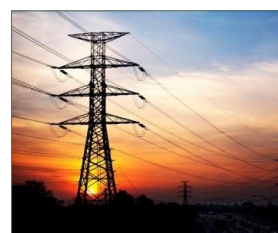


Guidance on the interpretation and application of the Demonstrably Inefficient or Wasteful Expenditure (DIWE) Provision

27 July 2017



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; 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

In its final decision on the licence modifications for the SONI 2015 - 2020 price control, the Utility Regulator (UR) undertook to provide guidance on how the term 'Demonstrably Inefficient or Wasteful Expenditure' (DIWE) would be interpreted and applied.

The DIWE term is also in the NIE Networks Ltd's electricity distribution and the transmission licence.

Certain elements of the revenue which a licensee would otherwise be entitled to recover may be reduced by the UR to the extent that the company's expenditure is held to be 'Demonstrably Inefficient or Wasteful Expenditure'

This information note provides the licensee with guidance on the interpretation and application of the Demonstrably Inefficient or Wasteful Expenditure Provision.

Audience

Regulated Companies; Consumer Groups; Industry and Statutory Bodies.

Consumer impact

SONI and NIE Networks have a pivotal role in terms of 'keeping the lights on' and the effectiveness and efficiency of regulated monopolies is key to industry and consumers.

If and when the Utility Regulator publishes the outcome of a DIWE decision, it will identify the impact of this decision on consumers.

Contents

Contents 1

Introduction 2

The Definition..... 3

The Interpretation of DIWE..... 4

Factors to be taken into account in the application of DIWE 5

The Procedure..... 7

Introduction

1. In its final decision on the licence modifications for the System Operator for Northern Ireland (**SONI**) 2015 - 2020 price control¹, the Utility Regulator (**UR**) undertook to provide guidance on how the term 'Demonstrably Inefficient or Wasteful Expenditure' (**DIWE**) would be interpreted and applied.
2. DIWE is defined in each of the following –
 - (a) SONI's electricity transmission licence,
 - (b) NIE Networks Ltd's electricity transmission licence, and
 - (c) NIE Networks Ltd's electricity distribution licence.
3. In each case, certain elements of the revenue which the company holding the licence (the **Licensee**) would otherwise be entitled to recover may be reduced by the UR to the extent that the company's expenditure is held to be DIWE.
4. The UR intends the guidance provided in this document to be applicable to each of the three licences in which the term DIWE is used.

¹ <https://www.uregni.gov.uk/sites/uregni/files/media-files/SONI%20Price%20Control%20Licence%20Decision%202015-2020%20UR%2014%20March%202017.pdf>

The Definition

5. DIWE is defined in SONI's licence (paragraph 1.1 of Annex 1) as follows –

'[DIWE] means expenditure which the Authority has (giving the reasons for its decision) determined to be demonstrably inefficient and/or wasteful, given the information reasonably available to the Licensee at the time that the Licensee made the relevant decision about that expenditure. For the avoidance of doubt, no expenditure is demonstrably inefficient or wasteful expenditure simply by virtue of a statistical or quantitative analysis that compares aggregated measures of the Licensee's costs with the costs of other companies.'

6. DIWE is defined in each of the NIE Networks Ltd licences (paragraph 1.1. of Annex 2) as follows –

'[DIWE] means expenditure which the Authority has (in a published decision giving reasons) determined to be demonstrably inefficient and/or wasteful, given the information reasonably available to the Licensee at the time that the Licensee made the relevant decision about that expenditure. For the avoidance of doubt, no expenditure is Demonstrably Inefficient or Wasteful Expenditure simply by virtue of a statistical or quantitative analysis that compares very aggregated measures of the Licensee's costs with the costs of other companies.'

7. These definitions are essentially the same. The NIE Networks definition refers to the decisions of the UR being published, and the SONI definition does not. However, the UR can confirm that it would be its general intention to publish any DIWE decision made in respect of SONI. The UR does not consider the other very minor differences between the definitions to be material to their interpretation.

The Interpretation of DIWE

8. The use of the word '*Demonstrably*' serves to reverse the normal burden of proof.
9. Where the Licensee is requesting allowances – whether before the start of the price control period, or by way of approvals for expenditure incurred during it (for instance under the D_t mechanism) – it is usually for the Licensee to show that the allowances that it seeks represent efficient expenditure.
10. However, where the UR decides that expenditure which has already been incurred is to be disallowed as DIWE, the UR must be able to demonstrate that the expenditure which was incurred was inefficient or wasteful.
11. The starting point is therefore that expenditure which is potentially subject to DIWE is presumed efficient; unless and until the UR establishes that it is not.
12. The words '*inefficient*' and '*wasteful*' are not separately defined, and are therefore to be given their natural meaning.

Factors to be taken into account in the application of DIWE

13. Where the UR chooses to inquire into whether certain expenditure may be DIWE, it will take into account all the relevant circumstances. This will include, but may not be limited to, consideration of the following factors, to the extent that they are relevant –
 - (a) The extent to which the Licensee identified and utilised appropriate resources.
 - (b) The process by which any third party contract was procured.
 - (c) The extent to which the Licensee was, or ought to have been, able to control the relevant expenditure, including –
 - (i) whether the Licensee had in place appropriate processes to oversee and control its internal costs;
 - (ii) whether the Licensee had in place appropriate contract management processes to oversee and control third party costs;
 - (iii) whether any of these processes were applied effectively.
 - (d) The information that was reasonably available to the Licensee and/or its third party contractors, at the time that it and/or they made any relevant decisions in relation to expenditure or the control of expenditure.

- (e) The extent to which any expenditure involved an unnecessary duplication of activity on the part of the Licensee and/or its third party contractors.
- (f) The extent to which any expenditure was increased by any material error or mistake on the part of the Licensee and/or its third party contractors.
- (g) The extent to which any expenditure was increased by any avoidable delay on the part of the Licensee and/or its third party contractors.
- (h) The extent to which any expenditure was proportionate to the outputs which that expenditure was intended to, and/or did, deliver.
- (i) The extent to which those outputs were appropriate outputs to be delivered in the context of the project or other activity for which the Licensee was given an allowance (or other form of approval to recover revenue) in accordance with its price control.

13.2 For the avoidance of doubt, where costs allocated to a particular item of expenditure are costs for which an allowance or approval has been made under another provision of the Licensee's price control, the UR will usually regard that expenditure as DIWE.

13.3 In accordance with the definition of DIWE, the UR will not determine any expenditure to be DIWE solely because of a comparative financial analysis of the costs of the Licensee as against those of other companies. However, such an analysis may be one factor which the UR takes into account.

The Procedure

14. The UR will decide in its discretion whether or not to undertake an assessment of whether specified expenditure is DIWE. It may (but shall not be required to) do so in particular where information has come to the attention of the UR that expenditure incurred by the Licensee might be DIWE. It may do so from time to time, by way of occasional audit, in relation to a random sample of expenditure, without any specific information that expenditure might be DIWE.
15. The UR will usually seek to notify the Licensee as soon as reasonably practicable if it decides to assess whether any expenditure is DIWE. However, it reserves the right to carry out an assessment at any time without such notice having been given.
16. The UR will follow such procedures as it considers appropriate in each case for the purpose of determining whether expenditure is DIWE. These may (without limitation) include the use of any audit, assessment or consultation in respect of the expenditure and the conduct of the Licensee and/or its third party contractors in relation to it.
17. In considering whether expenditure is DIWE, the UR will have regard to all relevant information submitted by the Licensee, and may request further information as part of its review.
18. Where it identifies expenditure that it considers may be DIWE, the UR will invite the Licensee to make representations, and will take those representations into account before making its final determination.
19. Where the UR determines that any expenditure is DIWE, it will, in accordance with the definition of that term, provide the Licensee with reasons for its decision.