

Decision on the Licence Modifications for the Price Control 2015-2020 of the Electricity System Operator for Northern Ireland (SONI)

14 March 2017



About the Utility Regulator

The Utility Regulator (UR) is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries and 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; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our Mission

Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

The purpose of this document is to notify stakeholders of the new licence modifications to give effect to the 2015-2020 price control for the electricity transmission System Operator for Northern Ireland (SONI).

Audience

Regulated Companies; Consumer Groups; Industry and Statutory Bodies.

Consumer impact

SONI has a pivotal role in terms of 'keeping the lights on' and the effectiveness and efficiency of SONI is key to industry and consumers. The impact of this price control on SONI System Support Services (SSS) tariff is a reduction of c£7 million (9%) over the 5 year period. This translates to an annual average reduction in tariffs for domestic users of c£0.70 and c£1,600 for Large Energy Users. In comparison SONI submitted a £27 million (35%) increase for the 5 year period, translating to an annual average tariff impact of c£2.60 increase on domestic consumers and an increase of c£6,200 on Large Energy Users.

Executive Summary

SONI Ltd (**SONI**) is licensed as the Transmission System Operator (**TSO**) for Northern Ireland and is subject to a regulated price control. The SONI price control takes place in the context of increased renewable electricity generation, an evolving legislative subsidy environment and wider changing European legislative developments¹. Furthermore, during 2014, as a result of implementing IME3², SONI is now responsible for transmission network planning up to the construction phase.

This price control is effective for a five year period from 1 October 2015 to 30 September 2020. The overall objective of this price control is to ensure that SONI can continue to operate the transmission system in Northern Ireland securely and efficiently, and at a reasonable cost to consumers.

The Utility Regulator (**UR**) consulted upon a Draft Determination³ for which five responses were received.

Following this, the UR published a Final Determination paper⁴ on the 22 February 2016 (the **Final Determination**) which was accompanied by a consultation on the proposed licence modifications (the **Consultation**). Responses to the Consultation were requested by 23 March 2016; SONI was the only stake holder that responded to the Consultation.

SONI's response to the Consultation was in two parts: a general paper outlining substantive points of concern against common themes and a tabular response with specific comments on individual licence provisions. SONI also set out alternative text in respect of a number of the points where SONI believed the modifications failed to achieve the effect referred to in the Notice within the Final Determination paper and commented on several areas where SONI felt that the proposed licence modifications required reconsideration.

The UR has considered the comments put forward and is now issuing the licence modifications relating to the Price Control 2015-2020 for SONI in its capacity as the electricity Transmission System Operator for Northern Ireland.

In light of SONI's response to the Consultation we will also issue a further consultation on certain individual aspects of the price control, as identified within this decision paper, and this will be published in due course.

Throughout this process, there has been engagement, discussions, clarifications and several correspondences between the UR and SONI.

² EU Third Internal Energy Package (IME3)

³ http://www.uregni.gov.uk/news/view/soni_price_control_2015-2020_consultation/

⁴ http://www.uregni.gov.uk/news/decision_on_soni_2015_2020_price_control_and_licence_modification_consultation/ - The paper was issued to SONI on the 22nd February 2016 and publicly available on the UR website on 24th February.

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1. Introduction

1. The System Operator for Northern Ireland (SONI) is responsible for planning and operating the electricity transmission network in Northern Ireland. SONI is a monopoly and therefore subject to a regulated price control.
2. In accordance with Article 14(5) of the Electricity (Northern Ireland) Order 1992 (the "Electricity Order") the Authority has considered representations duly made to it and has decided to proceed with the making of modifications of the conditions of the licence in exercise of its powers under Article 14(1) of the Electricity Order.
3. This paper gives notice, under Article 14(8) of the Electricity Order, of the Utility Regulator's (UR's) decision to proceed to modify the electricity transmission licence (the "Licence") held by SONI Limited ("the Licensee"). It contains the UR's decision on updated licence modifications associated with SONI's allowed revenue specific to the SONI system operation business for the five year period commencing 1 October 2015 to 30 September 2020, following its consideration of responses to the Final Determination.

1.1 Responses to Draft Determination and Final Determination

4. The UR published a consultation paper on 2 April 2015 which invited interested stakeholders to express a view on any particular aspect of the Draft Determination. The UR received five responses to the Draft Determination. The parties who responded were:
 - SONI Ltd
 - Manufacturing Northern Ireland
 - The Consumer Council
 - Northern Ireland Renewables Industry Group
 - Prospect Union
5. The UR considered each of the responses received, which were published with the Final Determination on 22 February 2016 along with the proposed licence modifications.
6. This paper sets out our consideration of the responses to the Final Determination and the proposed licence modifications. It explains our decision on the relevant aspects and the licence modifications which we are proceeding to make. It also addresses further issues raised by SONI within its response to the Final Determination; the UR received this response on 23 March 2016.
7. References to "SONI" within this paper should be taken to mean SONI in its capacity as Transmission System Operator (TSO) unless otherwise stated. SONI's response was in two parts: a general paper outlining substantive points of concern against common

themes and a tabular response with specific comments on individual licence provisions.

8. The UR responded to SONI's comments on the proposed licence modifications on the 13 May 2016. Since then there has been further correspondence from and to SONI on specific matters concerning the price control.
9. The UR has also met with SONI on several occasions and indicated its intention to further consult on certain elements of the Price Control following consideration of SONI's response. SONI responded with a further follow-up correspondence restating its position and concerns, further meetings have also been accommodated.
10. In SONI's view the licence modifications accompanying the Final Determination, if implemented, would not allow SONI to meet its licence obligations, would be inconsistent with the UR's statutory duty to protect the interests of customers and would not be in the public interest. It was SONI's view that it (the price control) does not provide a basis for it to finance its activities. SONI also commented on a number of general aspects in regards to the Price Control and said it followed that SONI considered the current regulatory model not fit for purpose and the licence modifications were also defective and needed amendment.
11. The overall purpose of this price control is to ensure that SONI can continue to plan and operate an efficient, coordinated and economical system for the transmission of electricity in Northern Ireland.
12. Following consideration of SONI's comments, considering further submitted information and allowing for the unique nature of the risk carried by SONI in relation to I-SEM, DS3 and network development obligations the UR has decided to implement the Final Determination licence modifications with some updated changes. We have also decided to consult further on Pensions and Change of Law provisions and therefore will be issuing a further consultation on these topics. Further consultation will also be required in relation to contingent capital in the context of the I-SEM work programme.
13. This paper will set out the revised licence modifications and provide additional commentary on;
 - Demonstrably Inefficient or Wasteful Expenditure
 - Excluded SSS/TUoS Costs
 - Network Planning function
 - Cost & Outturn Reporting
 - Financeability
 - Change of Law
 - Pensions
 - Other clarifications
14. We have carefully considered all consultation responses and other relevant factors in this Decision paper. We will set out our consideration of consultation responses in the respective sections of this document along with our decision on relevant aspects.

15. All aspects of the Final Determination remain the UR's proposed position unless specifically highlighted in this paper where the UR's position has changed.
16. As an additional consultation paper will be considered we have modified the "Price Control Decision Paper" in the definitions table of Annex 1 of the licence to include "*and as supplemented or amended by any further decision paper on the same subject*".

1.2 Duration

17. The approach and price control design is considered appropriate for SONI for this five year period that is 1 October 2015 to 30 September 2020. The UR will again review and consider the appropriateness of both the approach and price control design at the beginning of next price control period.
18. In its correspondence SONI has suggested that it has a legitimate expectation regarding implementation of changes and raised concerns on the effective start date of the price control.
19. The UR's decision set out in this paper applies in respect of the price control period starting on 1 October 2015. Accordingly, the effective start date of the price control set by the Decision is 1 October 2015. That this is, and always has been, the case is confirmed and clarified not only within and by the Draft Determination and the Final Determination but also within the broader consultation and engagement process undertaken by the UR on the price control and proposed licence modifications, including with SONI individually. The position has not changed – the effective start date of this price control is 1 October 2015.
20. The licence modifications which are made will therefore have the effect of setting the maximum regulated revenue for the five year period from 1 October 2015 to 30 September 2020 (subject to any modifications made following further consultation on the matters noted in this decision paper).
21. Accordingly, as the first year of the price control has passed, in order to ensure that the maximum revenue for that relevant year t is calculated/assessed on the basis of the price control that should apply we have included a new term (Q_t) which makes the adjustment that is required (as determined by the UR).
22. This Q_t term will be added into 2.2 (e) of Annex 1 and reads;
means an adjustment to be applied to the maximum core SSS/TUoS revenue, which:
 - (i) *in Relevant Year t ending 30 September 2017 shall be the amount which is determined by the Authority and notified to the Licensee in accordance with principles set out in guidance provided to the Licensee and;*
 - (ii) *in each other Relevant Year shall be equal to zero.*

1.3 Revenue Entitlement for the 2010-2015 price control

- 23. Overall SONI's business plan proposed a level of revenue of £132 million. Following analysis the UR has determined £97 million to be appropriate. This includes £28 million forecast for specific network pre-construction projects.
- 24. Table A below provides a comparison between the 2010-2015 price control and this 2015-2020 price control Decision.

	2010 - 2015 Allowance	2010 - 2015 SONI Actuals (estimate 2014/15)	2015 - 2020 SONI Submission *	2015 - 2020 UR Draft Determination	2015 - 2020 UR Decision
	£'000	£'000	£'000	£'000	£'000
Payroll (incl ongoing pension)	33,282	31,219	42,881	37,576	36,083
IT and Telecoms	10,559	7,988	9,501	9,501	9,501
Other Operating Costs	7,919	8,624	17,379	6,681	7,056
Pension Deficit	172	391	740	740	943
OPEX Total	51,932	48,222	70,501	54,499	53,583
Depreciation	19,336	9,926	9,761	10,279	11,980
Rate of Return (excl Pre-construction)	4,538	4,115	2,702	1,538	1,768
	75,806	62,263	82,965	66,316	67,330
Innovation Fund			2,625	0	0
Remunerate Contingent Capital (PCG)			6,900	0	0
Margin			13,000	0	0
	75,806	62,263	105,490	66,316	67,330
Network Planning Function**	3,100	3,443	25,100	25,100	28,000
Real Price Effects & Productivity			1,289	0	1,496
Total	78,906	65,706	131,879	91,416	96,826

* Based on the SONI original submission made 21 October 2014

** SONI responsible for Network Planning from May 2014. Therefore the 2015-2020 UR Decision payroll and network planning function allowances are not directly comparable with the other columns.

Table A: Summary of SONI TSO Actuals, Submission and UR Allowances (April 2014 prices)

- 25. Table A above is shown diagrammatically below in Diagram A.

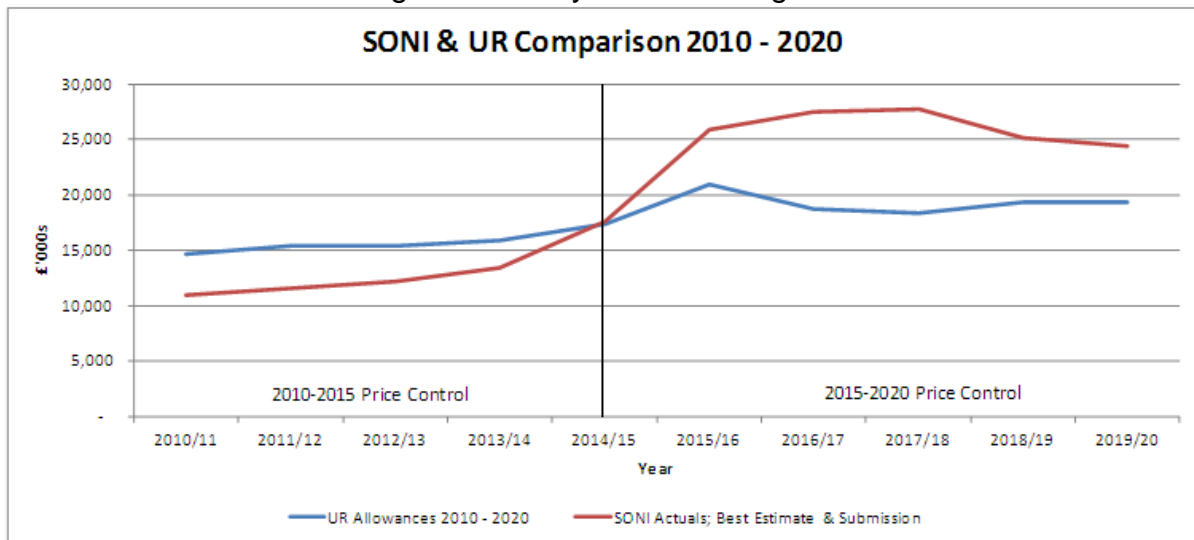


Diagram A: Summary of SONI TSO Actuals, Submission and UR Allowances (April 2014 prices)

26. It is important to note that the overall allowance applicable to SONI will increase, during this price control period, once the finalised I-SEM and DS3 (Delivering a Secure, Sustainable Electricity System) implementation costs have been established and approved by the relevant authorities. The TSO has estimated the proportion of the SONI I-SEM and DS3 expenditure. Based on the forecasted information submitted to date for these two projects, the estimated figures could mean that SONI could receive an additional £15m+ on top of the 2015-2020 price control decision.
27. This potentially could bring SONI's revenue entitlement for 2015-2020 to approximately **£112m+** which is a significant increase from their 2010-2015 price control actuals of **£65m**.
28. This price control is also intended to allow SONI to recover relevant costs and earn an appropriate return. The UR continues to consider that it provides SONI with the opportunity to invest appropriately and operate efficiently, and that it is able to finance the activities required by its obligations for the 2015-2020 period.
29. Unless specifically highlighted in this paper all other aspects of the Final Determination remains the UR's position.

2. Demonstrably Inefficient or Wasteful Expenditure

30. In the Final Determination we considered the Ofgem and the Competition Commission's terminology of 'demonstrably inefficient or wasteful expenditure' (DIWE) and decided that we would include this provision within the Licence.
31. This would enable the UR to determine adjustments to the SONI maximum regulated revenue or RAB to protect consumers from exposure to any costs that the UR has found to be demonstrably inefficient or wasteful.
32. This clause was to be applied to SONI TSO in respect of System Support Services (A_{TSO}), price control actual costs, excluded (D_{TSO}) actual costs, Change of Law actual costs and transmission pre-construction projects.

2.1 SONI Response

33. In its response to the Consultation SONI stated that as some of the costs with A_{TSO} are outside of SONI's control, and it cannot be appropriate for pass-through costs to be subject to a DIWE test or exclusion on that basis.
34. SONI requested that further detail regarding the distinction to be made between those costs which are within SONI's control, and those which are not, and to identify appropriate remuneration mechanisms for the risks which will be accorded to each. SONI also noted that there is no discussion of the recourse available to SONI in the event that the UR makes a determination which SONI wishes to dispute in respect of DIWE.
35. SONI notes further that at paragraph 5.110 of the Competition Commission's⁵ Final Determination on NIE's price control, the Competition Commission states that *"we would expect the UR to publish a reasoned decision for any adjustment to NIE's maximum regulated revenue of RAB in light of an assessment under the proposed inefficient spend clause"*.
36. SONI also commented that given that a sizeable reduction for DIWE will have significant repercussions for SONI's financeability (particularly if applied to costs which are outside of SONI's control), it is crucial that SONI is furnished with the framework of assessment for DIWE deductions, and potential avenues of recourse in the event that SONI does not agree with the UR's resulting determinations.

⁵ Now the Competition and Markets Authority (CMA).

37. Failing this, SONI proposes that the definition of A_{TSOT} be amended to remove the words *"minus that part (if any) of such costs that the Authority determines to be Demonstrably Inefficient or Wasteful Expenditure"*.
38. Also in its response to the Final Determination paper SONI objected to the inclusion, in paragraph 9.1 of the proposed licence modifications, of a provision for the UR to issue guidance as to the manner in which the term 'Demonstrably Inefficient or Wasteful Expenditure' is to be interpreted and applied. In particular, SONI submits that it is inappropriate for the UR to rely on guidance that is not yet drafted or consulted upon and that it is inconsistent with good regulatory practice.

2.2 UR Decision on Demonstrably Inefficient or Wasteful Expenditure

39. All costs within the licensed activity even if they are treated as pass-through and are considered to be outside of SONI's price control should be challenged to ensure customers are getting value for money. However, the UR accepts SONI's commentary and has decided to remove the Demonstrably Inefficient or Wasteful element the A_{TSOT} term within 2.2 (a) of Annex 1.
40. As, to date, detailed guidance on Demonstrably Inefficient or Wasteful Expenditure has not been provided to SONI, the UR has therefore revisited its proposal and has decided not to proceed with the inclusion of paragraph 9.1 at this time.
41. However, if the Demonstrably Inefficient or Wasteful element is used within the other elements of the Annex 1, the UR will provide guidance as to how this mechanism will be applied and in the event of an investigation and determination into SONI's spend under the proposed inefficient spend clause, similar to the Competition Commission's determination for NIE Networks, the UR would also publish a reasoned decision for any adjustment to SONI's maximum regulated revenue.

3. Excluded SSS/TUoS Costs

42. Under paragraph 8 of Annex 1 of the Licence, the Licensee may make a claim (to the Authority) for costs and revenues of the Licensee (whether a positive or negative amount) to be treated as excluded TUoS/SSS costs.
43. SONI provide several commentaries of the proposed Licence modifications.

3.1 SONI Response

44. SONI commented within its correspondences that in some circumstances it is not appropriate for the UR to propose to rely on the Dt term to enable SONI to recover its costs as neither SONI nor third parties would be afforded the opportunity to appeal, the UR decisions on Dt, under the Electricity Order. SONI also comments on the Competition's Commission decision on NIE with regard to the use of ex-post approvals under the Dt term.
45. In its response SONI observes that there are repeated references in paragraph 8 to the Transmission Owner Licence including under paragraph 8. (a), paragraph 8.1(b) and paragraph 8.3(c). SONI objected to the UR including a reference to another regulated entity's licence within Annex 1.
46. SONI also objected to the deletion of existing paragraph 8.1(f). In particular, SONI noted that it is acknowledged (at paragraph 440 of the Final Determination) that Moyle Interconnector Administration Costs are likely to form Dt claims by SONI.
47. SONI objected to the proposed modification to paragraph 8.1(b), where a new provision in relation to I-SEM implementation costs is limited to costs *'pursuant to any changes made to such arrangements for the purpose of implementing'* the I-SEM.
48. SONI objected to the inclusion, in paragraph 8.2(a) of the proposed licence modifications, of a requirement that (in making a claim pursuant to paragraph 8.1) that SONI must ensure that it takes account of, and gives regard to, the Final Determination.
49. SONI objected to the inclusion, in paragraph 8.3 of the proposed licence modifications, of a requirement that submissions for approval under the Dt mechanism must be made to the UR no later than the first day in April immediately preceding the year in respect of which SONI wishes the claim to take effect.
50. SONI also requested clarification on non-system services elements of the wider DS3 programme.

3.2 UR Response

51. The UR notes SONI's concerns that it cannot appeal a decision made by the UR in response to a Dt submission. However, this does not mean that there is no mechanism by which SONI can challenge the UR's decision. The Dt mechanism is considered by the UR to be an appropriate mechanism to allocate uncertain costs. The mechanism is in the current Annex. Any rights which are available to SONI in respect of a decision made by the UR under the existing mechanism continue to be available in respect of any decision that may be made under the proposed modification. SONI's rights are not affected by the changes proposed to Dt.
52. Within Annex 1 the 'Transmission Owner Licence' means the licence held by Northern Ireland Electricity Limited which has effect under Article 10(1)(b) of the Order (to participate in the transmission of electricity) pursuant to Regulation 90(1)(a) of the Internal Markets Regulation. With regards to references within paragraph 8, the Transmission Owner Licence are currently referenced in the existing Annex, and the UR proposes to keep the references as a matter for consistency and clarity purposes to the extent that there is no double counting and the costs are not recovered under other licences.
53. With regard to the deletion of paragraph 8.1(f), the purpose of this paragraph was to make specific provision for a Dt claim to be made in light of financing costs resulting from the misalignment between the Relevant Year under the licence and the relevant year under arrangements relating to the Moyle Interconnector. By virtue of the Deed of Amendment (dated 30 September 2013), this misalignment has been removed. The need for this specific provision no longer exists.
54. The removal of paragraph 8.1 (f) does not prevent SONI submitting claims in respect of Moyle Interconnector Administration Costs, which may be submitted in accordance with paragraph 8.1(h). Following receipt of any such submission, the UR will, as with any other Dt claim, give due consideration to it and consider whether or not to approve it (taking into account all relevant factors, including its statutory duties).
55. With regards to the proposed modification to paragraph 8.1(b), the UR did not consider there was any substantive difference between the type of costs that may be claimed under paragraph 8.1(b) (i) or (ii), save that in respect of paragraph (i) the costs relate to SEM whereas in paragraph (ii) the costs relate to I-SEM (and in each case subject to the costs in question not already being recovered under or through another route).
56. However the UR has proposed revising paragraph 8.1(b)(ii) to reflect the drafting of paragraph 8.1(b)(i). "*Pursuant to any changes made to such arrangements implementing theI-SEM*" has been replaced with "*under the arrangements implementing theI-SEM*". This should provide clarity for recovery of additional

costs (once assessed and approved) that SONI may incur in implementing the I-SEM arrangements.

57. With regards to paragraph 8.2(a) the UR considers the obligation in this paragraph to be reasonable and appropriate as in calculating the claim submission SONI should have regard, to the extent appropriate and relevant, relevant regulatory policy documents which will help inform its decision-making processes in respect of making such a claim, along with other relevant factors, before reaching a decision to submit a Dt claim to the UR.
58. In relation to paragraph 8.3, the UR has decided to keep the first day in April on the application of time period for submission of information and claims; however the UR has also decided to revise this provision such that it requires SONI to use its best endeavours to make the claim by the date stated. We have therefore updated 8.3(a) to state that any claim made by the licensee pursuant to paragraph 8.1 shall "*be submitted by the licensee, using best endeavours, by*"..... We have also modified Paragraph 8.3 (c) to relate to costs not recovered (*or recoverable*) under *any other provision of this licence*..... This is to allow SONI the ability to make a claim for recoverable costs under the licence provisions within this licence.
59. All claims made submitted under 8.1 require the UR's' approval before they become effective within tariffs. It is in all parties' interests for submissions to be received by a particular point for our consideration so that they can be determined prior to the commencement of the Relevant Year. The UR considers that for the licensee to use best endeavours to submit by the first day in April will enable sufficient time to the Regulator to conduct the appropriate for checks and balances for the costs to be implemented into the relevant tariff year.
60. A claim can still be submitted after the first of April but may be at risk of not being approved in time for the tariff year if the relevant information has not been provided and/or if it has not been evaluated/confirmed in good time to be reflected within the tariffs to be set. Furthermore, the alternative to requiring approval would equate to a simple pass through with no checks and balances in place as to the legitimacy of the costs incurred and would not be in the public interest.
61. SONI will need to provide the UR with all the relevant information that it reasonably requires to make an assessment to ensure that the request is in the public interest and that the requested costs are to be efficiently incurred.
62. We have also revised (where appropriate) 8.1 to include the text "*(or likely to be incurred)*". This is essentially to confirm and clarify that where relevant and appropriate, a Dt claim may be made are not only for costs that have already incurred but also costs that SONI considers it is likely to incur going forward (in essence its forecast of costs).
63. We have also modified a number of paragraphs, including 2.2 (a)(iii), 8.1(a),

8.1(b) and 8.1(f) to replace “*not recovered under another part of the licence*” with “*not recovered under any other provision of this licence*”. This is to provide confirmation and clarity that costs which are recovered or recoverable under any other provision of the SONI licence. Including any other aspect of the price control, are not costs for which a Dt claim can be made.

64. We have also updated within 8(1) the Transmission Network Pre-Construction Project Dt in regards to undertaking these activities to state “*any reasonable and efficient costs incurred in Relevant Year in undertaking electricity transmission network planning activities associated with a Transmission Network Pre-Construction Project*”

65. With regard to costs relating to the non-system services elements of the wider DS3 programme, SONI would have to demonstrate that the “non-system services” element of DS3 is part of the DS3 System Services programme. It would also have to demonstrate that such costs are not recovered or recoverable through the IS capital expenditure allowed for within the price control. For the avoidance of doubt this does not prevent SONI from claiming additional “*non-system services*” as part of the DS3 Dt request. Following the submission request, as with any other Dt claim, the UR would give due consideration to it and consider whether or not to approve it (in accordance with its statutory duties).

4. Network Planning function

67. As part of the implementation of IME3 in Northern Ireland, the SONI⁶ and NIE⁷ transmission licences were modified on the 28th March 2014 to transfer the responsibility for planning the network from NIE to SONI.
68. A number of roles have been identified as relating to this function which includes advancing pre-construction projects. Based on SONI's business plan submission SONI has estimated that over the next price control period it will spend approximately £25 million on pre-construction network projects, equating to c£5 million per annum.
69. As stated in the Final Determination, as a general principle the UR's view was that the consumer should not be materially impacted by this transfer of network planning function from NIE Networks to SONI. We also acknowledge that these transferred staff are additional TUPE costs that are inherited from NIE Networks and are required to be covered within SONI allowances. Within the paper the UR also decided to split the funding of the network planning function between OPEX and CAPEX.
70. OPEX allowances reflect the day-to-day business as usual cost associated with network planning whereas the pre-construction projects would be treated as CAPEX via the pre-construction Transmission Load/Capacity Related (TLCR) project provision. Furthermore, it was also decided that the 50/50 risk share mechanism would not apply to the CAPEX pre-construction project costs.
71. The approved amount for each pre-construction project would be capped at a maximum amount (determined by the Authority) and only actual costs (up to that cap) that are efficiently incurred should be recovered either via the SSS tariff or the TUoS Tariff, depending on whether the project is ultimately constructed.
72. Costs associated with the pre-construction projects would accumulate on a separate RAB and attract a return until such time as they transfer to NIE Networks for construction or the project does not progress and is remunerated through the SSS tariff, after approval from the UR.
73. It was also stated that the UR would continue to work with both SONI and NIE Networks in relation to pre-construction and D5 construction projects. The inter-relation between the SONI and NIE Networks' price controls requires a high level of co-operation between NIE Networks and SONI. The UR would seek to regulate this

⁶ http://www.uregni.gov.uk/uploads/publications/SONI_Transmission_Licence_-_Clean_with_IME3_Modifications_Effective_from_28_March_2014.pdf

⁷ http://www.uregni.gov.uk/uploads/publications/NIE_transmission_Licence_-_IME3_Modifications_-_effective_28_March_2014.pdf

on the general principle that the consumer should not be materially impacted by this transfer of network planning function from NIE Networks to SONI.

4.1 SONI Response

74. SONI had a number of concerns over the UR's requirement for 'prior approval' of SONI expenditure. These concerns included:
 - a. progressing compliance with network planning standards,
 - b. the UR's general duty to secure that SONI is able to finance the activities which are the subject of obligations imposed on it , and
 - c. the UR's approval would lead to an extension of the overall timeline.
75. SONI commented that any such requirement for approval could fetter SONI's ability to fulfil its statutory and licence obligations
76. SONI also commented there is no express reference in the Licence obliging SONI to seek prior approval of costs, nor indeed concerning the advancement of projects in principle.
77. SONI have also requested clarification on how the network planning should work under the price control and that all efficiently incurred costs associated with its obligations in respect of transmission network planning, including the advancement of pre-construction activities will be provided on a pass through basis.
78. Within the licence drafting SONI also observed that the definition of Transmission Network Pre- construction Project includes the words "*and where required approved by the Authority*" in parenthesis. SONI questioned whether the Authority intends that this applies only in circumstances where the project has been identified by the Transmission Owner.
79. SONI submitted that "and where required by the Authority" should be deleted as the Authority does not, in SONI's view, have the right to approve such pre-construction projects.
80. SONI commented on the risk profile associated with them undertaking the pre-construction profile, given its interpretation of paragraph 489 of the Final Determination that where an approved amount for each pre-construction project will be capped at a maximum amount (determined by the Authority) and only actual costs (up to that cap) that are efficiently incurred should be recovered, then it is fully at risk and exposed to costs in delivering this activity.

81. SONI also asked about which funding arrangements would be relied upon in the event that it should exercise its step in rights (as it believes is provided for in paragraph 60 of the EC Decision⁸).
82. SONI have also stated in a wider comment that the price control does not allow for recovery of the entirety of the inherited costs that SONI will incur in undertaking the role of exercising the network planning function, in particular to the costs associated with the TUPE (Transfer of Undertakings (Protection of Employment)) amount with regard to the OPEX personnel.

4.2 UR Decision

83. With regard to the wording of “*where required approved by the Authority*”, it is expected that the costs of all projects whether they are initiated by SONI or NIE Networks would need to be approved by the Regulator. We note SONI’s comments and have modified the definition of a Transmission Network Pre-construction project to clarify the position such that it now reads that it means a transmission network project;
“(a) identified, by the Licensee or the Transmission Owner as a project which is necessary for the purposes of developing the transmission system;
(b) in respect of which the Licensee is, as the Transmission System Operator, responsible for carrying out activities required to progress the project from the conceptual design stage to, but not including, the construction stage; and
(c) approved by the Authority, following a submission by the Licensee for such approval, as a project in respect of which the Licensee may proceed to carry out the activities referred to in paragraph (b) above “
84. SONI is a regulated company and accordingly a level of oversight must be maintained which is in the public interest and for the protection of consumers. Work associated with developing the transmission system is carried out by SONI as part of its licenced activities and therefore the UR is well placed and entitled to determine whether SONI should be permitted to recover the costs associated with these activities.
85. The UR does not consider it appropriate that the costs associated with these activities are recovered on a pass through basis. SONI will be required to obtain the UR’s approval in relation to costs of any and each project that is considered to be necessary for the purposes of developing the transmission system.
86. In carrying out the approval review, the UR would make a fresh assessment of the costs of the project, as there may be substantial changes to the nature or scope

⁸ <https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/commission%20decision.pdf> - Paragraph 60 “If NIE is unable to finance required investments; it is open to the Utility Regulator to bring in another entity, including SONI, to realise and own such investments.”

of the project since it was included in SONI Forecast CapEx (Phase 2) Project list that the UR used for this price control.

87. The UR will need to consider the following as part of its decision-making:
 - whether SONI (or NIE networks if relevant) has already received some funding in relation to the project as part of the expenditure allowances used to calculate their respective price control;
 - an assessment of whether a proposed project is in the interests of consumers. The project assessment will include consideration of alternative options including
 - operational measures that can avoid or delay the need for network investment, and
 - the possibility of delaying a decision on the proposed project until more information is available on its need and appropriate design;
 - a determination of an appropriate upfront cost allowance (including contingencies); and
 - the potential use of agreed delivery dates or milestones for the project, financial penalties for late delivery will also be considered if appropriate and in the public interest.
88. SONI is regulated through the licensing regime and the price control framework. The UR approves the tariffs that regulated companies submit for approval, non-approved allowances would not be considered for tariffs as they have not had the appropriate provision to deem if they are an efficient spend that consumers should be paying for.
89. Therefore only approved amounts provided to the licensee through the price control or through its mechanisms (e.g. a sharing mechanism or a Dt,) within the price control would be considered for tariffs. Approval therefore should be sought before investment expenditure is incurred.
90. The pre-construction projects would be submitted in a similar format and process to when NIE Networks requested pre-construction requests for transmission projects, including normal levels of contingency. An initial high level preconstruction Cost Benefit Analysis will be submitted for UR consideration and approval.
91. Previously when this activity was undertaken by NIE Networks, the costs were set on each submission with the regulated company spending up to the cap. While assessing the case by case submission may bring an additional level of regulatory work, it also brings in a level of certainty in addressing potential excessive costs concerns, is adaptable and flexible for each project, brings a degree of efficiency on the regulated company, and also ensures scrutiny so that customers do not pay for unnecessary investment.
92. SONI commented on the risk profile associated with them undertaking the pre-construction profile, and having a capped upper limit to a project. We have reiterated

to SONI that it has the ability to submit additional Dt claim(s) if unexpected costs develop beyond the upper cap. As with any other claim under the Dt provisions, if such claims were to be submitted then the UR would assess it to determine if it is in customer interest and make a decision on whether or not to approve it accordingly.

93. As stated in the Final Determination costs associated with pre-construction of TPCR projects, being planned by SONI, will also accumulate on a separate RAB until such time as the project receives the UR's approval to transfer the project to NIE for development or the project is deemed no longer viable. Each of these projects will be subject to case-by-case approval before costs associated with the project can be accumulated on a separate RAB. Only amounts approved by the UR will either be added to the SSS tariff (if not progressed) or transferred between SONI and NIE Networks.
94. The elements of these Dt submissions that relate to the CAPEX TUPED staff are not currently allowed for within this price control as these Dt costs have not yet been submitted but the UR accepts that these staff costs will need to be accounted for and will consider these costs within any future submissions. We will also consider the pensions element of these CAPEX TUPED staff within the upcoming pensions consultation paper.
95. With regard to step in rights (as referred to in paragraph 60 of the EC Decision), if the situation arose, the UR would be publicly consulting on whether SONI or another third party can act as either constructor or asset owner of the associated network development. This is to ensure that the process is transparent and the Northern Ireland customer is protected. If further licence modifications are required to facilitate these arrangements for any licenced company, these will form part of that public consultation.
96. With regard to the OPEX Transfer of Planning TUPE staff, the UR identified an appropriate allowance with regard to staff allocated to this role. While SONI disagreed with this, we acknowledge that the actual staff transferred are additional TUPE costs that SONI have inherited from NIE Networks and we have taken that into account, based on the age profile of the staff (some of the staff will be retiring within the price control period), we have determined that the costs allocated to these roles should be sufficient to cover the cost of the staff for this activity for the period.
97. The UR will continue to work with SONI to finalise and agree the process to be adopted and followed for network pre-construction Transmission Load/Capacity Related (TPCR) project approval.

5 Cost & Outturn Reporting

98. The UR proposed to enhance the monitoring of the SONI TSO business and therefore the UR's introduction proposed cost reporting measures to cover this price control and beyond.
99. It was proposed that the overall objective was to bring together in one source actual outturn information (in nominal terms) which draws on the existing requirement of annual audited regulatory accounts, notes and statements, price control information including network pre-construction projects, 'Dt' outturn, Ancillary Services outturn and other tariff information. This annual information was to benefit the UR's workstreams including SONI Regulation, Network Projects, Ancillary Services review, Dt cost review and the annual tariff process.
100. The UR published reporting templates at the same time as publication of the Final Determination, whereby the templates were included at Appendix B of the Final Determination⁹.
101. The Final Determination Paper also stated that the 31 March of each year was an appropriate timeline for SONI to submit the annual cost reporting information for the previous (i.e. most recent) relevant year ending 30 September. Also in paragraph 4.2 of the Annex it was proposed for SONI to provide the information to the UR at least 4 months (unless otherwise approved by the UR) prior to the date that the change in the SSS/TUoS Charges is intended to take effect.

5.1 SONI Response

102. SONI commented that these modifications place a significant and unjustified burden upon SONI, because in certain circumstances it is reliant on third parties (such as NIE) to provide information to SONI, and these parties may not have an obligation to provide information to SONI. Therefore SONI objected to the modifications. SONI also proposed that the current timeframe of "14 days prior to the date of publication of such charges" be reinstated.
103. SONI also queried the inclusion in paragraph 4.9 of the proposed licence modifications of a requirement that information in respect of Dt costs should be provided to the Authority by no later than 31 March preceding the start of that Relevant Year t for which SONI is or will be making a claim. SONI considered that it would be impossible to comply with the provision, because the paragraphs relating to Dt claims provided for it only to make a claim in respect of incurred costs (i.e. after the event).

⁹ <https://www.uregni.gov.uk/publications/decision-2015-2020-price-control-soni>

104. SONI also objected to the inclusion, in the report section paragraph 10.1 of the proposed licence modifications, to a provision requiring it to provide the UR with all information requested in association with Annex 1, in such format and by such time as the UR may from time to time direct.

105. It considered it inappropriate for the UR to seek to request information from SONI which may not have been retained or collated by it in the format being requested. It also asked it should, following publication of the finalised reporting template, be accorded reasonable time to implement the systems and templates for preparation of data. This is on the basis that the reporting template in its current format requires information to be collected by SONI, which SONI does not currently collect and in respect of which no revenue provision has been provided for in the proposed price control

5.2 UR Decision

106. Provision of information in relation to Regulated SSS/TUoS Revenue should be provided for in a transparent and comprehensible manner and adequate notice of any intention to modify conditions needs to be provided within a reasonable time to give consideration to it.

107. The UR is aware that the production of certain information may be reliant on third parties outside the control of the regulated company. The UR also notes that SONI may not have all the information required to submit a finalised Dt submission. The UR has therefore revised the licence modifications so that SONI is required to use its best endeavours to submit the relevant information to us by 31 March.

108. The UR considers that regulated and licensed companies should use “*best endeavors*” to provide information as soon as is reasonably practical to ensure appropriate amount to time to effectively consider any proposed changes on behalf of consumers, therefore we have decided to change the relevant paragraph (now paragraph 4.8 in Annex 1) so that for SONI to submit to the Authority, “*its best endeavors to*”.....

109. With regard to information to be provided to the Authority in respect of changes to SONI's tariffs, we had through paragraph 4.2 proposed that timeframe should be 4 months prior to the date the change was to take effect. SONI requested that this been reinstated to 14 days. Having considered this request the UR has decided to redraft paragraph 4.2 so that the relevant time “*shall be one month prior to the publication by the Licensee of such charges*”. The reason that we have decided on at least one month is with regard to the Directive 2009/72/EC, in particular Annex 1 Measures on Customer Protection 2 (b)¹⁰. The UR considers one month to be a

¹⁰ Annex 1 Measures on Customer Protection 2 (b) ensures that customers “*are given adequate notice of any intention to modify contractual conditions and are informed about their right of*

reasonable period to enable transparent and comprehensible customer information for publication of such changes.

110. Appendix B in the Final Determination set out the detailed cost reporting templates which are due to be completed annually by SONI and will inform the UR of the annual adjustments for the risk share mechanism. Under the proposed licence condition, the UR is required to determine, in accordance with its statutory objectives and duties, the information it would be appropriate for SONI to report and to what timescale.
111. Reporting volume information on an annual basis, rather than leaving it to the next price control review, will help to reveal and resolve any problems or concerns as to the reliability and consistency of data reported.
112. An increase in the quality of standardized data reporting will further enable SONI to be compared with other regulated entities; it will provide all stakeholders with more transparency and greater confidence about how SONI is performing which is in the public interest.
113. As stated in the Final Determination, the UR agrees that the required reporting should be targeted and proportionate. Regarding Paragraph 10.1 the UR does not accept that the proposed licence modification is inappropriate, or that there has been insufficient consultation in relation to its introduction. Further, there is nothing ex-post in the proposed licence modification. It is entirely in line with good regulatory practice for the UR to require SONI to provide annual outturn reporting. However the reporting request should be as “*reasonably*” directed by the Authority and therefore we have also included this wording in the reporting section within the Annex.
114. SONI will also be required to report its outturn activities annually on each project to a reporting template in conjunction with NIE Networks, to enable the UR to obtain a complete picture of each D5/transmission project at a pre-construction and a construction level.
115. It should be noted that the whole Price Control period needs to be reported upon; we understand that SONI may not have historical data collected in our format but the initial years can be based on best estimate and confidence levels. We will liaise and work with SONI to outline and agree the steps that SONI would take over time to develop and improve its reporting and transparency.

withdrawal when the notice is given. Service providers shall notify their subscribers directly of any increase in charges, at an appropriate time no later than one normal billing period after the increase comes into effect in a transparent and comprehensible manner.....”

6. Financeability

116. This section gives consideration of SONI's further responses to the UR's assessment on Financeability and the appropriate level of WACC to apply.
117. As stated in the Final Determination, the approach taken within the Final Determination reflected the approach and focus adopted by other regulators when considering financeability. The UR continues to conclude the existing RAB * WACC regulatory framework remains appropriate.

6.1 SONI Response

118. SONI commented on the financial ratios which the UR employed in its overall assessment of financeability. SONI commented that the revenues provided for in the model are not however consistent with those now proposed to be codified in the Licence.
119. SONI also commented that paragraph 328 of the Final Determination, stated, with reference to the WACC, that "*the pre-tax WACC calculation amends the above formula [the vanilla WACC] to uplift the cost of equity to allow for corporation tax liabilities.*" SONI believes that by applying the taxation uplift to the real cost of equity, the Authority has not provided for a WACC formula which gives effect to this stated intent. It stated that as tax is a nominal cash flow, the indexation of depreciation generates an additional tax liability which cannot be offset against the revenue allowance, as the capital allowances used to calculate the revenue allowance for taxation are based on historical-cost asset values.
120. SONI stated that this additional liability should be reflected through a taxation uplift to the nominal cost of equity instead of the real cost of equity in the WACC formula and that the Authority should reflect this by making the necessary modifications to the Licence.

6.2 UR Decision

121. In setting price limits the UR considered the appropriate WACC that SONI should earn on its Regulated Asset Base (RAB). The UR has monitored regulatory decisions and has considered the Tax issue along with similar regulatory decisions¹¹.
122. With regard to concerns relating to the financial ratios which the UR used in its overall assessment of financeability and those in the proposed licence modifications,

¹¹ https://www.uregni.gov.uk/sites/uregni/files/media-files/2016-09-15_GD17_Final_Determination_-_final_1.pdf

we confirm that the difference between the figures is due to the inclusion of costs forecast to be recovered under the Dt mechanism in the financial model which was published alongside the Final Determination, whereas the licence did not include these costs in the revenue projections as at that time they were forecasts and not approved.

123. As stated in the Final Determination the UR recognises that SONI is an asset light business with a high level of operational gearing. As the SONI TSO business has a relatively small RAB the UR has decided to remain consistent with its approach for SONI and therefore will continue to use a pre-tax WACC.

124. The UR has also considered SONI's comments to this type of treatment in relation to other regulatory decisions¹². In the Final Determination the UR made a number of amendments including, raising the WACC to 5.9% reflecting SONI's risk profile and providing 2% above LIBOR if SONI under-recovers from tariffs and providing costs for accessing a debt facility, because of this the UR considers that WACC formula in the Final Determination is appropriate for SONI.

125. In further correspondence SONI also commented on their funding requirements in particular the Parent Company undertaking and the costs associated with this facility. As part of the review process we assessed that the facilities that SONI have in place are for the benefit of the SONI market operator business and that the market operator price control provides some remuneration for them.

126. However, if focused evidence is provided that provides clear identification of requirement of contingent capital to the system operator business that is in the public interest then we will consider this in line with our duties.

127. This is an area that is also under consideration as part of the I-SEM project and further consultation will take place on this topic. This will include consideration of the need SONI have identified within their submission to the Price Control licence modifications.

¹² See, for example, CAA (2014), Estimating the cost of capital: a technical appendix to the CAA's final proposal for economic regulation of Heathrow and Gatwick after April 2014, paras 7.103 to 7.107.
<http://publicapps.caa.co.uk/docs/33/CAP1115.pdf>

7. Change of Law

128. In the Final Determination we proposed licence modifications which had proposed changes to section 6 of the Annex 1, including the deletion of paragraph 6.3 and proposing new drafting which involved the inclusion of Legal Requirement and Relevant Change of Law into the definitions table of Annex 1.

7.1 SONI Response

129. SONI objected to the modifications and proposes that the paragraph be revised as follows: "*The licensee may request that the Authority determine that there has been, or is likely to be, a Relevant Change of law which has had, or is likely to have, a material effect on the financial position and performance of the Transmission System Operation Business*".

130. SONI commented that the deletion of the provision removed the right of SONI to challenge any determination in relation to Change of Law and that the provision did not require the UR to consult before making a determination under paragraph 6.1. SONI also raised a concern that the proposals to make licence modifications in respect of changes of law have not been the subject of adequate consultation.

7.2 UR Decision

131. Having considered these concerns, we have determined that the proposals to make licence modifications in respect of change of law should be the subject of further consultation. Therefore we no longer propose to make changes to the existing licence provisions in respect of change of law as part of the licence modifications which are made following this decision.

132. Within Section 6 of Annex 1 we have therefore reverted to the text in the previous Annex 1 and will shortly issue a further consultation paper to give stakeholders the opportunity to consider future modifications in this area.

8. Pensions

8.1 SONI Response

133. In SONI'S response to the Final Determination, it raised concerns in respect of the consultation process the UR had engaged in and the proposed licence modifications relating to pensions.

134. These concerns were in relation to whether there has been adequate consultation in some specific areas relating to pensions.

8.2 UR Response

135. While the UR does not necessarily share SONI's concerns, we have determined that it would be appropriate to consult further in some specific areas to allow stakeholders a further opportunity to provide additional information.

136. We will therefore consult further by way of a separate, additional consultation which encompasses our proposals in respect of pensions. Accordingly, in respect of the licence modifications which are to be made by way of this decision, we have reinserted the Pensions cost element back into paragraph 8.1 relating to "Excluded SSS/TUoS costs".

137. Therefore there following has been reinserted into Annex 1 8.1 (as paragraph (d)) *"the pension costs (in Relevant Year t) of the Transmission System Operator Business to the extent not recovered under any other provision of this Licence;"*.

138. We have also decided not to include proposed new paragraph 4.8 which related to the provision of information regarding pension deficits, such that it was to be provided in line with information submitted by the Great Britain network operators.

139. Furthermore, as we have been provided with the initial results of a further actuarial valuation as at 31 March 2016, we consider that it would be beneficial to consult further on pensions more generally, including both the ongoing contributions (Opex) and any additional pension deficit occurring from 1 April 2015.

140. These elements will be reconsidered in the further consultation which will be issued shortly.

9. Other clarifications

9.1 Dispatch Balancing Costs (DBC) incentive

141. Within the Final Determination licence modifications we provided certainty in relation to the percentile target levels in calculating the Dispatch Balancing Costs success and failure amount. This was a proposed change was in relation to the Dispatch Balancing Costs (DBC) Incentive.
142. SONI commented that the Authority was seeking to modify the percentages referred to in paragraph 2.2(f)(iii)(A) and (iv)(A) and to insert the word "whole" and lodged its objection to this calculation. SONI stated that the modification is inconsistent with the SEM Committee decision on DBC Incentivisation in June 2012 - Incentivisation of All Island Dispatch Balancing Costs, SEM-12-033¹³ (the Incentivisation Decision) and that it has been recovering partial amounts since 2012 and has stated that there is no reason why it should not continue to do so.
143. The Incentivisation Decision is very clear that where SONI's actual balancing costs are the relevant target it will be permitted to retain 10% of every 2.5% that it is below the target and that where such actual costs are above the relevant target it will be subject to a penalty which is 5% for every 2.5% that it is above the target. As DBC costs represent nearly 100% of the Imperfections Allowance, a significant cost of which is passed on to the all-island customer, it is in the customer's interests to provide certainty and clarity as to the costs that they are paying.
144. Given that SONI appears to have misinterpreted the Incentivisation Decision and the current licence provisions reflecting that decision, it is necessary to make the proposed change as it provides such certainty and clarity on the way in which the relevant amount is to be calculated and is entirely consistent with the Incentivisation Decision.

9.2 Condition 12 SONI Independence

145. Condition 12 of the licence requires SONI to maintain the full operational independence of its TSO business. SONI has raised a number of questions regarding the meaning and effect of the condition as it applies to the governance of the company and the management of its operations.
146. As stated in the Final Determination the UR agrees that, in the light of the

¹³ <https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-12-033%20Decision%20Paper%20on%20Incentivisation%20of%20All%20Island%20Dispatch%20Balancing%20Costs.pdf>

questions raised, these are matters at which it needs to review and consider in order to ensure that the obligations under Condition 12 are clear and certain in their application to the present circumstances.

147. SEM-16-041¹⁴ also notes that the UR will progress additional work to clarify the independence requirements in both the SONI System Operator and Market Operator licences. The outcome of this reconsideration of the licence conditions is likely to result in proposals for licence modifications to be made to Condition 12 of the Licence during the price control period.

148. Any additional costs likely to be incurred by SONI in consequence of any modifications made to Condition 12 and taking effect within the price control period could be recoverable by use of the Dt mechanism. However, we are also willing to consider an interim reopener of the price control to reflect any changes that would be appropriate for the purposes of reflecting, within the price control mechanism, any such additional costs that may be incurred by SONI. We will consult on matters relating to cost recovery within the consultation on our proposed modifications to Condition 12.

149. The UR looks forward to continuing to work with SONI and other stakeholders in regard to future public consultations within the price control period.

¹⁴ <https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-16-041%20I-SEM-%20DS3%20Mitigations%20for%20Potential%20Conflicts%20of%20Interest%20in%20EirGrid%20Group.pdf>