



# Technical annex: Service and outcomes

Final Determination  
Annex 2



## 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

This annex presents our final determinations in relation to the introduction of an evaluative performance framework for SONI, and additional arrangements, beyond the evaluative performance framework, to ensure that SONI will be accountable for its delivery and performance in relation to specific projects or initiatives explicitly funded through price control allowances.

## Audience

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

## Consumer impact

SONI's TSO costs of running its business which we price control 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 as 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.



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# 1. Recap on draft determination proposals

1.1 This section presents a recap on our draft determinations in the following areas:

- The introduction of an evaluative performance framework.
- Additional arrangements, beyond the evaluative performance framework, 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.

1.2 We set out our final determinations on the evaluative performance framework in section 2 and our determinations on the additional accountability arrangements in section 3.

## Evaluative performance framework

1.3 In our draft determinations, we proposed the introduction of a new annual evaluative performance framework which was 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.

1.4 In our draft determinations (Annex 4) we set out detailed proposed for the design of the evaluative performance framework. In very brief terms, we proposed that:

- SONI's performance would be assessed annually by an independent evaluation panel, who would determine scores in a number of individual areas of performance.
- The scores would constitute a recommendation to the UR and, subject to any amendments of those scores made and adopted by the UR, would be used to calculate a potential financial reward or penalty for SONI.
- 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; some 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 to scoring performance.

1.5 In proposing this type of evaluative performance framework, we proposed not to adopt SONI's proposed benefits sharing mechanism from its business plan, which



would be an alternative approach. We took account of a detailed review of SONI's proposals and a range of considerations. For instance, we considered that:

- SONI's benefit sharing framework was not well aligned with the proposals from our March 2019 regulatory approach for the 2020-25 price control framework. The approach we set out in March 2019 would involve financial incentives arising from a more ongoing evaluative assessment of performance, whereas SONI's proposed approach was more mechanistic and metric-focused than we had envisaged.
- The material provided by SONI did not provide confidence that, if substantial further work was done to put it into practice, the benefit sharing framework would work well in terms of holding SONI to account and encouraging ongoing improvements across desired outcomes.
- SONI's proposals did not show awareness of why Ofgem had moved away from mechanistic financial incentives for National Grid's electricity system operation role, towards an evaluative approach.
- While a report by SONI's advisors (KPMG), included as part of SONI's business plan, emphasised the potential drawback of a more subjective/evaluative incentive approach compared to a more mechanistic incentive approach (e.g. in terms of less certainty for the regulated company), it showed no awareness of the potential benefits from such an approach in comparison to a mechanistic approach.

1.6 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 we proposed in our draft determinations.

## **Accountability for price control deliverables**

1.7 In the addition to the evaluative performance framework, we proposed additional arrangements in our draft determinations 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.

1.8 These additional arrangements were proposed because we did not consider that the evaluative performance framework would be sufficient, on its own, to ensure delivery or protect customers in the event of non-delivery or under-delivery. For instance, in a simple example, if SONI had received £1m of price control funding to carry out a project to benefit customers, and did not do this project at all, the financial incentives from the evaluative performance framework would not, on their own, be sufficient to prevent SONI from profiting significantly from this situation.

1.9 We proposed a set of default arrangements that would apply where a hypothecated expenditure allowance to fund a specific project or initiative is included as part of the ex ante allowances subject to conditional cost-sharing incentives (while allowing discretion not to apply these default arrangements if we decided it was not



necessary in specific cases). These arrangements involved:

- An approach to the specification of price control deliverables associated with the upfront funding (including a target delivery date and potentially a series of milestones for projects split into phases) which SONI would be held accountable for.
- Provisions to make financial adjustments to price control allowances if there is no delivery, or partial delivery, of the price control deliverables.
- A provision to potentially deduct the value of any financing costs benefit (e.g. allowed return) that SONI has received from delays to the delivery of a project.
- There would be no automatic financial adjustment for over-delivery (i.e. delivering benefits beyond the price control deliverables).

1.10 We included an initial set of price control deliverables, or outputs, in a spreadsheet published as part of our draft determinations.<sup>1</sup>

1.11 In addition, we said that performance against the price control deliverables would be taken into account as part of the evaluative performance framework:

- Delivering in line with the specified price control deliverables would constitute baseline performance for the purposes of the evaluative performance framework, qualifying for neither reward nor penalty.
- SONI might receive a financial penalty under the framework (or a lower reward) if the performance evaluation finds a likelihood of significant harm to desired outcomes from non-delivery, under-delivery or late delivery against deliverables that have been funded through the price control.
- SONI might receive a financial reward under the framework (or a lower penalty) if the performance evaluation finds that non-delivery or under-delivery was likely to improve outcomes (i.e. a variation from the delivery plan).
- SONI might receive a financial reward for over-delivery, if the performance evaluation finds significant net benefit from SONI having gone beyond the price control deliverables.

## 2. Evaluative performance framework

2.1 This section summarises stakeholder feedback on the evaluative performance framework and sets out our final determination in light of that feedback and further consideration. It starts with stakeholder feedback on the principle of introducing such a framework and then covers a number of key policy areas concerning the

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<sup>1</sup> [[UR Output Monitoring](#)]



design and implementation of the framework.

2.2 We take the following topics in turn:

- Introduction of an evaluative performance framework.
- TSO outcomes.
- Asymmetric financial rewards and penalties.
- Role for an independent assessment panel.
- The number of scored areas.
- The set of roles for separate evaluation.
- Greater clarity on the baselines for the assessment.
- Greater role for SONI's annual forward plan.
- Refined approach to service expectations and priority areas.
- Guidance on the assessment criteria.
- Weights for the calculation of financial incentives.
- Determination of the incentive amount.
- All-island issues and interactions.
- Start date for the evaluative performance framework.
- Licence implementation and appeals of evaluation outcome.
- Guidance document for the evaluative performance framework.
- Proportionality.

2.3 Not all aspects of the design and implementation of the framework are covered in this section. Alongside our draft determinations, we are publishing draft guidance, which provides more detail on how the framework would operate in practice.

## **Introduction of an evaluative performance framework**

### **Stakeholder views and further engagement**

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

2.5 Some stakeholders directly supported the introduction of an evaluative performance framework. The Consumer Council agreed that an evaluative rather than





mechanistic approach to performance incentivisation was appropriate for the SONI price control, and said that the framework proposed in the draft determinations appeared to be generally well designed (while also making suggestions for changes in a few areas). There was also explicit support from Manufacturing NI and Mutual Energy.

- 2.6 SONI said in its draft determinations response that it supported the introduction of an evaluative performance framework. But it considered that there needed to be significant changes to the framework proposed in draft determinations and further guidance. SONI said that under the framework proposed in our draft determinations there would be no clarity as to what good looks like, the independent assessment panel would have no baseline or benchmark against which to judge success, and that this means the framework will fail to maximise outcomes for consumers.
- 2.7 Our interpretation from SONI's draft determination response, and the engagement we had with SONI subsequent to the draft determinations, was that it was not directly objecting to our draft determination position to introduce an evaluative performance framework in favour of the benefits sharing mechanism it had proposed in its business plan, but it wanted aspects of the evaluative framework we had proposed to be adapted in ways that would bring this some way closer to the benefits sharing mechanism (e.g. in terms of the weight placed on performance against performance metrics specified upfront).
- 2.8 We engaged further with SONI in the period since publication of our draft determinations to understand SONI's concerns with the details of what we proposed in our draft determinations and to explore how these might be addressed.
- 2.9 NIE Networks raised some general concerns with a more evaluative incentive approach. NIE said that: "*Whilst recognising the particular nature of SONI's service offerings and the uncertainties of the energy transition, NIE Networks in general considers it best for customers as well as best regulatory practice, that incentives are based where at all possible on quantifiable metrics and ex-ante targets in order to provide a clear understanding for all stakeholders of both service expectations and the assessment criteria and approach that will apply*".
- 2.10 Some stakeholders with renewable generation interests (NIREG, SSE, DP Energy and IWEA) considered that there should be a greater role for financial incentives based on quantified targets, at least in in specific areas which relate to renewable generation and penetration (e.g. renewable dispatch down, SNSP and RES-E).
- 2.11 We also received feedback from stakeholders on how the framework would work, including constructive suggestions and identification of areas that warranted further consideration.

### **FD position**

- 2.12 We have decided to introduce a modified version of the evaluative performance framework that we had proposed in our draft determinations. We set out in the sub-sections that follow the modifications we decided to make, in light of stakeholder feedback and further work to develop and improve the approach.



- 2.13 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 determinations.
- 2.14 SONI's response emphasised concerns about regulatory uncertainty and subjectivity under an evaluative framework and the lack of predictability. Following our draft determinations, we identified ways to reduce the extent of regulatory uncertainty and subjectivity and to improve predictability. We recognised that, even with these changes, there would be some residual uncertainty and subjectivity in the determination of financial incentives, relative to a mechanistic incentive approach. But we considered that that this was worthwhile overall, given the benefits we saw from an evaluative framework that could take account of a range of different information on performance (not just metrics), look across the full set of SONI's roles and services, and allow for judgement.
- 2.15 It was unclear to us that NIE Networks was objecting to the use of an evaluative framework for the SONI price control, or making more general observations that would be relevant in other situations. In terms of the SONI price control, we felt that NIE's response lacked attention to the difficulties of applying quantifiable metrics and ex-ante targets for SONI. On the more general point, we consider that a case-by-case approach is appropriate, as the benefits and drawbacks of evaluative and mechanistic incentive approaches are likely to vary according to the circumstances.
- 2.16 We did not consider that the 2020-25 period was appropriate for a mechanistic use of financial incentives based on performance targets in specific areas of performance that had not previously been covered by incentives under SONI's price control. We recognised that such an approach might allow for stronger financial incentives in specific areas, but we did not consider that this type of approach would best serve overall outcomes across SONI's activities. For instance, we were concerned about: strong incentives in some areas compromising performance elsewhere; the difficulty of setting baselines; and the extent to which other parties besides SONI, and external factors, can influence relevant performance metrics, making it difficult to distinguish SONI's performance without taking account of wider considerations.
- 2.17 Nonetheless, as set out below and in our draft guidance, we saw a clear role for performance metrics and performance commitments (or targets) as part of the evidence base used within the evaluative performance framework.
- 2.18 Finally, it is worth emphasising that we have sought to develop and establish an evaluative performance framework that is fit for purpose in the 2020-25 price control period. We expect that such a framework will remain useful in future price control periods, but that its scope and characteristics may be adapted over time. There may be greater scope for linking incentives more closely to performance metrics in future price control periods, in light of the information generated from the evaluative performance framework on the relevance and suitability of particularly metrics. Furthermore, there may be opportunities to incorporate more aspects of SONI's cost performance into the framework in the future. This could enable a more holistic evaluation compared to our approach for 2020-25 which involves separate



regulatory incentives and processes for SONI's internal costs (e.g. the conditional cost-sharing approach).

## TSO outcomes

### Recap on DD position

- 2.19 In our draft determination, we said that, as part of the introduction of the evaluative performance framework, we considered it useful to establish a set of outcomes from the regulation of SONI (and from SONI itself) that we want to influence through the performance framework.
- 2.20 We proposed to define four high-level outcomes that we are seeking to influence through the regulation of SONI:
- **Decarbonisation.** 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.
- 2.21 These outcomes drew on, but adapted, four benefit areas proposed by SONI in its proposed benefits sharing mechanism as part of its business plan.

### Stakeholder views

- 2.22 There was support from SONI and other stakeholders for the four TSO outcomes proposed in our draft determinations.

### FD position

- 2.23 We have chosen to adopt these for the purposes of our final determinations and, in particular, to incorporate these into the design of the evaluative performance framework.

## Asymmetric financial rewards and penalties

### Recap on DD position

- 2.24 Our draft determinations proposals proposed a symmetric incentive structure in which the maximum potential financial upside (reward) to SONI under the framework would be capped at £1m and the maximum financial downside (penalty)



would be capped £1m. We also set out an approach to calculation of the incentive amount under the evaluative performance framework which involved the same strength of financial incentives for performance above the baseline grade as for performance below the baseline grade.

### **Stakeholder views**

- 2.25 SONI's objected to a symmetric incentive, saying that this was not appropriate and that it should be given more financial upside than downside in order to encourage the right behaviours.
- 2.26 In addition, some other stakeholders were in favour of SONI having greater incentive upside, for example as a means to overcome risk aversion bias. However, the Consumer Council said that do not see a good reason why it would be in consumers' interests for the incentives to be capped at a larger value in the upward direction than in the downward direction.

### **FD position**

- 2.27 Especially for the launch of a new scheme, the calibration of incentives is a matter of judgement and something that might need to be revised at future price control period in light of experience of how the framework has worked in practice. We have reconsidered this issue, in the light of the stakeholder feedback.
- 2.28 We have decided that the framework for the 2020-25 should provide a greater financial upside to SONI than financial downside. Our view reflects the following considerations:
- The general balance of stakeholder feedback on our draft determinations was in favour of a framework that provided greater financial upside than financial downside.
  - Attention was drawn by some stakeholders (Business Alliance and Mutual Energy) to the possibility of loss aversion bias, which might merit in a greater upside as a means to deliver real organisational change within SONI that drives performance improvements.
  - A higher financial upside can provide an incentive for SONI to incur (and plan to incur) additional costs to carry out new initiatives or activities that help improve performance beyond historical levels and which can benefit consumers over the longer term.
  - Ofgem's final determinations for its evaluative performance framework for the GB electricity system operator in the RIIO-2 price control period included a higher financial upside than downside.
- 2.29 At the same time, it is important to draw attention to differences between the overall price control framework we are setting for the 2020-25 period and the framework envisaged under SONI's business plan. Under SONI's proposed framework, the main route through which SONI could earn additional price control funding for



improved performance and new initiatives during the price control period was via its proposed performance incentive framework (which had a maximum reward of £3m and a maximum penalty of £1.5m per year). In contrast, under our framework, the SONI can earn additional price control funding for improved performance and new initiatives during the price control through three separate channels:

- The opportunity for financial rewards from the evaluative performance framework.
- The opportunity for SONI to gain approval from the UR for additional price control funding for new initiatives during the price control period via uncertainty mechanisms.
- The potential, under the conditional cost-sharing incentive approach, for an over-spend against ex ante allowances to be fully funded by customers if SONI can provide good evidence to show that an over-spend was due to the efficient costs of justified improvement in performance.

- 2.30 Given these differences, we consider that it is not a like-for-like comparison to compare the maximum upside from SONI's proposed performance incentive framework with the maximum upside under our evaluative performance framework.
- 2.31 Given the considerations set out above, we saw grounds for some re-balancing of the upside and downside financial incentives in favour of the upside, but we did not consider that the evaluative framework should offer as high an financial upside as SONI had proposed in the context of a rather different price control package.
- 2.32 We decided that the evaluative performance framework should have an asymmetric incentive structure, with higher rewards than penalties, and that the applicable cap for financial incentives should allow for a maximum financial reward of **£1.25m** and a maximum financial penalty of **£0.75m**.
- 2.33 This allows for a modest increase in the upside incentive, and a corresponding reduction to the downside incentive, compared to our draft determinations.
- 2.34 We provide more information on the details of the incentive calibration in the separate sub-section below on "Determination of the incentive amount".
- 2.35 Our position on the incentive calibration for the evaluative framework in the 2020-25 period reflects its specific circumstances, and should not be taken out of context to draw implications about how the framework might work in future price control periods, or to draw implications on incentive calibration in economic regulation more generally.

## **Role for an independent assessment panel**

### **Recap on DD**

- 2.36 Our draft determination had proposed that the evaluative performance framework would involve SONI's performance being assessed by an evaluation panel



comprising individuals with a range of relevant knowledge and perspectives. The panel would not have any decision-making powers. Instead, its evaluation would form a recommendation that goes to the UR Board, who would make the decision on any financial reward or penalty. We said we did not see the panel as a substitute for wider stakeholder input to the performance evaluation process.

### **Stakeholder views**

- 2.37 One stakeholder (Mutual Energy) said that it was not convinced that the use of a separate evaluation panel was appropriate, and gave its view that:
- Individuals will always have vested interests or biases which will skew any assessment and, while this may also be the case if UR performs or leads the evaluation, UR are best qualified to fulfil that role as part of their statutory obligations with respect to regulating SONI.
  - From experience, this may be a demanding role for people to fulfil on a voluntary basis, particularly when one considers the volume of documentation related to the price control process.
- 2.38 SONI said that because the final decision on the financial reward rests with the UR, rather than being determined by the panel, this adds another level of discretion to the process (which linked to SONI's wider concerns about regulatory uncertainty under the framework). SONI referred to an example where Ofgem took a different view on performance of the GB electricity system operator to its panel, which led to a smaller financial reward.

### **FD position**

- 2.39 We see the rationale for Mutual Energy's points, but have considered that these were outweighed by the benefits of an independent evaluation panel (e.g. bringing a wider range of perspectives into play and laying foundation for broader stakeholder buy-in to the outcome of the assessment than if it was simply a decision of the regulator). Furthermore, we considered that our approach would help mitigate these concerns significantly:
- The final decision on any financial penalty or reward would be a matter for the UR, in light of its statutory functions, following recommendation from the panel.
  - The UR will provide a secretariat role, to support the panel.
  - We have sought to specify the evaluation process in a way that is not impractical for an independent panel. The panel's role does not encompass all aspects of SONI's performance.
- 2.40 We have decided on the use of a separate evaluation panel. This may be a matter to reconsider at future price control reviews, in light of experience with the framework.





- 2.41 In terms of SONI's point above, we accept that this aspect of our proposed approach adds another level of discretion to the process, but we consider that it is appropriate to retain this element of discretion in the light of our statutory duties. This is especially so in the case of a new performance framework and process that has not been applied or tested in Northern Ireland.

## **The number of scored areas**

### **Recap on DD**

- 2.42 Our draft determination proposed that the panel would determine a score in 16 separate areas (made up of scores for each of four roles across the four TSO outcomes). The draft determinations proposed explicit weights which would then be used to combine the scores in each of the 16 areas into a single overall score or incentive amount for each financial year.
- 2.43 At one level, a larger number of scored assessment areas helps make the outcome of the assessment more predictable and less subjective, as the discretion of the panel on how to weigh different aspects of performance is more constrained in transparent upfront guidance. For instance, insight from the evolution over time in public sector procurement exercises shows that purchasing authorities may often set out quite granular scoring and weighting approaches, as a means to provide guidance to bidders and manage the risk of legal challenge from unsuccessful bidders.
- 2.44 However, a larger number of scored assessment areas also brings some downsides. In particular:
- a) It may increase the actual and/or perceived complexity of the framework.
  - b) It requires a larger number of formal decisions from the panel which might be more burdensome on the panel. This is exacerbated because, even within each scored assessment area, there would be a range of further criteria or factors for the panel to consider.
  - c) The weights that are specified upfront as a means to combine the scores across different areas might be argued to be somewhat arbitrary and inflexible, and this becomes more of an issue the more assessment areas there are.
  - d) It also limits the judgement of the panel to give greatest weight in the scoring to what the panel considers important in terms of overall performance.

### **Stakeholder views**

- 2.45 The feedback from SONI, and some other stakeholders, was that we should try to reduce the number of scored assessment areas.
- 2.46 The Consumer Council said that the 16 different combinations of role and output is a large number of different areas to evaluate and it may be difficult to independently



evaluate each of the combinations without reference to the other aspects of the outcomes. The Consumer Council recommended that this approach could be reviewed after a year of trial working, with the potential for one or more SONI outcomes to be collapsed down, rather than have all four outcomes independently assessed – which would make the process more focussed. The Consumer Council suggested a modified assessment matrix in which some aspects of performance were combined into a single assessment.

- 2.47 SONI argued that the focus should be on scores against the four TSO outcomes, which would be the approach most similar to that from the benefits sharing mechanism that it had proposed in its business plan.

### **FD position**

- 2.48 On further reflection we have decided that it would be better to have a smaller number of assessment areas that are formally scored or graded. To limit uncertainty we thought that it would be better to do this from the start rather than after a trial year.
- 2.49 Given that our draft determinations approach envisaged 16 assessment areas derived from assessments for each of four TSO roles against each of four TSO outcomes, we considered two main options for modification:
- Assessment across the four TSO roles.
  - Assessment across the four TSO outcomes.
- 2.50 We also considered the specific suggestion from the Consumer Council for a slightly reduced version of the matrix from our draft determination but we did not consider that this would be a sufficient improvement in simplicity of the scoring structure for the purposes of our draft determinations (though we recognised that this approach had some logic as a way to make incremental improvements on the draft determinations approach).
- 2.51 In terms of SONI's view that the focus should be on scores against the four TSO outcomes, we felt that there was a stronger case to focus the set of scored assessment areas on the TSO roles. We considered that this approach would better encourage the right types of behaviour from SONI and be more practical than SONI's preferred approach. One important consideration is that while the TSO can have a significant influence on the TSO outcomes, they may also be heavily affected by the actions of other parties (e.g. government, network companies, generators and suppliers) and by external factors. Furthermore, the TSO's action may be directing at improving outcomes but the impact on outcomes may not materialise for a number of years or could be spread across a long time-frame. In this context, we considered that the panel's assessment of performance would be more effective and meaningful if it was focused on the TSO's roles (e.g. what the TSO has been doing to improve outcomes) rather than on outcomes directly (e.g. whether outcomes have improved and the extent to which the TSO was responsible).





- 2.52 On this matter we have decided that:
- The panel should determine a separate grade (score) for each TSO role, without breaking down scores between individual outcomes.
  - The panel's assessment process should take account of SONI's actions and behaviours in respect of the four outcomes as part of the assessment under each role.
- 2.53 As a consequence of the focus on the framework on the four TSO roles, and in the wider interests of limiting complexity, we decided that it was not necessary for the guidance for the evaluative framework to include the "Mapping of service areas to outcomes" that we had proposed in our draft determinations.

## **The set of roles for separate evaluation**

### **Recap on DD**

- 2.54 Our draft determinations proposed that a separate assessment would be made for four TSO roles:
- System operation and adequacy.
  - Independent expert.
  - Transmission network development and system planning.
  - Commercial interface.
- 2.55 Within each role the draft determinations specified a number of services (or service areas or activities) that fell under that role. The roles and services were largely based on categorisations that SONI provided as part of its business plan, subject to a number of modifications that we proposed.

### **Stakeholder views**

- 2.56 We did not receive detailed feedback from stakeholders on the substance of the categorisation of roles and services. On terminology, NIE networks said that because it was responsible for transmission network development, the use of the word "development" was not appropriate under the second role.
- 2.57 Furthermore, one substantive issue that did come up from an SECC member was a potential concern that structuring the assessment across a set of TSO roles might not work well in the cases of potential SONI initiatives or activities that are overlapping across roles. Potential examples include stakeholder engagement initiatives and the TSO's digitalisation strategy.

### **FD position**

- 2.58 We refined our terminology in light of feedback from NIE Networks and for our final determinations we refer to the second role above simply as "system planning".



- 2.59 To tackle the more substantive issue above, we identified an option of including a fifth TSO role category, intended to capture more cross-cutting aspects, for the purposes of the panel's grading of SONI's performance.
- 2.60 However, we also saw some downsides from this approach:
- It would not be straightforward to define the scope of a cross-cutting category, or determine which initiatives should fit within that role.
  - While stakeholder engagement might be seen as part of a cross-cutting role, we did not want to remove consideration of stakeholder engagement from the assessment of individual roles as there might be quite different issues under each role.
  - An additional scored category could increase the workload required from the panel in terms of decision-making on grades.
- 2.61 Furthermore, Ofgem's corresponding evaluative performance framework uses three roles for the GB electricity system operator and, while Ofgem has made significant changes to its framework and guidance over time, it has not (yet) found the need to introduce an additional role to capture cross-cutting initiatives or aspects.
- 2.62 On balance, we decided that for the introduction of the evaluative performance framework in 2020-25, we should retain the use of four TSO roles as proposed in draft determinations without introducing a cross-cutting role. Our guidance document for the evaluative framework will provide guidance to SONI and the panel on how cross-cutting initiatives could be categorised across roles and taken into account.
- 2.63 It may be appropriate to revisit the option to introduce a fifth role, intended to capture more cross-cutting aspects, at the next price control review.

## **Greater clarity on the baselines for the assessment**

### **Stakeholder views**

- 2.64 One of the points that SONI emphasised in its feedback to us is that the incentive framework should be predictable, with upfront clarity on "what good looks like" and the baselines used to assess whether it should qualify for financial rewards or penalties.
- 2.65 In SONI's view, the best approach would be to give the most weight to mechanistic financial incentives against pre-specified performance metrics and baselines.

### **FD position**

- 2.66 In the case of SONI's price control framework, we disagree strongly with the idea that consumers would be best served by a framework that places most weight on mechanistic financial incentives, and we remain committed to an evaluative approach which allows a wider range of performance information and other



considerations to be taken into account. While this type of approach might not have the same strength of incentives as a mechanistic incentive scheme, it can better align incentives with what matters to customers and overall outcomes, helping to encourage good behaviours overall from SONI. Our view reflects the nature of what SONI does and how its performance and actions can contribute to better outcomes.

- 2.67 We do not consider that it is essential, for the incentive properties of the framework, for the panel's assessment of SONI's performance (and the resulting financial reward or penalty) to be perfectly predictable in advance, or that we should take all practical steps to make the framework as predictable as possible.
- 2.68 SONI does not need to be able to predict the panel's decision-making with 100% accuracy on every occasion for it to face financial incentives to engage in behaviours that benefit overall outcomes. But incentives are dependent on some degree of predictability and ability of SONI to gauge the likely response of the panel to things it might do.
- 2.69 We recognised that if the guidance and baselines used for the evaluative framework were too conceptual and subjective, this could unduly dampen the incentives of SONI and create practical difficulties for the panel when making its assessment.
- 2.70 On further consideration, we identified that there were opportunities to improve predictability to the benefit of overall outcomes, compared to the proposals set out in our draft determinations, while retaining the overall principles of the approach.
- 2.71 In our work since the draft determinations, and in light of the feedback from SONI, we explored ways to retain the broad approach of an evaluative framework but with greater guidance and predictability of how SONI's performance would be assessed in each area. We engaged with SONI through several workshops and reviewed developments from Ofgem's approach to the financial incentives for the GB electricity system operator.
- 2.72 We decided on several modifications to the approach from our draft determinations:
- A greater role for the annual forward plan.
  - A refined approach to service expectations and service priorities.
  - More guidance on the assessment criteria
- 2.73 We take each of these in turn below.
- 2.74 We consider that our chosen approach strikes a balance between: providing practical guidance and a reasonable degree of predictability on how the panel should make the evaluation; including consideration of aspects of performance that are difficult to quantify; and retaining scope for judgement by the panel on SONI's performance. This scope for judgement is particularly important in the context of a new performance framework that has not yet been applied in practice in Northern Ireland.



- 2.75 We have decided on a broad approach that should apply for the 2020-25 price control period, but that there should be some scope for refinement of the guidance in light of experience (e.g. in terms of the details of the guidance on individual assessment criteria).
- 2.76 We expect that the guidance to the panel on the assessment will evolve over time, drawing on insight and lessons from the practical application of the evaluative performance framework.

### **Greater role for the annual forward plan**

- 2.77 We have identified as part of the FD that greater predictability and clarity could be given to the annual performance assessment process if that process places weight on SONI's performance against its annual forward plan, rather than SONI's performance against more subjective concepts of good performance or broadly-drafted service expectations.
- 2.78 SONI's response to our draft determinations also saw opportunities to adapt the framework to give more emphasis to its annual forward plan as a means to reduce subjectivity. For instance, SONI proposed that the plan should have clear objectives, some of which should be linked to quantitative metrics, and that the plan should include measurable outcomes which should relate to the five-year period of the price control (not all outcomes being deliverable within a one year timeframe). SONI proposed that this could form the basis of a clear and shared understanding of how SONI's performance will be evaluated (and hence the financial reward/penalty).
- 2.79 We have decided that the forward plan should include, for each TSO role:
- a clear set of deliverables, success measures and milestones; and
  - where relevant and meaningful for a TSO role, a set of performance metrics or KPIs with performance targets or baselines.
- 2.80 This can then provide a baseline against which the panel can assess the performance of SONI in terms of its delivery against these aspects of the plan.
- 2.81 However, we also saw risks from an approach that focused solely on SONI's delivery of its forward plan. In particular:
- SONI might have incentives to propose an undemanding and unambitious forward plan.
  - The forward plan may overlook, or provide insufficient detail on, areas of performance that matter to customers and other stakeholders, in which SONI's performance may deteriorate.
  - SONI might be encouraged to stick rigidly to its plan even when adaptation or deviation from the plan could improve overall outcomes.



- 2.82 We have decided on an approach which gave a prominent role to SONI's forward plan (and its delivery of specific outputs/deliverables specified by the UR as part of approval for price control funding) but supplemented it in three ways to tackle the risks above.
- 2.83 To tackle the first risk, we have decided that SONI's forward plan should itself be subject to a separate assessment by the panel, to tackle the risk that SONI puts forward an undemanding plan or a plan that is not well aligned with customers' interests, and to directly encourage a good forward plan. There will be a financial incentive amount attached directly to the plan so that, for example, SONI could get a larger financial incentive reward for an ambitious forward plan. Our draft determinations had already proposed that the panel would consider SONI's forward plan as part of the overall scoring of performance, but we have considered that there would be significant benefits from separating out the assessment of the plan and providing more detailed guidance to the panel on how to make that assessment.
- 2.84 To tackle the second risk, we have decided that there should be a clear role for the panel to take account of stakeholder feedback on SONI's performance and service quality that goes beyond feedback on SONI's delivery against its plan. To help provide greater clarity to the panel, SONI and stakeholders on this aspect of performance assessment we decided that, subject to the qualification that follows, the baseline should be set at SONI's historical level of performance and service quality at the end of the 2015-2020 price control period, i.e. performance in 2019/20. The one important qualification to this is that, if SONI has committed to improvements versus historical performance in its forward plan(s) or received additional price control funding to improve aspects of performance (e.g. through allowances for new initiatives in our final determinations or via uncertainty mechanisms), the baseline for performance should reflect those improvements.
- 2.85 This baseline is arguably less demanding than the baseline of a "hypothetical TSO which is reasonably well-run and reasonably efficient" proposed in our draft determinations, but it has the benefit of being less hypothetical and, in turn, more practical to apply in practice. And even in our draft determinations we had said that the position SONI finds itself in on 1 October 2020 should be taken as a constraint on what level of baseline performance should be expected at a subsequent point in time.
- 2.86 Furthermore, by providing financial incentives around a panel assessment of SONI's forward plan it is possible to encourage SONI to respond to any stakeholder concerns that the 2019/20 level of performance is not satisfactory in some areas.
- 2.87 To tackle the third risk above, we have decided that the evaluation criteria for the assessment of SONI's performance should include consideration of the performance of SONI in relation to a criterion concerning adaptability during the financial year. This will concern SONI's actions in going beyond its forward plan, or in deviating from its plan, in ways that are shown to improve overall outcomes.
- 2.88 We have also considered whether the UR (or the panel) should have a formal role



in approving the annual forward plan, which is not something we had proposed in our draft determinations. One stakeholder, Mutual Energy, said that to maximise the potential benefits and provide clear direction, the UR (and the evaluation panel as relevant) should approve the annual forward plan that SONI aims to deliver against. It said that there is little point in SONI performing well against an underwhelming plan, but that a concise and high-quality plan with clear objectives will benefit the industry as a whole.

2.89 We have decided against a phase of formal approval, for several reasons:

- Approval of the plan by the UR or the panel could dilute the ownership and accountability of SONI for the quality and ambition of its plan.
- For an annual plan, we felt that a formal approval stage could bring disproportionate work for the annual timetable. This approach might require a series of iterations before approval could be made, and risks of no plan being approved in time for each financial year.
- We have considered that the risks of “an underwhelming plan” could be tackled by the approach we set out above of applying panel evaluation, and financial incentives, targeted on the annual forward plan.
- Under the price control uncertainty mechanisms, we expect that the UR would be playing a role during the price control period in reviewing, and potentially approving, requests from SONI for additional price control funding for new initiatives that are expected to improve outcomes. If approved, these initiatives and their associated deliverables will feed into SONI’s annual plans.

## **Refined approach to service expectations and priorities**

### **Recap on DD**

2.90 In our draft determinations, we proposed that our guidance on the framework would specify a set of “upfront service expectations”. These would set out our position on what a good TSO would do and/or achieve in relation to its activity under each service area, taking account of each service area’s influence on, and contribution to, the TSO outcomes. We proposed that this would play a central role in the annual evaluation of SONI performance, by providing information on the baseline level of performance expected (i.e. the level of performance that does not qualify for a financial reward or penalty). We also included an initial draft of upfront service expectations in an annex to Annex 4 of our draft determinations.

### **Stakeholder views**

2.91 From our review of SONI’s response to our draft determinations, and engagement with SONI after publication of our draft determinations, we identified two broad types of concerns that SONI had with the approach from our draft determinations:

- This concept of performance baselines implied by the service expectations





is subjective and difficult to predict or make an assessment against.

- The service expectations may imply levels of performance or service beyond SONI's historical levels, which cannot be funded through the cost allowances (which the UR had set in light of historical costs with additions for some specific projects or initiatives).

### **FD position**

- 2.92 As part of our broader consideration of how we might make the evaluative assessment more predictable, we reconsidered the approach to service expectations.
- 2.93 We have decided that we should refine the use of service expectations within the framework as follows:
- We would refocus these on what we consider to be priority areas for SONI to bring service improvements and improve its performance, rather than a mix of areas for improvement and expectations about baseline performance.
  - SONI should take account of these priority areas when preparing its annual forward plan, and the panel's assessment of the plan should include consideration of the alignment of the plan with these priority areas.
  - These priority areas would not be used directly as a baseline in the evaluation of SONI's performance during the financial year (but SONI would be held to any deliverables or performance commitment in the plan which concern these priority areas).
- 2.94 We consider that this approach enables the service priorities to shape SONI's efforts and performance over the 2020-25 period, but in a way that enables greater clarity on performance baselines for delivery and performance in each year.
- 2.95 We have included information on service priorities in the separate draft guidance document we are publishing alongside our final determinations.

## **Guidance on the assessment criteria**

### **Recap on DD**

- 2.96 In our draft determination, we proposed that in each of the 16 assessment areas, the panel would determine a grade for SONI's performance in the range 1 to 5 (5 being the best). We set out an initial set of draft guidance to inform the panel's assessment of SONI's performance, which included guidance on what considerations the panel should draw on for its assessment, and a table that provided examples of the types of characteristics we would expect to see under each performance grade.

### **FD position**



2.97 Since our draft determination, we have considered ways to enhance the guidance to provide greater to panel, SONI and stakeholders on the assessment. We took particular account of the type of approach Ofgem had recently proposed as part of refinements to its evaluative performance framework for the GB electricity system operator.<sup>2</sup>

2.98 We have decided that our guidance for the performance framework should:

- Set out a series of assessment criteria for the panel's assessment of the SONI's annual forward plan and another set of assessment criteria for the panel's assessment of the TSO's performance during the financial year.
- Require that as part of its assessment of the plan or performance, the panel decides whether it considers that SOMI's plan/performance exceeds the criterion, meets the criterion or falls short of the criterion.
- Provide practical guidance to the panel, for each of the individual criteria, to help it distinguish between whether SONI's plan/performance exceeds the criterion, meets the criterion or falls short of the criterion.
- Provide guidance to the panel on how to determine an overall grade (on a range of 1 to 5, with 5 being the best) in light of its assessment against individual assessment criteria.

2.99 We have decided that, within this approach, there should be room for judgement in the panel's assessment under each criterion (e.g. so that if, for a specific criterion, performance is mixed across different aspects of a TSO role, the panel can give weight to those aspects it considers most important).

2.100 The panel's assessment will be made separately for each of the four TSO roles, but our draft guidance is intended to be applicable across all roles.

## **Weights for the calculation of financial incentives**

### **Recap on DD**

2.101 In our draft determinations, we set out proposed weights to be applied to each of the 16 scored assessment areas in order to calculate an overall incentive amount from the grades determined in each of those 16 areas. To select the weights we drew on, and refined, some analysis that SONI had carried out as part of its business plan concerning the extent to which different roles and services within its business can influence four benefit areas (which are closely related to our four TSO outcomes).

### **FD position**

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<sup>2</sup>[https://www.ofgem.gov.uk/system/files/docs/2020/10/esori\\_guidance\\_document\\_draft\\_for\\_consultation.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/10/esori_guidance_document_draft_for_consultation.pdf)





- 2.102 As a consequence of the modification set out above on the number of graded assessment areas, the focus for our final determinations was on what weights to apply to the four TSO roles, rather than what weights to apply to 16 individual assessment areas. The weights that we set out in draft determinations, for each role summed across the four outcomes, were as follows:
- System operation and adequacy: 27.5%.
  - Independent expert: 22.5%.
  - Network development and system planning: 27.5%.
  - Commercial interface: 22.5%.
- 2.103 In its draft determinations response, SONI said that there is no easy way to define weightings that accurately reflect the potential benefit to consumers in each role and outcome but that the draft determination proposals appears to be overly simplistic and did not truly reflect the roles SONI has to play in the outcomes. SONI said weights do not reflect the year on year variation in focus that might be expected (e.g. improving connection and access rights may be a key focus for SONI in one or two years of the price control if this area is being reviewed – however, it is unlikely to require the same level of focus across all five years).
- 2.104 SONI also provided some further analysis which it described as an exercise which looked to apportion the weights based on the average influence scores outlined in the UR's heat map (from the draft determination), to the SONI outcome weightings across the roles. SONI noted that this provided different weightings to the draft determinations. This exercise by SONI provided weights across the 16 assessment areas and also sub-total for the four TSO roles which are reproduced below:
- System operation and adequacy: 27.3%.
  - Independent expert: 24.4%.
  - Network development and system planning: 26.6%.
  - Commercial interface: 21.7%.
- 2.105 SONI said that there are several shortfalls even in using its further analysis to assign weights to SONI activities. SONI said that the influence scores from the heat map are themselves subjective and sensitive to change over the course of a price control period, and that the framework must be flexible and agile in responding to changes in the energy system. SONI also said that, as stakeholder expectations are subject to change over time, this would change the evolution of potential benefit to be gained by each role in each outcome as well as the extent to which the roles overlap.
- 2.106 Much of SONI's comments on the weights concern the proposal from our draft determinations for 16 scored assessment areas. For our final determination, as set out above, we reduced this to four graded areas (for each phase of assessment)



which mitigates some of SONI's concerns. At the level of the weights for the four TSO roles, SONI did not propose weights that were significantly different to those from our draft determinations, and the main residual point it emphasised seemed to be about the need for flexibility over time.

- 2.107 We received limited comments on the weights from other stakeholders. NIE Network said that the weighting for the "independent expert" role appeared high in comparison to the importance of other areas such as system operation.
- 2.108 For our final determination, we have decided that for the 2020-25 price control period:
- The weight for each of the four roles should be constrained to lie in a range of **20% to 30%**.
  - The framework guidance document should specify the exact weight within this range for each role.
  - The total weights across all four roles should equal 100%.
- 2.109 We consider that this approach strikes a balance between setting out sufficient structure for the evaluative framework in our final determinations and providing a degree of flexibility over time. It will also allow, as part of our consultation on the draft guidance document, for further stakeholder engagement on the precise weights with the context of the broader set of modifications we made to the evaluative framework.

## Determination of the incentive amount

### Recap on DD

- 2.110 In our draft determinations, we set out an approach to the calculation and determination of the incentive amount (potential financial reward or penalty) in the light of the scores determined by the panel. We also provided a worked example.

### FD position

- 2.111 Due to the modifications to the framework that we decided to make for our final determinations, the incentive amount calculation method from our draft determinations is no longer applicable. These changes are, in particular: the move to an asymmetric incentive structure, the reduction in the number of graded assessment areas from 16 to four; and the introduction of a separate phase of evaluation of the forward plan.
- 2.112 For our final determinations, we decided that the calculation of the incentive amount for each financial year (whether positive or negative) should involve three stages:
- **Stage 1: determination of final grades.** For each of the forward plan and performance assessments, we will determine a final grade for each TSO role, which will be a whole number from 1 to 5 (5 being the best). We will



decide whether to accept in full the grading of the evaluation panel, or to use adjusted grades for specific roles. We will give reasons for any departure from the panel's grades.

- **Stage 2: calculation of overall grade.** For each of the forward plan and performance assessments, we will calculate the weighted average grade across the four TSO roles, based on the weights for each role set out in the guidance. We will then take the sum of the weighted-average grade for the forward plan and the weighted-average grade for performance and divide by two to calculate an “overall grade” for the financial year.
- **Stage 3: calculation of incentive amounts before caps.** The incentive amount (before application of any caps) will be calculated as follows:
  - If the overall grade is above 3, then the incentive amount will be calculated as the overall grade minus 3, multiplied by £800,000. This will be a positive number, indicating a financial reward under the incentive scheme.
  - If the overall grade is below 3, then the incentive amount will be calculated as the overall grade minus 3, multiplied by £375,000. This will be a negative number, indicating a financial penalty under the incentive scheme.
  - If the overall grade is 3, the incentive amount will be zero.

2.113 In terms of timing, we will complete stage 1 in respect of the forward plan during the financial year, following the panel's assessment of the plan rather than waiting to the assessment phase at the end of the year. We will then determine and publish a provisional incentive amount which is based on grades for the forward plan, and the working assumption that the weighted-average grade for performance will be grade 3 (i.e. the baseline). The final incentive amount will be re-calculated following the panel's evaluation of performance and our determination of final grades for performance.

2.114 In considering the calibration of these incentive amounts, we sought to give effect to our policy decision above that the incentive scheme should provide greater financial incentives to SONI on the upside than on the downside. We also considered that, in line with the approach in draft determinations, the theoretical maximum upside from the incentives, before the application of the caps could be set higher than the caps to increase the incentives' overall strength within the evaluative framework (i.e. we proposed that the caps could bite in respect of the evaluative performance incentives alone). Given the smaller number of assessment areas compared to our draft determinations, and the reduced scope for grades in different assessment areas to average out, we did not consider that the theoretical incentive upside needed to be as high as in our draft determinations. On the downside, and given the reduction in the overall cap since our draft determinations, we decided to limit the downside incentive to an amount such that the worst conceivable outcome under the evaluative performance framework would hit but not exceed the cap.



Given the reduced downside cap, we were concerned that stronger downside incentives could unduly dampen incentives on cost efficiency in situations where SONI expects to receive a relatively low grade in the evaluative assessment.

- 2.115 The possible outcomes under the evaluative performance framework incentive structure are illustrated in the table below which shows overall incentive amounts for different combinations of grades for the assessment of the forward plan and the assessment of performance. These are figures before the caps apply.

**Table [x]: Illustration of possible incentive outcomes (before caps)**

Forward plan grade	Performance grade				
	1	2	3	4	5
1	-£750,000	-£562,500	-£375,000	-£187,500	£0
2	-£562,500	-£375,000	-£187,500	£0	£400,000
3	-£375,000	-£187,500	£0	£400,000	£800,000
4	-£187,500	£0	£400,000	£800,000	£1,200,000
5	£0	£400,000	£800,000	£1,200,000	£1,600,000

- 2.116 The final incentive amount will be subject to caps (the maximum financial reward will be **£1.25m** and the maximum financial penalty will be **£0.75m**) which apply to the net incentive position, in respect of each financial year, across the following elements of the price control framework:

- The evaluative performance framework.
- The conditional cost-sharing arrangements.
- The 25% mechanistic cost-sharing incentives for costs of new initiatives or projects for which we provided hypothecated ex ante funding and set associated price control deliverables.

## All-island issues and interactions

### Stakeholder views

- 2.117 A number of stakeholders made comments about all-island issues and interactions in their responses to draft determinations, which are potentially relevant to the design and application of the evaluative performance framework.
- 2.118 SONI said that it is critical that the evaluation framework reflects the all-island nature of the work that it carries out with EirGrid and joint working needs to be given due regard in the framework so as not to lead to impractical and unintended consequences.
- 2.119 NIREG referred to the ongoing CRU draft determination consultation on EirGrid's price control (2021-2025) proposed annual targets for dispatch down and SNSP,



and said that it did not believe these targets should, or even can, be progressed on a jurisdictional basis as SONI/EirGrid operate an all-island system. NIREG considered that divergence in incentive targets and objectives also leads to an uneven playing field for industry and could potentially distort investment signals on the island.

- 2.120 SSE said that given that system operation impacts on the wholesale market across the whole island this requires significant co-ordination between SONI and EirGrid and that it would appear only rational that the UR and CRU work together to ensure that the TSOs are incentivised appropriately and consistently to work together for the benefit of all customers and consumers on the island of Ireland. SSE's view was that the UR should also be conscious of the impact on consumers that diverging incentive regimes (including penalties for poor performance) may have on the market, as well as the impact this may have on the ability to meet any future energy policy requirements.
- 2.121 DP Energy said that it is essential that there is co-ordinated approach in both jurisdictions in relation to the funding, incentives and regulation of the grid. It stressed the importance of North-South co-operation and alignment in policy areas such as DS3 and other all-island initiatives to integrate renewables onto the power
- 2.122 IWEA said that it is essential that there is a co-ordinated approach in both jurisdictions in relation to the funding, incentives and regulation of the grid.

### **FD position**

- 2.123 The comments have implications beyond the design of the evaluative performance framework (e.g. some stakeholders were concerned about the projects that should be approved for additional price control funding, which we consider separately in annex 4.
- 2.124 Focusing on the evaluative framework design, we consider that one of the benefits of an evaluative approach, compared to more mechanistic incentives, is that it can allow for consideration and understanding of the circumstances in which specific performance outcomes or perceived problems have arisen.
- 2.125 For instance, SONI will have an opportunity under the evaluative framework to explain the influence of all-island issues and interactions on aspects of its performance or plans. This might include cases where all-island factors operate as a constraint on how SONI operates, which lead to a different approach than might be taken from a Northern Ireland perspective in isolation. Likewise, stakeholders have an opportunity to raise potential concerns with performance and plans if they considered that all-island issues and interactions are not being taken into account sufficiently well as part of SONI's roles.
- 2.126 One further, related issue concerns the potential interactions with the role of the SEM Committee. In our draft determination, we said that SONI's performance in relation to external costs (costs of purchasing system support services), would be taken into account, alongside other information, under the evaluative performance framework – at least insofar as this would not conflict with any incentives or



performance arrangements imposed on these costs on an all-island basis by the SEM Committee. This recognised that it was possible that, in the future, the SEM Committee could introduce regulatory arrangements for certain all-island matters which are not compatible with certain aspects of SONI's performance being covered by the panel's evaluation (and the corresponding financial incentive) under our evaluative performance framework.

2.127 For our final determinations our position is that, for areas of performance such as system services which have significant all-island aspects:

- SONI and the UR would provide input to the panel, to highlight the relevance of all-island issues and interactions to the panel's evaluation of SONI's forward plan and performance.
- The UR may instruct the panel, in specific cases, to disregard certain aspects of SONI's performance if the UR considers this to be necessary in consequence of decisions taken by the SEM Committee.

## **Start date for evaluative performance framework**

### **Recap on DD**

2.128 In our draft determination we proposed that, given the timescales for the price control review process, the evaluative performance framework is introduced as part of the 2020-25 SONI price control, but that the financial incentives would only be available for price control financial years from 1 October 2021 onwards.

2.129 We proposed that the performance framework and evaluation process (including performance panel evaluation) are applied as far as possible for the price control financial year running from 1 October 2020 to 30 September 2021, but that no financial reward or penalty is set in light of the scores produced for this year. Furthermore, SONI would provide a full forward plan for the year 2020/21 but would instead provide an update to the UR and other stakeholders on its key priorities for the financial year, in each of the four roles.

### **Stakeholder views**

2.130 SONI did not explicitly comment on this issue in its response to our draft determinations. But in our engagement with SONI since the draft determinations SONI raised concerns about the practicality of applying the framework in any form for 2020/21.

### **FD position**

2.131 We considered this matter further for our final determinations.

2.132 Given the extra emphasis that we have decided to place on the 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.





2.133 We also continued to see value in a transition year in which the framework would apply but without the application of financial incentives. While it cannot be expected that SONI would behave in the same way regardless of whether financial incentives are available, we considered that given the novelty of the framework and the processes around it, it would be best for its initial application to be on a basis that does not seek to directly expose SONI to a financial penalty or reward. There would still be reputational incentives on SONI. We would expect SONI, the panel, the UR and other stakeholders to gain insight and learning from this transition year which improves the effectiveness of the framework in subsequent years.

2.134 On that basis, 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 any financial incentives.
- The framework should apply in full, including financial incentives, in respect of the financial years 2022/23, 2023/24 and 2024/25.

## **Size and composition of the evaluation panel**

### **Recap on DD**

2.135 Our draft determination provided some initial discussion of the composition of the evaluation panel and said that we would welcome stakeholder input on is the design of panel membership and the number of members. We said that our initial view was that the panel would be chaired by an independent individual. We identified a question of whether the panel should be fully independent, comprised of industry/stakeholder representatives, or a mix of both. We said that if the panel were to include active stakeholders then we may need a larger panel to allow for more balanced and representative view, but a larger panel may be difficult to manage in terms of it producing an agreed set of evaluation scores. Our initial suggestion was for four members of the panel, in addition to the independent chairperson and that this should be a mixture of independents and industry personnel.

2.136 We also proposed that the UR staff team would provide support services to the evaluation panel, including a secretariat/record-keeping role and may carry out bespoke pieces of research and analysis that the panel requests.

### **Stakeholder views**

2.137 We received some stakeholder feedback on the size and composition of the panel.

2.138 Manufacturing NI said that: consumers should have a seat at that table; the panel should have a balance of technical and financial expertise and consumer



representation; and that the panel should be independent on the UR, including an independent chair. Manufacturing NI said it would be content for the panel to pass its recommendation to the UR Board who are the decision makers in law.

- 2.139 The Consumer Council said that it will be important that the evaluation panel properly represents the views of consumers, with appropriate terms of reference. It also highlighted its view that, from its experience from similar panels in other areas of UK regulation, to be effective, the panel needs to be properly resourced and the panel members properly compensated to allow them to spend sufficient time to consider the appropriate grade for each area.
- 2.140 SONI said that if the framework is based on a higher percentage of subjective evaluation, then it is critical that: the members of the expert panel have expertise across the various functions that SONI fulfils; the panel members are truly independent (e.g. academia, NGO, umbrella organisations); and panel members need to understand the all-island context and market as there are crucial differences to the Great Britain market. SONI also said that a member of the UR's markets team should be involved in the development of this framework and have input or be part of the panel, to ensure a whole system perspective is reflected in the assessment.

### **FD position**

- 2.141 Following draft determination, and in light of feedback from stakeholders, we considered further the size and composition of the panel.
- 2.142 We have decided that the panel should operate on the following basis:
- The panel should be chaired by an individual who is independent of the UR.
  - The panel should have between three and seven members in total, including the chair.
  - The panel members should have a published terms of reference and commit sufficient time to be able to participate effectively in the processes required under the framework.
  - The individual members of the panel should 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.
  - The panel is not intended to play the role of customer or stakeholder representation directly. The panel should draw on evidence and views provided by customers, consumers, their representatives and other stakeholders (or stakeholder groups) in making its evaluation.
  - The UR may establish one or more stakeholder groups to help inform the panel's assessment, and to help guide SONI's planning and performance.





- The UR would provide support services to the evaluation panel, including a secretariat/record-keeping role and may carry out bespoke pieces of research, analysis and information gathering that the panel requests.
- 2.143 Our current plan is to establish a panel of five members. In the decision above, we provided a range for the number of panel members to provide some flexibility over the size for the duration of the price control period.
- 2.144 As part of the work to establish the panel, we will consider whether any panel members should be remunerated (e.g. one option would be to remunerate the chair). This is something we decided to leave open in our final determinations, as it seemed premature to lock in to an approach at this stage.
- 2.145 We plan to commence the process for the appointment of the panel shortly after our final determinations.

### **Licence implementation and appeals of evaluation outcome**

- 2.146 In our draft determinations, we proposed that the evaluative framework is implemented in the following way through modifications to the TSO licence conditions:
- The licence would place obligations on SONI to participate in the various processes required under the framework.
  - The potential financial reward or penalty would be specified in the licence as an adjustment to the calculation of SONI's maximum regulated revenue in each price control financial year, the value of which is to be determined by the UR with the UR having regard to specified guidance documents.
- 2.147 Under this approach, SONI or other parties would be able to seek judicial review of the UR's decision on the financial reward or penalty to apply in a given year.
- 2.148 We said that we did not consider it necessary or proportionate for the decision on the level of financial reward or penalty in a specific year to be a matter that would be implemented through licence modification and, in turn, potentially subject to CMA appeal.
- 2.149 We did not receive feedback from stakeholders on the details of the licence modifications and appeal arrangements. We have decided to maintain our draft determinations position on this matter.

### **Guidance document for the evaluative performance framework**

- 2.150 In our draft determinations, we said that a key feature of the evaluative performance framework is that it can developed over time, allowing adaptation in light of growing experience and emerging issues. We said that we planned to determine the overall structure and approach of the framework, including key financial aspects (e.g. maximum financial reward or penalty) as part of our final determinations, with



further details specified in regulatory guidance documents. We proposed that the guidance documents could be updated during the price control period.

- 2.151 This was not a matter on which we received direct stakeholder responses. SONI's general concerns about the potential for regulatory uncertainty under the evaluative performance framework highlight the importance of guidance on the framework.
- 2.152 In line with the approach envisaged in our draft determinations, we have decided that there should be a guidance document on the application of the evaluative performance framework.
- 2.153 We have produced a draft guidance document which we are publishing alongside our draft determinations.
- 2.154 This guidance document is consistent with the policy positions set out in this annex, and provides greater detail on how the framework will work in practice, including detailed guidance to SONI on what is expected from it, and guidance to the panel on how it should evaluate SONI's forward plan and performance. The guidance also covers the timings for the annual processes.
- 2.155 For our final determination, we have decided that the guidance document should be constrained by the set of decisions in this annex and, subject to this, allowed to change over time during the price control period.
- 2.156 We will consult stakeholders on any changes to the guidance.

## **Proportionality**

- 2.157 SONI raised concerns in its draft determinations response about the proportionality of the evaluative approach we had proposed.
- 2.158 As set out above, we have made a series of modifications to the evaluative performance framework since our draft determinations, taking account of stakeholder feedback and further consideration.
- 2.159 In some areas we have reduced the scope and complexity of the framework (e.g. fewer graded assessment areas and clarifying that panel is not to be involved in reviewing the merits of SONI's requests for additional price control funding via uncertainty mechanisms). In some other areas, we added scope to the framework to address other concerns (e.g. forward plan assessment phase to bring greater clarity and predictability on performance baselines, without incentivising an undemanding plan).
- 2.160 We recognise that the framework that we have decided on for our final determinations represents a substantial addition to the price control framework. This should be viewed in the context of the limited attention that the existing price control framework gives to SONI's performance, besides internal costs, and the difficulties in applying traditional price control incentive arrangements to the performance of an electricity transmission system operator.



- 2.161 We recognise that the framework will require some additional resource from SONI and from the UR, in addition to the time and effort from the panel and other stakeholders. We consider that this additional resource requirement is worthwhile overall and proportionate for a business of SONI's scale, and given its influence within the wider Northern Ireland electricity system.



## 3. Accountability for price control deliverables

3.1 We now turn to our final determinations on the arrangements to ensure that SONI will be accountable for its delivery and performance in relation to specific projects or initiatives explicitly funded through price control allowances. We summarised our draft determinations on these arrangements in section 1 of this annex.

### Stakeholder views

3.2 In general stakeholders said very little if anything about this aspect of DD. SONI made general comments about need for guidance/clarification.

### FD position

3.3 We set out our FD position, organised into three key areas:

- Specification of price control deliverables.
- Financial adjustments in relation to delivery (which apply outside of, and in addition to, the treatment of price control deliverables as part of the evaluative performance framework).
- Treatment of price control deliverables under the evaluative performance framework.

### Specification of price control deliverables

3.4 We have decided on the following approach to the specification of price control deliverables:

- Where we included a hypothecated expenditure allowance to fund a specific project or initiative within the price control allowances set as part of our final determinations we have specified price control deliverables that are expected to be delivered or achieved as a condition of this funding.
- Where we allow additional price control funding for specific project or initiative during the price control period, we will specify price control deliverables that are expected to be delivered or achieved as a condition of this funding.
- The deliverables should be specified in a way that provides clarity on what is to be delivered in practice, and/or how successful delivery would be measured, in order for delivery to be verified. This may require a significant amount of detail on the scope and quality of what is planned.
- The specification of deliverables should contain clear dates for delivery, potentially using milestones where a project or initiative is broken into



phases.

- Where possible subject to the points above, and the overall need for effective accountability, deliverables should be specified in a way that provides flexibility for SONI as to how exactly it achieves or delivers the benefits expected from the project or initiative.
- The specification of deliverables, and their monitoring, should take account of timeframes over which benefits from projects or initiatives are to be sustained. For instance, an investment initiative might be expected to bring a certain benefit over a five-year period and it would be important to recognise that achieving those benefits for two years only represents under-delivery. This point means that holding SONI to account for delivery of a project might span multiple price control periods.

### **Financial adjustments in relation to delivery**

- 3.5 This sub-section focuses on arrangements that apply outside of, and in addition to, the treatment of price control deliverables as part of the evaluative performance framework.
- 3.6 These additional arrangements are needed because we did not consider that the evaluative performance framework would be sufficient, on its own, to ensure delivery or protect customers in the event of non-delivery or under-delivery. For instance, in a simple example, if SONI had received £1m of price control funding to carry out a project to benefit customers, and did not do this project at all, the financial incentives from the evaluative performance framework would not, on their own, be sufficient to prevent SONI from profiting significantly from this situation. These provisions are not intended to penalise SONI for under-delivery, but rather to ensure that it does not benefit financially and inappropriately from under-delivery.
- 3.7 In line with the approach from our draft determinations, we have decided that the following provisions should be included within the price control framework in relation to ex ante expenditure allowances for specific projects or initiatives for which we have specified price control deliverables.
- If there is no delivery of the deliverable, financial adjustments would be made to price control allowances to deduct the value of the ex-ante funding that had been provided for that deliverable (including the value of return on capital and regulatory depreciation for the ex-ante allowance).
  - If there is partial delivery of the deliverable, financial adjustments would be made to deduct part of the value of the ante cost allowance for that initiative, with the proportion reflecting an estimate by the UR of the proportion of the deliverable that is delivered or achieved.
  - If there is late delivery of the deliverable, we reserve the right to make financial adjustments to deduct the value of any financing costs benefit (e.g. allowed return) that SONI has received from delays to the project.



- 3.8 These provisions apply to price control deliverables set as part of our final determinations and those set during the price control period via uncertainty mechanisms.
- 3.9 Subject to the provisions above, any over- or under-spend would be subject to mechanistic cost-sharing incentives (with 25% incentive rate) and outside the scope of the conditional cost-sharing incentives. This is consistent with the detail and substance of what was proposed in our draft determinations, but it represents a clarification in terms of the presentation of the arrangements.

### **Treatment of price control deliverables under evaluative performance framework**

- 3.10 This sub-section focuses the treatment of price control deliverables as part of the evaluative performance framework.
- 3.11 Drawing on our draft determinations position, and further work to develop and refine the evaluative performance framework, we have decided on the following approach:
- SONI should include any price control deliverables set by the UR in its annual forward plan, if they are relevant to its activities over that year.
  - For each of the four TSO roles, SONI's performance in delivery of price control deliverables would be taken into account as part of the wider evaluation of its performance (including its delivery against its forward plan). This evaluation will take account of delivery across the TSO role and other considerations (e.g. external factors that may explain under-delivery).
  - There is a potential, as part of this evaluation, for SONI to receive a lower assessment grade (and hence financial downside) as a consequence of under-delivery of price control deliverables that worsens outcomes.
  - There is potential, as part of this evaluation, for SONI to receive a higher assessment grade (and hence financial upside) if the panel finds significant benefit to outcomes from going beyond the price control deliverables.
- 3.12 More detailed information on our approach to the treatment of price control deliverables within the evaluative performance framework provided in the draft guidance we are publishing alongside our final determinations.

### **SONI deliverables for approved initiatives**

- 3.13 We have included, in our Deliverables spreadsheet, the set of price control deliverables corresponding to the ex ante funding for specific projects and initiatives that we have allowed as part of final determinations. For avoidance of doubt, we feel that SONI should be held to account to 'success' measures as well as deliverables.
- 3.14 These deliverables (and success measures) are based primarily on SONI's submissions to us for the initiatives that we approved. Even for these initiatives, we considered that SONI had generally not provided a sufficient degree of detail on the



scope and specification of deliverables to provide a firm basis for accountability. As a result, the price control deliverables we have set out are less well-specified than we would have liked.

- 3.15 In this context, our policy will be that, in assessing whether SONI has delivered, we should ensure that SONI does not benefit unduly from any residual ambiguity on the scope and specification of deliverables. For instance, where the deliverables we have specified as part of our final determinations give rise to a range of reasonable interpretations of what is required for full delivery, we will try to strike a balance across those interpretations rather than holding SONI accountable for the least challenging interpretation.