs, including transaction costs (e.g. bank arrangement fees).

Putting the pre-tax WACC in context

7.30 Overall, our final determination is for a pre-tax WACC of 4.03%. Even when placed on a post-tax basis (3.32% vanilla), we do not consider that this is directly comparable to recent regulatory precedent for vanilla WACC for large regulated network infrastructure companies (e.g. water companies regulated by Ofgem and energy networks regulated by Ofgem). On one hand, the WACC for 2020-25 for the notional TSO is pushed up due to our allowance for substantially higher risk exposure. On the other hand, it is pushed down by the lower debt finance costs, due to a lack of long-term embedded debt at historical interest rates. Rather than informing on the overall WACC for the TSO, we considered regulatory precedent informative for specific aspects of the WACC build-up, as set out in Annex 7.

7.31 Our WACC for the notional TSO in the 2020-25 period is substantially lower than SONI's view (5.08%). We considered that SONI had, in particular, over-estimated the cost of debt for a notional efficient TSO, and that its TSO asset beta assumption was too high given the evidence available. We are satisfied that we have understood the reasons for our proposed pre-tax WACC being lower than SONI's proposal, and that our pre-tax WACC is reasonable in the light of the overall evidence base for our final determinations.

7.32 It should be recognised that, despite reductions in the WACC compared to the 2015-20 price control period, this pre-tax WACC will be applied to a RAB which is, on average, higher in the 2020-25 period than the 2015-20 period, leading to increased allowances for SONI in pounds. Our estimates are that the WACC*RAB allowances for the 2020-25 period are £1.23m per year, [12] compared to estimates of £1.16m for the 2015-2020 period (post-CMA remedies).

Other elements of the allowed return

7.33 The subsequent sections overview our allowances for the other three potential elements of the overall allowed return for SONI, besides the WACC*RAB allowance:

- Remuneration of parent company guarantee.
- Remuneration of risk from revenue collection activity.
- Adjustment to allowed return for asymmetric risk.

FD position on remuneration of parent company guarantee

7.34 Under the existing licence, SONI is required to have the benefit of a parent company guarantee (PCG) of £10m from EirGrid. In this context, the PCG was explicitly remunerated as part of the CMA determination in the 2017 appeal.

7.35 In our draft determinations, we proposed to remove the requirement for the PCG for the 2020-25 period (subject to some safeguards) and, in turn, not to provide remuneration for the PCG. We did not consider that SONI's business plan had made the case for retaining the PCG remuneration and licence requirements, especially given growth in SONI's RAB over time.

7.36 SONI objected strongly to the draft determination position that did not remunerate

[12] Includes returns on buildings, non-buildings, special projects and the network pre-construction project RABs.

the PCG, and which proposed to remove the existing PCG requirement.

7.37 After further consideration, we have decided for our final determinations to include remuneration for a £10m PCG (nominal) at a rate of 1.75% per year (nominal), which is the same rate as from the 2017 CMA determination.

7.38 We did not consider that there was strong evidence in either direction as to whether a hypothetical efficient TSO would need, or have, a PCG. In this context, we gave weight to what we saw as a reasonable theoretical case that a PCG could act to decrease overall financing costs, by improving the terms of debt finance offered by banks. We were also concerned that the information we used for the TSO cost of debt could be rendered less relevant, and potentially inconsistent, if applied to a notional TSO without a PCG.

7.39 We also considered that such a PCG obligation can bring additional value to consumers via additional protection in extreme downside scenarios, and that this is particularly relevant given SONI's low asset base.

FD position on remuneration of risk from revenue collection activity

7.40 In our draft determinations we considered both the role of SONI in relation to its revenue collection activities and the appropriate margin to allow for risk in respect of those activities.

7.41 We proposed changes to the financial arrangements between NIE Networks and SONI which would have the effect of de-risking SONI. We proposed that no margin would apply to TUoS revenues once TUoS revenues have been de-risked in this way. For the remaining aspects of SONI's revenue collection role, we proposed to retain the margin rate of 0.5% on qualifying revenues that applies under the 2015-20 price control framework.

7.42 SONI's response objected to our proposals to de-risk its TUoS revenue collection role, and argued for a higher margin rate.

7.43 Our final determination is to retain the margin rate of 0.5% from the 2017 CMA determination and apply this to the same set of revenues as under the CMA remedies. We considered SONI's submissions for an increase in the margin rate from 0.5% (e.g. to 0.6% as proposed by SONI in its business plan) but did not consider that these submissions demonstrated that such a change was necessary.

7.44 We remain concerned that the current TUoS arrangements impose unnecessary costs on consumers. SONI's response to our draft determinations provided no explanation of why it is best placed to perform this role in such a way that exposes it to material financial risk.

7.45 However, on further consideration of the points raised by SONI, we recognised that there are some practical implementation issues to work through in relation to the de-risking of SONI's revenue collection role. This will require further engagement with stakeholders. Rather than pursuing this through our final determinations, we plan to develop a separate consultation on licence modifications to de-risk SONI's revenue collection role. As part of that consultation, we will propose any reductions to the TSO revenue collection allowances that we consider appropriate in consequence of the change.

FD position on adjustment to allowed return for asymmetric risk

7.46 We decided to adopt the approach proposed in our draft determinations, of including within the overall allowed return an adjustment for asymmetric risk based on forecasts of costs subject to the approach of remuneration up to a cap. Based on updated forecasts, and the 3% allowance we had proposed, this gives an additional element of allowed return of £0.136m per annum (pre-tax). This is consistent with the approach from the CMA determination in the 2017 SONI appeal.

7.47 We decided not to make any further adjustments for asymmetric risk. Leaving aside the costs to be subject to remuneration up to approved caps, our review indicated that the remainder of the framework is likely to be slightly asymmetric to the benefit of SONI. However, given the complexity of the matter, we decided that it was not appropriate for our final determinations to seek to develop and apply a downward adjustment to allowed returns.

FD position on insight from debt financeability metrics and RORE analysis

7.48 SONI's response to our draft determinations focused on concerns about SONI's profitability and our RORE analysis.

7.49 As part of our review we have carried out further analysis to check the robustness and internal consistency of our proposals for draft determinations. In particular, we considered:

- Financial modelling to provide analysis of debt financeability metrics.
- Analysis of the potential impacts on equity return under hypothetical upside and downside scenarios for a notional efficient TSO's performance and costs during the price control period.

7.50 Analysis of debt financeability metrics, for the notional efficient TSO, is a useful and important exercise as part of the determination of the SONI price control (at least if the notional gearing assumption includes some debt rather than being 100% equity). This analysis we carried out did not indicate any problem with our final determinations for the various elements of the SONI allowed return, including the pre-tax WACC.

7.51 We found the RORE upside and downside analysis helpful in two main ways. First we used it to help with the calibration of the financial incentives under our proposed price control framework, including on the maximum downside penalty under the evaluative performance framework and the incentive rate for the conditional cost sharing incentives. Second, we made comparisons of the estimated RORE upside and downside risk for SONI against Ofwat's recent assessment of RORE upside and downside risk for regulated water companies, and took account of this as part of our considerations on the SONI asset beta.

7.52 Finally, we also considered SONI's claim that it was a requirement for its financeability that it earns a 10% EBIT margin on a measure of its controllable revenue. We found that, when we looked into the evidence that SONI provided to support this proposition, it contained significant errors and was insufficient to support SONI's proposition (which, if accepted, could act to overturn the outcome of our cost of debt assessment and CAPM-based cost of equity assessment). Furthermore, we considered that SONI's views on the relevance of this benchmark, and its importance to financeability, were inconsistent with the CMA's determination in the 2017 appeal.

8. SONI RAB

8.1 As part of our final determinations for the 2020-25 price control, we needed to take some decisions, and make some forecasts, relating to SONI's RAB. We set out our decision on the SONI RAB in Appendix 1 to Annex 5. We briefly summarise below.

Context

8.2 In broad terms, the value of the regulated asset base (RAB) of SONI in any year represents the value of accumulated investment which is allowed to be recoverable through the price control framework; but which SONI has not yet recovered through tariffs to customers (via the depreciation elements of its revenue allowances).

8.3 The RAB evolves over time according to price control allowances for capital expenditure, the outturn capital expenditure of SONI and rules and policies determined by us as part of our price control determinations (e.g. rules on the additions to be made to the RAB and the depreciation to be deducted from it).

8.4 The 2015-20 SONI price control recognises four main types of RAB, or RAB components, based on the nature of the investment and differences in the rules that apply in relation to the RAB. These are summarised briefly below.

- **Building assets RAB**. Additions to this RAB relate to capital expenditure by SONI on buildings, facilities and premises. Additions to this RAB are depreciated over 25 years (straight line).

- **Transmission network pre-construction projects (TNPP) RAB**. Additions to this RAB relate to expenditure by SONI on TNPP projects. Additions to this RAB are not depreciated and they remain in the SONI's RAB until the value is transferred to NIE Networks (or written off the RAB and charged to SONI's customers, with our permission).

- **Special Projects RAB**. Additions to this RAB relate to expenditure by SONI on special projects approved by us from time to time. The special projects RAB has been used so far for I-SEM and DS3 implementation costs as well as some control room tool costs. This expenditure is depreciated over five years.

- **Non-building assets RAB**. Additions to this RAB relate to all other capital expenditure. Additions to this RAB are depreciated over 5 years (straight line). This RAB includes, for example, capital expenditure on IT that does not fall under any of the other RABs above.

8.5 We decided to retain each of these four RAB types for the 2020-25 period.[13]

[13] In addition the 2015-20 price control determination allowed for depreciation on a special capex overspend RAB, which provided our allowance for SONI's over-spend in the 2010-2015 period. This RAB was limited to this purpose and fully depreciated by the end of 2019/20. We do not propose to use this RAB in the future.

8.6 For the purposes of the 2020-25 SONI price control we need to determine, or make forecasts of, values for the historical RAB for each year in the period up to and including the financial year 2019/20. In addition, for some of the modelling analysis used as part of our final determinations, we needed forecasts relating to the RAB over the 2020-25 price control period.

8.7 In Annex 8 to our draft determinations we set out our proposed approach to SONI's RAB, and the reasoning for this. This included, in particular:

- How we proposed to update the non-buildings and buildings RAB, for the implementation of the 50:50 cost-sharing incentives applied to capital expenditure incurred in the 2015-20 period.
- Our approach to updating the TNPP RAB and special projects RAB for the expenditure incurred in the 2015-20 period.
- Proposed RAB policies for the 2020-25 period (e.g. asset lives for regulatory depreciation purposes).
- How we made forecasts of RAB values, for the financial years 2020/21 to 2024/25, we made forecasts of RAB values, taking account of our proposed capital expenditure allowances.

8.8 We also published, as part of our draft determinations, a draft financial model which included draft figures for the various elements of the SONI RAB.

The transition from RPI to CPIH indexation of the RAB

8.9 In our draft determinations, we said that we had decided to move from indexing SONI's RAB using the RPI inflation measure to indexing using the CPIH inflation measure, for the price control period from 1 October 2020 to 30 September 2025.

8.10 In Annex 8 of our draft determinations, we considered the approach to the transition from RPI indexation to CPIH indexation and the calculation of the new CPIH-indexed opening values of the TSO's RAB in 2020/21.

8.11 In its business plan submissions, SONI proposed a specific methodology, and set of calculations, to be used to make the transition from RPI indexation of the RAB to CPI indexation. We reviewed these in detail.

8.12 We did not consider that SONI had justified the need for the relatively complicated approach it had proposed. Furthermore, if combined with a CPIH-stripped WACC we consider that it would lead to excessive returns to SONI at the expense of customers.

8.13 We identified a simpler approach that we considered to be reasonable for the purposes to the transition to CPIH.

Stakeholder views

8.14 SONI disagreed with our approach to the transition from RPI indexation to CPIH indexation, and repeated its preference for the approach that it had set out in its business plan submission, but did not provide any further justification of its approach.

8.15 SONI asked that we update our assumptions on actual depreciation and capital expenditure in the 2015-20 period in light of new information provided after our draft determinations.

FD position

8.16 For our final determinations, we have used the approach to the SONI RAB that we proposed in our draft determinations. We updated this as follows:

- Updates to the assumptions we made about the amount of RAB depreciation recovered by SONI through tariffs and capital expenditure in the 2015-20 period, based on updated information provided to us by SONI.
- Updates to RAB values for the 2015-20 period, to reflect updated figures from SONI on its actual capital expenditure in 2019/20.
- Updates to the RAB values for the 2020-25 period to reflect our final determination allowances for capital expenditure, and updates to our forecasts of the amount of additional capital expenditure to be approved during the price control period via uncertainty mechanisms.

8.17 We are also publishing the financial model we used for our final determinations, which contains our RAB values, assumptions and forecasts

8.18 We have decided to adopt the approach to CPIH transition set out in our draft determinations. SONI did not provide any information to support its view that our draft determination approach is not appropriate.

9. Allowed Revenues and Bills

Revenues

9.1 In this section we draw on our final determinations, and our financial modelling, to present an estimate of the maximum regulated revenue for SONI under the SONI price control, before turning to consider potential impacts on bills.

9.2 SONI faces a revenue restriction on the aggregate of revenue it raises from charges for System Support Services (i.e. revenue from SSS tariffs) and from charges for the use of the All-Island Transmission Networks (i.e. revenue from TUoS and GTUoS charges). These sources comprise the majority of SONI's revenues; some other sources of income (e.g. new connections income) are not covered by this regulatory revenue control.

9.3 It is important to emphasise at the outset that the SSS/TUoS revenue control that SONI is subject to is not a fixed amount, determined in advance, but is dependent on what happens during the price control period. In particular:

- Even where we set ex ante allowances (i.e. for opex and capex falling under the conditional cost-sharing approach), the revenue control will be adjusted in light of any differences between the ex-ante allowance and SONI's outturn expenditure (so that some proportion of the variation in costs is shared with customers).

- For transmission network planning scoping and feasibility costs, our approach is to allow SONI to recover the costs it actually incurs, up to approved caps, rather than to determine ex ante allowances for these costs.

- Under our approach to uncertainty mechanisms, certain other costs are recoverable through the SSS/TUoS revenue control up to approved caps.

- The depreciation and allowed return provided on SONI's RAB is not a fixed amount because: (i) the value of the RAB each year will depend on SONI's outturn capital expenditure; and (ii) we propose that the pre-tax WACC applied to the RAB adjusts according to prevailing corporation tax rate.

- A large amount of the maximum regulated SSS/TUoS comprises the pass-through of "external cost" incurred by SONI in its TSO role, and the revenue control adjusts to allow for the actual level of these costs that arises. The external costs include the charges paid by generators and suppliers for use of the transmission network (which SONI collects and passes on to NIE Networks) and the costs incurred by SONI in making payments to other parties (e.g. generators) for their provision of certain network services (system support services or ancillary services).

9.4 It is also worth highlighting that, for the majority of transmission network planning costs, SONI does not recover these costs through the SSS/TUoS revenue control. Instead, they are added to its TNPP RAB and the SSS/TUoS revenue control simply funds a temporary return on capital for these costs. This applies until network planning projects are transferred to NIE Networks, at which point SONI recovers the upfront costs through fees paid by NIE Networks and they are removed from the RAB. Only in the event of project costs being abandoned and not transferred to NIE Networks would the upfront costs be recoverable under the SSS/TUoS revenue control.

9.5 In the table below we present a forecast of the maximum regulated revenue under the SONI price control, given other parts of our final determinations (as indicated above, we are not determining the maximum regulated revenue for SONI).

Table 8: UR regulated revenue forecast under final determinations (April 2019 CPIH price base)

Revenue item (central forecasts)	2020-21 £000s	2021-22 £000s	2022-23 £000s	2023-24 £000s	2024-25 £000s	Totals £000s
Revenue allowance for TSO internal costs						
Opex subject to cost-sharing						
Payroll	9,183	9,153	9,198	9,074	9,033	45,641
IT & Communications	3,753	3,765	3,950	4,083	2,899	18,450
Other Opex	1,862	1,763	1,730	2,137	1,843	9,335
Real Price Effects	22	33	45	58	63	222
Forecast additional opex approved during price control period	476	782	672	693	665	3,288
Adjustment for overheads funded by connections income	0	0	-100	-100	-100	-300
Allowance for pension deficit repair	861	861	861	258	258	3,100
Network planning costs remunerated up to cap & expensed						
Project scoping and feasibility costs	588	587	587	583	581	2,926
Uncertain costs remunerated up to cap & expensed						
ENTSO-E ITC costs	100	100	100	100	100	500
Section 75 Pension Costs: expensed in year	143	143	143	143	0	572
Forecast of other potential uncertain costs allowed	120	120	120	120	120	600
RAB depreciation allowances						
Non-building RAB depreciation	1,382	2,116	2,678	2,974	3,144	12,294
Buildings RAB depreciation	132	134	135	135	136	671
TNPP RAB depreciation	N/A	N/A	N/A	N/A	N/A	N/A
TNPP abandoned project costs written off	0	0	0	0	0	0
Special projects RAB depreciation	5,212	5,242	5,272	5,302	150	21,178

Revenue item (central forecasts)	**2020-21 £000s**	**2021-22 £000s**	**2022-23 £000s**	**2023-24 £000s**	**2024-25 £000s**	**Totals £000s**
Allowed return (excluding revenue collection margin)						
Pre-tax WACC applied to non-building RAB	158	285	341	330	3020	1,414
Pre-tax WACC applied to building RAB	87	84	79	74	69	393
Pre-tax WACC applied to TNPP RAB	572	716	809	723	468	3,288
Pre-tax WACC applied to special projects RAB	733	528	323	116	12	1,712
Allowance for asymmetric risk	136	136	136	136	136	679
Remuneration of parent company guarantee	170	167	163	160	157	817
Sub-total: Revenue allowance for TSO internal costs	**25,353**	**26,379**	**26,905**	**26,767**	**19,702**	**125,106**
Revenue allowance for TSO external costs						
Costs subject to remuneration of costs incurred (no cap)						
System support services (SSS) costs	38,715	48,472	49,723	50,013	50,296	237,221
Amounts payable to NIE for TUoS (incl. GTUoS)	39,550	40,050	40,250	40,300	40,300	200,450
Moyle Collection Agreement costs	30	30	30	30	30	152
Margin applied to qualifying revenue collection activities						
Margin on SSS costs & imperfection charge revenues	642	693	700	702	703	3,440
Sub-total: Revenue allowance for TSO external costs	**78,937**	**89,246**	**90,703**	**91,046**	**91,330**	**441,262**
Total forecast regulated SSS/TUoS revenues	**104,290**	**115,625**	**117,609**	**117,813**	**111,032**	**566,368**

9.6 The figures in the table above assume that SONI achieves a neutral or baseline position on price control incentive arrangements (e.g. no penalty or reward under the evaluative performance framework and expenditure in line with our ex ante allowances for costs falling under the conditional cost-sharing arrangements). They also leave aside any revenue adjustments to SONI for past under- or over-recovery of regulated revenues in previous price control periods.

Interactions with connection charges

9.7 SONI's income from the provision of new connections is outside the SSS/TUoS revenue control, but there are interactions between connections charges and the SSS/TUoS revenue control. In our draft determinations, we identified concerns about potential double counting within the price control arrangements: our ex ante allowances are intended to cover the whole of SONI's overheads (e.g. HR and support functions, depreciation and return on capital for central IT investment). However, we said that we would also expect SONI's connection charges to make some contribution to overheads used in the performance of connection activities. There is a risk that SONI is remunerated twice for overheads associated with connections one through the SSS/TUoS regulated revenue stream and once through the connection charge income.

9.8 In the table above we have included a negative adjustment for overheads funded by connections income, reflecting a high-level forecast of how an element of its connection charges in the 2020-25 period may contribute to overheads.

9.9 Our final determination on this connection issues is explained in Annex 3. In brief, the figures used in the table above are forecasts and the price control will be calculated in a way that makes adjustments for the contributions that SONI's connection charges make to its overheads. These might be zero, if SONI retains what it told us was its current approach of setting connection charges that do not contribute towards its overheads. But our approach provides flexibility for the price control to adapt if SONI's connection charges do make a proportionate contribution to overheads in the 2020-25 period.

9.10 The information provided by SONI in relation to our draft determinations on this matter also raised questions. These concerned the scale of SONI's connection charge income over the 2015-20 period relative to its reported costs (as well as its forecast income and costs for the 2020-25 period) which fall outside the scope of the determination of the SSS/TUoS revenue control. SONI told us that it issues refunds to customers where the income received up front from connections charges is materially more than the actual cost of the connection job. The figures we reviewed suggested that SONI has a backlog of refunds to process. We look forward to SONI processing these refunds to the benefit of its connection customers.

Impact on customer bills

9.11 Within Appendix R of the business plan, SONI estimates that its controllable costs in 2019-20 translates to £10.50 in an average domestic electricity bill of roughly £535 per year. It further estimates that business plan proposals will increase average SSS revenue by £6m above the 2019-20 level. This results in the following impact on bills for domestic and industrial / commercial customers:

Table 9: Impact on bills of SONI business plan proposals

Customer Group	Average Consumption (kWh)[14]	Unit Cost (p/kWh)	Annual Equivalent (£/year)	BP Increase £/year	BP Increase %
Domestics	3,430	15.6	£535	**£2.76**	**0.52%**

[14] Consumption figures are derived from the 2018 Annual Transparency Report (ATR) but adjusted by SONI's assumption of NI consumption remaining flat at 7,500 GWh.

Very Small [I&C < 20 MWh]	6,809	15.9	£1,083	**£5.47**	**0.51%**
Small [I&C 20 – 499 MWh]	72,040	13.8	£9,942	**£57.89**	**0.58%**
Small / Medium [I&C 500 – 1,999 MWh]	906,838	13.1	£118,796	**£729**	**0.61%**
Medium [I&C 2,000 – 19,999 MWh]	4,995,215	11.2	£559,464	**£4,014**	**0.72%**
Large / Very Large [I&C = 20,000 MWh]	36,743,263	9.8	£3,600,840	**£29,527**	**0.82%**

9.12 SONI argues that any bill increases will be outweighed by the benefits delivered to customers from its proposed service initiatives and from its existing day to day to role. It did not seek to quantify these but listed them instead as set out below:

- Savings in constraint costs once the second interconnector is energised;
- Savings in capacity market costs due to a change in algorithm;
- Avoided costs related to cyber security incidents or other threats;
- Improved decision making that results from better control centre training;
- Shorter times to obtain consents for grid infrastructure.

9.13 Whilst it is the case that SONI internal costs are a relatively small part of the electricity bill, the business plan proposals do represent a material increase. SONI estimates the £6m average uplift to be a 24% increase above 2019-20 revenues for SONI. If compared to the average existing price control allowances, the business plan increase is much greater.

9.14 Such increases could be justified if we had confidence that the benefits of new initiatives outweigh the costs. Such certainty does not yet exist as many of the initiatives are not fully scoped or the service level impact is ill-defined.

9.15 SONI has also based its customer impact calculations on changes against 2019-20 revenues. Whilst not unreasonable, we think it better to contrast decisions against the last price control average as opposed to a single year. We have also shown the impact on bills before and after removing special projects (Zt items) as they are ad hoc and have a material impact. The results are as follows:

Table 10: Impact on bills of final determination

Customer Group	Average Consumption	Unit Cost (p/kWh)	Annual Equivalent (£/year)	FD Ave Increase £/year	FD Ave Increase (excl. Zt) £/year

	(kWh)[15]				
Total Domestics	3,430	15.6	£535	**£2.43**	**£0.91**
Very Small [I&C < 20 MWh]	6,809	15.9	£1,083	**£4.83**	**£1.81**
Small [I&C 20 – 499 MWh]	72,040	13.8	£9,942	**£51.09**	**£19.13**
Small / Medium [I&C 500 – 1,999 MWh]	906,838	13.1	£118,796	**£643**	**£241**
Medium [I&C 2,000 – 19,999 MWh]	4,995,215	11.2	£559,464	**£3,543**	**£1,326**
Large / Very Large [I&C = 20,000 MWh]	36,743,263	9.8	£3,600,840	**£26,060**	**£9,757**

9.16 The figures excluding special project allowances are the most relevant. This is due to the fact that while special project costs were provided for in this control period, most of the revenue is recovered in the next period and represents a material sum. Such should therefore be excluded to give a more appropriate comparison between the price control periods.

9.17 The table indicates that the revenue decisions will increase ***domestic bills*** by approximately £0.91 against the current price control allowances when the special project allowances are removed.

9.18 The table also sets out the impact of decisions on non-domestic customers of varying size and consumption. As with domestic bills, the decisions will result in relatively small increases in non-domestic bills.

[15] Consumption figures are derived from the 2018 Annual Transparency Report (ATR) but adjusted by SONI's assumption of NI consumption remaining flat at 7,500 GWh.