

# Price Control for Northern Ireland TSO 2020-2025

Final Approach

March 2019



# 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

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 document sets out our approach framework proposals for a price control regulatory framework; our expectations for SONI, the electricity transmission system operator (TSO), to deliver a business plan for its customers, consumers and other stakeholders; and how we will assess SONI's business plan based on these expectations.

# Audience

This document will likely to be of interest to SONI's customers, consumers and other stakeholders

# Consumer impact

SONI's TSO costs which we are regulating typically represent around 2% of Northern Ireland electricity consumers bills (excluding system services). Its service can also impact consumer bills more widely where it affects the wider electricity system.

**Contents**

**1 Overarching framework and approach ..... 3**

- 1.1 Purpose of this document ..... 3
- 1.2 What we want SONI to demonstrate ..... 3
- 1.3 Our process of engagement ..... 5
- 1.4 Guiding regulatory principles ..... 6
- 1.5 UR strategic interactions ..... 7
- 1.6 UR statutory duties ..... 9
- 1.7 Form, duration and scope of price control ..... 9
- 1.8 Business plan expectations and assessment approach proposals ..... 10
- 1.9 Our key framework approach proposals ..... 12
- 1.10 Next steps ..... 15

**2. Our approach and expectations for achieving good outcomes 17**

- 2.1 Overview of key approach and expectations, consultation responses and our consideration ..... 17
- 2.2 Overview of SONI’s TSO services ..... 17
- 2.3 Delivering value for money ..... 19

**3 Our approach and expectations for services and costs .... 22**

- 3.1 Overview of key approach and expectations, consultation responses and our consideration ..... 22
- 3.2 Delivering services and outcomes ..... 23
- 3.3 Securing cost efficiency and managing uncertainty ..... 33
- 3.4 Aligning risk and return ..... 42

**4 Our approach and expectations for trust in delivery ..... 49**

- 4.1 Overview of key approach and expectations, consultation responses and our consideration ..... 49
- 4.2 Engaging customers, consumers and other stakeholders ..... 49
- 4.3 Ensuring resilience and governance ..... 50
- 4.4 Accounting for past delivery ..... 51
- 4.5 Securing confidence and assurance ..... 51

**5 Business plan expectations and assessment approach .... 55**

- 5.1 Overview of key approach and expectations, consultation responses and our consideration ..... 55

5.2	Introduction .....	56
5.3	Our approach .....	56
<b>6</b>	<b>Price control review process and stakeholder engagement</b>	<b>62</b>
6.1	Phases and milestones.....	62
6.2	Ways of working with SONI TSO .....	63
6.3	Stakeholder Expert Challenge Group (SECG) .....	64
6.4	Wider stakeholder engagement.....	66
	<b>Appendix A: Overview of existing price control framework .....</b>	<b>67</b>
	<b>Appendix B: SONI TSO roles and services.....</b>	<b>72</b>
	<b>Appendix C: Business plan assessment test area questions...</b>	<b>75</b>

# Executive summary

The electricity system is in transition, as the way electricity is consumed and produced is changing. There have been significant changes during the current price control period, including the I-SEM and DS3 System Services programme. These significant programmes have been delivered by SONI through collaborative working between the UR, SONI and market participants. The 2020 to 2025 period, over which this price control period will take place, may look very different than today's. There will be opportunities and challenges during this period, and how these are optimised and managed will, to some extent, determine how well consumers' benefit.

The shape and pace of change is uncertain and Northern Ireland (NI) Government policy will be integral to its development. SONI will have a vital part to play in managing opportunities and challenges as part of its Transmission System Operator (TSO) role. It can influence many aspects of the electricity system and so can deliver real benefits for its diverse set of NI consumers, customers and other stakeholders. We want SONI to deliver value for money and trust across its services. We expect it to do so by taking a system wide perspective and also facilitate electricity system wide change in a timely, effective and efficient way, during this period of change.

We also have an important part to play given our role to protect the interests of electricity consumers. One of our most important tasks is determining price controls which make sure consumers receive the best value for money. Our price control process results in an allowance which we provide to the company so it can provide and charge for its efficient services.

Our approach is our first key marker in developing a price control framework to deliver good outcomes for NI consumers from 2020 to 2025 and beyond. We recognise the importance of a predictable and stable price control framework, and so we are proposing to retain what works well. But at the same time, we are also conscious of the potentially significant nature of the changes which may arise during 2020 to 2025 period. So we want to build on the current framework where we feel that achievable improvement, which is based on good practice, would be of real benefit.

A key thread which runs through our framework approach, is our expectation that SONI takes responsibility for ownership of its business plan to deliver good outcomes. Our approach proposes a significant change in the level of quality which we expect from SONI's business plan. We expect SONI to set out a clear, well justified and high quality business plan.

In this context, we recognise the need to set clearer expectations of what we want from SONI and to also hold SONI accountable to its customers, consumers and other stakeholders. As part of our approach, we are giving SONI's consumers and customers a stronger voice to challenge its service proposition (and our framework proposals). We also propose that more can be done to incentivise service quality and performance, whilst ensuring consumers are protected from inefficiency or other poor outcomes. We also propose greater transparency which will be for the benefit of consumers, customers and other stakeholders.

We look forward to engaging with SONI and other stakeholders during the remainder of our price control process. In particular, engagement with the Department of the Economy (DfE) is key due to the role SONI will play in facilitating the delivery of future energy policy.

# 1 Overarching framework and approach

## 1.1 Purpose of this document

SONI provides electricity transmission system operator (TSO) services for the benefit of its Northern Ireland (NI) electricity customers and consumers. As a monopoly business, SONI does not face the same pressures to continuously drive efficiency and improve service and innovate, as a normal business might.

Our role is to protect the interests of current and future NI electricity consumers. A crucial way we do this is by providing SONI with a price control framework which ensures that its TSO interests can be aligned to its customers and consumers.<sup>1</sup> In this document, we are proposing to develop such a framework to deliver good outcomes for NI consumers from 2020 to 2025 and beyond.

We thank stakeholders for their responses to the December 2018 consultation. Our detailed consideration of specific issues which stakeholders raised are set out in the Annex published separately alongside this document. We also set out our consideration of the main points that are relevant to our approach throughout this main section of this document. Some responses made a similar point across a number of different areas of consultation, and so, generally, we respond to these in one place to minimise duplication.

The document sets out:

- our final approach framework proposals for a price control regulatory framework from 2020 to 2025, and beyond;
- our expectations for SONI to deliver a business plan for its customers, consumers and other stakeholders covering the 2020 to 2025 and beyond; and
- how we will assess SONI's business plan based on these expectations (including how we may intervene to ensure SONI's interests are aligned with consumers).

## 1.2 What we want SONI to demonstrate

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<sup>1</sup> We see customers as the direct users of its services who use the electricity system. This is distinct from end consumers (e.g. domestic or business electricity consumers).

The electricity system during 2020 to 2025 period (and beyond) could look very different to today's, as technology changes and we transition to a lower carbon emission world.

We are already seeing signs of this evolution. For example, the distinction between transmission and distribution networks is becoming more blurred.<sup>2</sup> The boundaries that separate consumers, customers and generators are becoming less clear.<sup>3</sup> Disruptive energy technologies, such as electric vehicles, may also change the way consumers use energy and have significant impacts on energy networks. Making the most of these opportunities and managing the challenges facing the electricity system is, therefore, very important for energy consumers.

NI Government policy will be a key enabler and manager of electricity system change. SONI, through its TSO role, also has an important part to play given the breadth and depth of its influence across the electricity system. Its role can affect a large part of the final electricity bill which NI consumers pay.

We recognise that there will be events which are outside of SONI's direct control, and that change which it can influence can sometimes take time to implement. However, where possible, we want SONI to demonstrate that it is taking responsibility for this change, in a way which has the customer and consumer interest at heart. Ideally, the two sets of interest should align across the electricity system.

We set out five objectives for SONI to deliver. We expect SONI to play a major part in demonstrating these to its consumers, customers and other stakeholders, for the 2020 to 2025 period and beyond:

Objective	Overarching expectations
<p><b>Confidence that SONI's service meets customer expectations and is aligned with system wide interests</b></p>	<p>We expect SONI services to be based on customers' needs and expectations, drawing on stakeholder engagement. And we expect SONI to take a system wide perspective in its decision making and also facilitate electricity system-wide change in a timely, effective and efficient way.</p>

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<sup>2</sup>For example, one possible scenario is that in the future more of the balancing of the system, through local generation, storage and demand management, will happen at the distribution level.

<sup>3</sup> For example, the distinction between consumer and what is known as 'prosumer'.

<b>Confidence that SONI is providing high-quality service and performance which improves over time</b>	SONI is a service provider. Therefore, it is essential that customers and consumers benefit from improvements in service quality. We want reassurance that customers and consumers receive high quality service at the levels which they expect and need.
<b>Confidence that costs are reasonable and efficient</b>	We want to ensure that consumers are protected from potential cost inefficiency which SONI may incur in running its TSO business, whilst seeing benefits to consumers from lower tariffs which make up the remainder of the consumer electricity bill (where SONI can influence).
<b>SONI service and cost transparency and clarity</b>	SONI can do much more to make its service and associated costs clearer and more transparent. This is not only helpful to support reasoned, fair and informed regulatory decisions, but is essential for SONI's customers who rely on transparency and clarity to inform their decisions on whether and how to participate in an (ever) faster moving market place. Consumers, in turn, should ultimately benefit from good market decision making.
<b>Confidence that framework provides SONI's investors with a fair package of remuneration and risk</b>	The price control framework for the SONI should represent a financeable package, which covers reasonable remuneration for the costs and risks which SONI bears.

In summary, we expect SONI to deliver value for money for NI consumers and customers across its range of full range of services and costs. Having trust in SONI's ability to deliver is also important.

### **1.3 Our process of engagement**

We are putting more emphasis on engaging with stakeholders as part of this price control. As such, a key input into our approach phase work has been stakeholder engagement.

We set up a new initiative in summer 2018 called Stakeholder Expert Challenge Group (SECG). The aim of SECG is to inform our regulatory expectations and also to provide insight and challenge to SONI as part of its business plan. We have

published material from this, including guidance, on our website.<sup>4</sup> We set out more on SECG and why we have set it up, in chapter 6.

We have held four very productive and constructive, day long, sessions with SECG to date. We have also held a number of useful and constructive bi-lateral meetings with SONI. We would like to thank all these stakeholders for providing helpful input. We have listened to their views and taken account of these within the document. We look forward to continued positive engagement throughout the price control process.

We are conscious of consulting more widely to ensure we take account of a broad canvas of stakeholder views. We will engage with the Department for the Economy (DfE) throughout the price control process. We are particularly interested to understand its views on how its emerging policy may affect our price control framework. We are also interested in the role it sees SONI playing in the energy transition as this will inform its business plan preparation. We will, therefore, engage with SONI and the DfE together over the coming months. More generally, we remain open to meeting all relevant stakeholders and welcome any views on how we can further engage effectively.

## 1.4 Guiding regulatory principles

We expect SONI to take responsibility for ownership of its business plan to deliver good outcomes. We also recognise that we have an important role in setting clear and well-reasoned regulatory expectations to support the price control process. We set out several principles below to act as a guide for our regulatory policy development. These are as follows:

- **Transparency:** we will continue to publish material where this is in the consumer interest to ensure a smooth process and facilitate understanding.
- **Predictability:** we want a predictable price control framework which can act as a platform for further development. We also want a credible, holistic and coherent price control package which is tailored to SONI and which builds on 2015-2020 framework, with well targeted adaptation. While we expect the framework to develop over time, we will seek to avoid unnecessary uncertainty or inconsistency with wider regulatory practice.
- **Proportionality:** as a regulator we recognise the need to be proactive and evaluative. This is particularly important as the energy system changes and we reconsider whether existing approaches remain appropriate. At the same time, we need to be aware of making proportionate changes to the regulatory

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<sup>4</sup> <https://www.uregni.gov.uk/stakeholder-engagement-challenge-group>

framework and of the administrative burden of our regulatory activity. We are considering insights from other regulators, whilst focusing on what is achievable and effective for the SONI TSO control.

- **Accountability:** SONI is accountable for the quality of its business plan and delivering for its customers. But to properly hold it to account we need to be confident that our decisions are well-informed and evidence-based. We have taken steps to introduce effective, positive and meaningful stakeholder engagement to allow more scrutiny of ours and SONI's decision making e.g. SECG. Where necessary, we are also using guidance to improve accountability in the case of this price control. We will also work to ensure there are no delays in the UR formal determination.

We welcome feedback from stakeholders on how our package of proposals meets these principles, during this approach phase and beyond.

## 1.5 UR strategic interactions

We have taken account of wider strategic considerations when considering our approach and framework. In doing so, we have been conscious of aligning our objectives with our existing UR corporate objectives.<sup>5</sup>

We are also conscious of taking a forward looking perspective given our price control period runs from 2020 to 2025. We have, therefore, also taken account of our consultation on our new UR corporate strategy which will overlap with the price control period.<sup>6</sup>

The proposed corporate strategy sets out three strategic objectives for consultation:

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

Our corporate strategy consultation also sets out strategy various drivers. As well as noting decarbonisation and technological drivers, which we have discussed above, it sets out a number of drivers which are particularly relevant to this price control project and SONI's role:

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<sup>5</sup> <https://www.uregni.gov.uk/publications/corporate-strategy-2014-2019>

<sup>6</sup> <https://www.uregni.gov.uk/news-centre/draft-corporate-strategy-2019-2024-published>

- Future energy policy and strategies: a new government policy framework will be required to provide direction after the DfE'S Strategic Energy Framework comes to an end in 2020; and ongoing uncertainty around the terms of the UK's departure from the EU may have negative impacts.
- Utility services and consumers: discusses how consumer expectations will continue to change requiring greater engagement from utility companies.
- Competitive markets: notes how the new SEM wholesale energy market (the ISEM) which went live on 1 October 2018 promotes effective competition.
- Supporting renewables: notes various policy drivers such as the Paris Climate Accord 2015, the EU's Clean Energy Package and the UK government's Clean Growth Strategy, which all set a strategic direction for energy and renewables.
- Security of supply: identifies the need for a secure and reliable supply remains, citing the roles of the construction of the second North South Interconnector and the SEM capacity market.
- Regulatory approach: given the changes and uncertainties, regulators are adopting approaches which are less prescriptive, more pragmatic, and focussed more on principles and outcomes. They are also adopting new approaches to accommodate innovation and a more diverse stakeholder environment.

SONI's TSO role cuts across all of these corporate objectives and drivers to some extent. We recognise the key role which SONI has been playing across many critical recent initiatives aimed at driving good outcomes for consumers. For example, it has a role in the system balancing under our Integrated Single Electricity Market (ISEM);<sup>7</sup> designing and planning the transmission network; and contracting for ancillary services to facilitate increased renewable penetration (developed through the DS3 programme). The TSO role is, therefore, highly relevant to the corporate strategy.

Our price control framework approach and expectations are consistent with, and reflective of, these proposed corporate objectives and drivers (as well as our existing ones). In particular, we want a framework which can support an environment which is continuing to undergo significant change and uncertainty.

Many of our price control proposals on service quality and performance are being proposed with this in mind. We propose to encourage approaches to accommodate the diverse stakeholder environment, as well placing specific expectations on SONI to engage with customers, consumers and other stakeholders. We will continue to be mindful of any position which develops from our corporate strategy process.

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<sup>7</sup> [https://www.semcommittee.com/sites/semc/files/media-files/ISEM%20quick%20guide\\_1.pdf](https://www.semcommittee.com/sites/semc/files/media-files/ISEM%20quick%20guide_1.pdf)

We also note that there may be interactions with SEM decision making, given the nature of SONI's role. We will engage with the SEM committee accordingly where this is the case.<sup>8</sup>

Some consultation respondents asked for clarity on our separate review of the approach to SONI governance. Our work on governance is ongoing and it is our intention to publish proposals for consultation in Q2 of 2019. If there are additional TSO costs for SONI created through from the implementation of any proposals, any such costs can be considered later within the price control process via some form of uncertainty mechanism. We also provide a further expectation under the 'Governance and resilience' test area about the how the high level intention of the governance review relates to SONI's TSO business so as to further assist SONI in its business plan development for the 2020 to 2025 period.

## 1.6 UR statutory duties

Our approach framework and expectations is also consistent and reflective of our statutory roles and duties:

- The principal objective of the UR in carrying out its electricity functions is to protect the interests of consumers of electricity supplied by authorised suppliers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.
- The UR has a duty, in carrying out its electricity functions, to do so in the manner which it considers is best calculated to further the principal objective, having regard to the need to secure: (i) that all reasonable demands in Northern Ireland (NI) or Republic of Ireland (RoI) for electricity are met; and (ii) that licence holders are able to finance the activities which are the subject of obligations under the regulatory framework.
- The (subject to our duty) UR must carry out its electricity functions in the manner which it considers is best calculated to achieve a range of outcomes, including promoting the efficient use of electricity and efficiency and economy in the transmission and supply of electricity.

## 1.7 Form, duration and scope of price control

The existing TSO price control runs for 5 years and is due to end on 1 October 2020. The form is a single revenue cap based control.

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<sup>8</sup> <https://www.semcommittee.com/who-we-are>

We do not propose changing the form and duration of the control. In coming to this view, we are mindful of our framework objectives of predictability and proportionality and we are not aware of a compelling case for a longer or shorter period. We have discussed this with a number of stakeholders who mostly agreed with us (including SONI). Respondents to the December 2018 consultation were also supportive of the proposed duration.

The existing price control framework is set out in Appendix A. For the 2020 to 2025 period, we expect SONI to set out the price control scope<sup>9</sup> clearly and robustly as part of its business plan. In particular, we expect SONI to set out, in detail, the range of activities and services which it proposes should fall within the scope of the TSO control. This should be accompanied with an explanation of why any of its other services or activities should fall outside of the scope of this control.

## **1.8 Business plan expectations and assessment approach proposals**

Our approach proposes a significant change in the level of quality which we expect from SONI's business plan. We expect SONI to really challenge itself and deliver an exceptional business plan for its NI consumers, customers and stakeholders. For our part, we are setting expectations and guidance for a high quality business plan. These will be supported with clear, simple, proportionate yet meaningful incentives to support such an outcome.

We want to see greater business plan ownership from SONI. This is not just about company ownership, but also SONI board assurance, governance, ownership and decision making, to drive the right outcomes for NI consumer and customer expectations. Ultimately, SONI is answerable to its customers and consumers for what it delivers.

We will adopt a proportionate approach. This means that we will have a bias against intervening where we are confident that areas of the business plan are of sufficient high quality and have been well-justified by SONI. However, we will intervene to protect the interest of consumers, where we feel this is not the case, based on evidence provided and our statutory duties. This approach, therefore, provides additional motivation for SONI to submit a high quality and well-justified plan.

The overall business plan will be categorised as either:

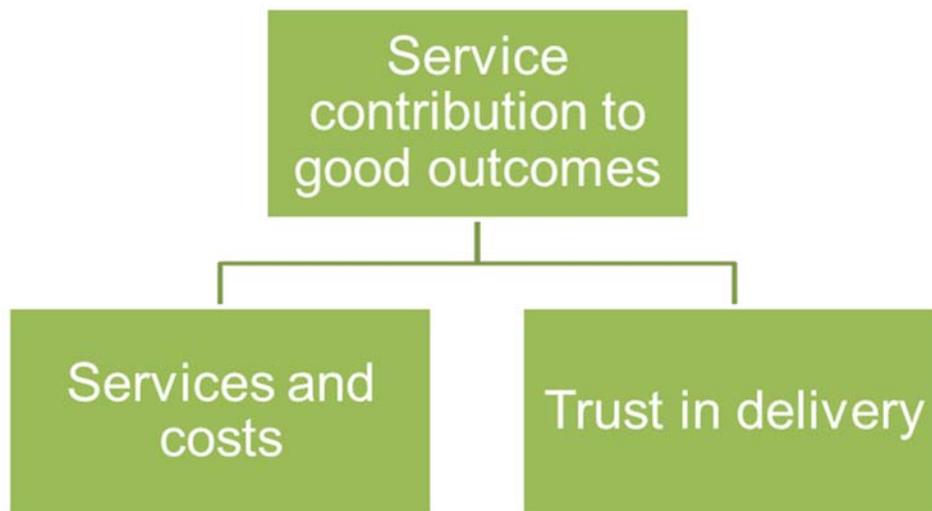
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<sup>9</sup> Our view is that the scope of the price control includes service which is required as part of SONI's TSO licence. This would not include that related to connections (as is currently the case) and Market Operator activity.

- **Exceptional**
- **Good**
- **Meeting basic expectations**
- **Poor**

We are proposing that there would be reputational incentives arising from the regulatory assessment of the business plan. Reputational incentives may also arise from SECG scrutiny and challenge and the potential for more or less regulatory intervention.

We are proposing to assess SONI across a range of different test areas. Our test questions under each test area is set out in Appendix C. We have grouped under three key areas (illustrated below) where we summarise our expectations for how SONI should deliver against these test areas.



### **Service contribution to good outcomes**

What matters to consumers and customers is that they benefit from SONI delivering good outcomes. Customers and consumers want SONI services which deliver value for money across these different outcomes.

- **Test area 1: delivering value for money:** we expect SONI to set out how its wide range of services will affect and deliver value for money its diverse range of consumers, customers and stakeholders. We set our considerations out on page 17.

### **Services and costs**

To achieve value for money across a range of good outcomes, we expect SONI to put forward proposals for service and cost:

- **Test area 2: delivering services and outcomes:** we expect SONI to justify its proposed services, explain how these will achieve good outcomes, and propose stretching but achievable levels of service and performance. We set out our considerations on page 20.
- **Test area 3: securing cost efficiency and managing uncertainty:** we expect SONI to demonstrate cost efficiency and manage uncertainty in delivering its service. We set out our considerations on page 30.
- **Test area 4: aligning risk and return:** we want a price control framework for SONI which represents a financeable package, and which covers reasonable remuneration for SONI's equity investors and any debt finance. We set out our considerations on page 39.

## **Trust in delivery**

Part of having confidence in SONI's service contribution to good outcomes, is for consumers, customers and other stakeholders (including us) to have trust in its delivery. This is not only about what SONI proposes in its business plan and how it has built up its proposition. Rather, it is also about SONI providing reassurance that its business delivers effectively on a consistent basis.

- **Test area 5: consumer, customer and stakeholder engagement:** we expect SONI to engage with the right people and organisations. It should incorporate effective ideas within its business plan and on-going operations. We set out our considerations on page 46.
- **Test area 6: ensuring resilience and governance:** we expect SONI to demonstrate resilience and effective governance. We set out our considerations on page 46.
- **Test area 7: accounting for past delivery:** we expect SONI to account for the past and justify what this means for how it will perform in the future. We set out our considerations on page 47.
- **Test area 8: securing confidence and assurance:** we expect SONI, and its Board, to challenge itself that it has a business which consistently delivers, whether it be through good data assurance and a clear and transparent offering. In a similar vein, we also expect it to be accountable to its stakeholders. We set out our considerations on page 47.

## **1.9 Our key framework approach proposals**

All of our framework proposals are set out within this document. But a summary of our key ones is set out in the table below for ease of reference:

Area	Proposals and expectations	Key changes since consultation
<b>Delivering value for money</b>	<ul style="list-style-type: none"> <li>Propose to take account of how SONI proposes delivering value for money across its TSO service provision in our business plan assessment.</li> </ul>	No change
<b>Delivering services and outcomes</b>	<ul style="list-style-type: none"> <li>Propose to take account of how SONI delivers services and outcomes in our business plan assessment.</li> <li>SONI should be responsible for defining and determining service outcomes and performance commitments (including by taking a system wide perspective and development).</li> <li>SONI should provide more accountability for service quality and performance. It should do so in a way which takes account of a complex and interacting set of services being delivered across an energy system which is in transition.</li> <li>Propose a framework which uses a mixture of financial and non-financial incentives. We also propose to take an on-going evaluative ('in the round') assessment approach. Finally, we propose to make greater use of stakeholder involvement.</li> <li>A flexible but robust approach to innovation which provides allowances at the price control review and during the price control period (subject to meeting certain non-exhaustive criteria).</li> </ul>	No change
<b>Securing cost efficiency and managing uncertainty</b>	<ul style="list-style-type: none"> <li>Propose to take account of how SONI proposes to secure cost efficiency and manage uncertainty in our business plan assessment.</li> <li>An approach to ensure that consumers are sufficiently protected from</li> </ul>	No change

	<p>inefficiency and which manages uncertainty, but which supports good outcomes on performance and service quality.</p> <ul style="list-style-type: none"> <li>• We are proposing to adapt existing cost structures to better balance incentives for SONI to invest and spend where it needs to, while continuing to encourage it to seek efficiencies.</li> <li>• Propose three types of cost remuneration structure to recover different service costs.</li> <li>• Propose (broadly) retaining the existing mechanism for Transmission Network Project Planning (TNPP).</li> </ul>	
<b>Aligning risk and return</b>	<ul style="list-style-type: none"> <li>• Propose to take account of how SONI proposes to align risks and return in our business plan assessment.</li> <li>• A price control framework which represents a financeable package and which covers reasonable remuneration for the TSO's operating expenditure, capital expenditure, debt finance, equity capital and corporation tax liabilities.</li> <li>• An approach to determining the remuneration of the TSO's equity capital and debt finance which builds on the approach from the 2015-20 TSO control and the outcome from SONI's appeal the CMA in 2017; and which gives attention to the different services which the TSO provides and the risks that the TSO faces under the price control framework.</li> <li>• Moving from away from RPI indexation of the TSO revenue control and RAB, and switching to either CPI or CPIH indexation.</li> </ul>	No change
<b>Consumer, customer and stakeholder engagement</b>	<ul style="list-style-type: none"> <li>• Propose to take account of how SONI engages effectively with its diverse range of consumers, customers and other stakeholders in our business plan assessment.</li> </ul>	No change

<b>Ensuring resilience and governance</b>	<ul style="list-style-type: none"> <li>Propose to take account of how SONI demonstrates resilience and effective governance across its TSO business in our business plan assessment.</li> </ul>	No change
<b>Accounting for past delivery</b>	<ul style="list-style-type: none"> <li>Propose to take account of how SONI takes account of past delivery in our business plan assessment.</li> </ul>	No change
<b>Securing confidence and assurance</b>	<ul style="list-style-type: none"> <li>Propose to take account of how SONI secures confidence and assurance across its TSO business in our business plan assessment.</li> <li>Propose that SONI publishes full business plans which are signed off and assured by a SONI Board. If SONI seeks to redact for publication, we would expect strong supporting reasoning.</li> <li>More generally, we are also expecting much more clarity and transparency across SONI's plan across various test areas.</li> </ul>	No change
<b>Business plan expectations and assessment</b>	<ul style="list-style-type: none"> <li>An approach to set clear regulatory expectations for SONI to deliver a high quality and well-justified business plan, and for assessing SONI's business plan (including test areas, categories and incentives to motivate SONI to produce a high quality and well justified business plan).</li> </ul>	<p>Not proposing a financial incentive to encourage a high quality business plan</p> <p>We have further clarified our guidance on the overall business plan assessment. This is especially in relation to the interactions between the Appendix C material and the main categorisation.</p>

## 1.10 Next steps

We set out the key milestones in the table below. We welcome views on our timetable.

2020 to 2025 SONI Price Control	Date
SONI business plan submission	31 July 2019

Draft Determination Paper	December 2019
Final Determination	May 2020
Price Control Commences	1 October 2020

## 2 Our approach and expectations for achieving good outcomes

### 2.1 Overview of key approach and expectations, consultation responses and our consideration

We said that we expect our understanding of SONI's roles and services will be developed and refined over time given their importance to stakeholders and increasing importance under the price control framework. We also said we will take account of how SONI proposes delivering value for money across its TSO service provision in our business plan assessment.

Stakeholders said that SONI's view of the description of its services could be refined and clarified further.

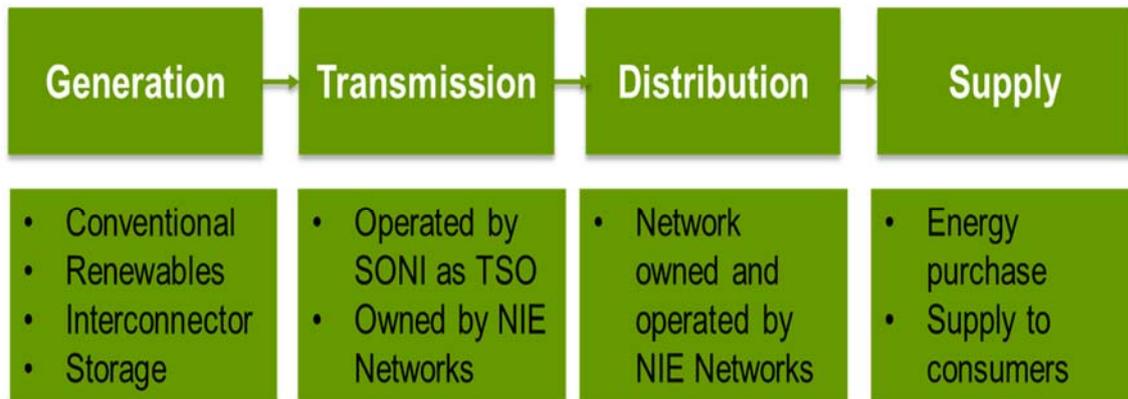
We agree with this and will engage with SONI to discuss how this can be developed for its business plan submission. We also expect SONI to engage stakeholders.

Most stakeholders were supportive of the idea of testing SONI's service proposition for value for money. Stakeholders cautioned that value for money (including allowances) would need to be justified and measured carefully.

We agree that it will be important for SONI to justify its business plan proposals. We also expect SONI to ensure its proposals can be carefully measured. We recognise the nature of SONI's service means value for money requires careful measurement. We expect our framework proposals, for example, on delivering service, securing costs and efficiency and delivering trust, will support accountability.

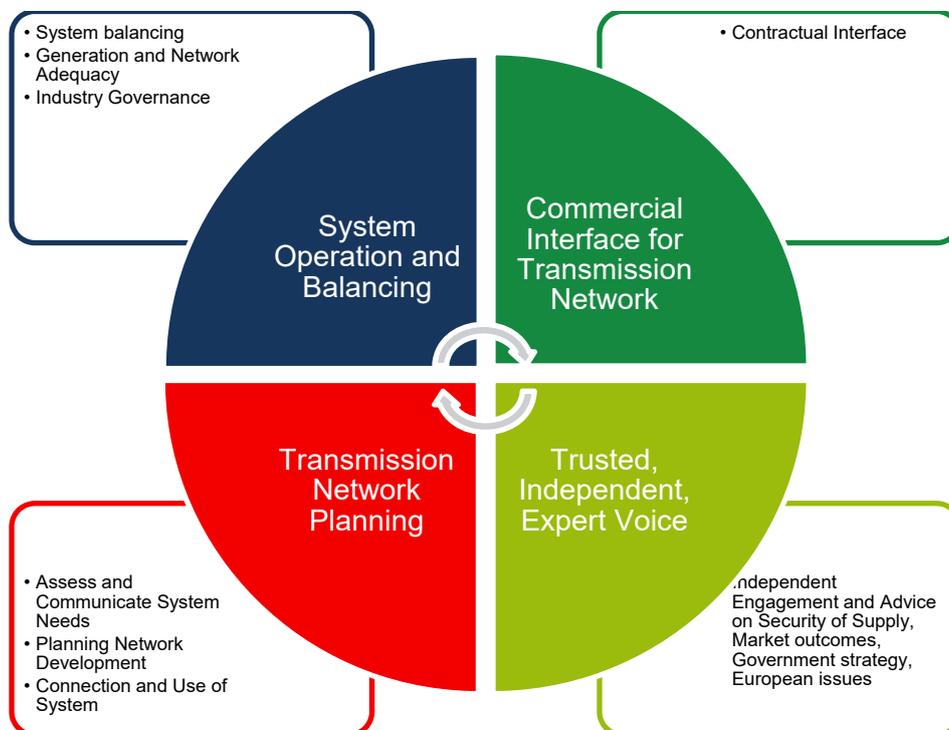
### 2.2 Overview of SONI's TSO services

SONI has an important role to play in influencing good outcomes across the electricity system. The services which it offers and the way they are provided is important to achieving high quality service at an efficient cost. Understanding its service is important for SONI's customers, consumers and other stakeholders, and for us to develop an appropriate price control framework. The diagram below is an overview of the electricity system.



We asked SONI to define what roles and services it provides across the electricity system to support our understanding of how it influences the system and inform our regulatory expectations. An overview of how SONI views its TSO roles and services is set out below. A more detailed perspective is set out in Appendix B.

We recognise that it is complex to define TSO services given that there may be a range of perspectives. We welcome views on what SONI's roles and services are to inform the price control work. We expect that our understanding of SONI's roles and services will be developed and refined over time.



SONI's roles and services are diverse and transcend across the whole electricity system. They are also complex. This complexity not only relates to how they are carried out on a stand-alone basis, but also how they interact with each other and affect a diverse base of customers and consumers. This is especially relevant in the context of an energy system in transition. SONI's primary roles and services include:

- balancing the system, ensuring system security and efficient and priority dispatch (e.g. operating the capacity market and operating the balancing market).
- assessing and communicating the needs of the system (e.g. work on transmission investment plan and future scenarios), planning and developing the network (e.g. options and making decisions on network development), connecting customers and delivering use of system.
- acting as an independent commercial interface for the transmission network; and
- providing independent advice and engaging different consumers, customers and stakeholders across a number of areas.

### **2.3 Delivering value for money**

Our principal objective to protect the interests of all existing and future consumers means that we should encourage outcomes which deliver value for money for consumers.

At the heart of our approach is the idea that SONI should be demonstrating that is delivering value for money for NI consumers in a robust, convincing and clear way. If SONI is delivering value for money, across the whole electricity system, this should mean lower bills for all services which its TSO consumers, customers and other stakeholders need and value.

The way SONI makes TSO decisions across its business is central to delivering value for money across its range of TSO services. SONI decision making and behaviour across its business is influenced by how its business performs across the various test areas set out in this document. This performance ultimately affects how it delivers value for money across all its different services and activities.

SECG highlighted the importance of SONI making clear and well informed decisions with respect to individual TSO service areas. For example, stakeholders sought clarity on how SONI:

- decides where transmission investment is to be located and how it makes decisions in this area to benefit consumers.
- makes decisions to dispatch and balance generation<sup>10</sup>.

As well as being confined to individual service areas, SONI's decision making can also cut across service areas. There are a number of different dimensions to this and the interactions can be complex. Stakeholders gave some examples of this:

- **strategic:** SECG noted the need for SONI to set out its strategic priorities across its various service areas to inform its price control business plan.
- **operational:** SECG noted how the decisions which SONI makes on areas such as network design and planning may also interact with actions it takes in balancing the system and vice versa.

SONI's decisions and actions will inevitably be influenced by the quality of how it responds to many of the test areas which we discuss in this document. To take an illustrative example, the quality and use of its data and customer and consumer engagement may affect how it delivers services and outcomes. There are, therefore, likely to be many linkages and trade-offs across SONI's services and test areas.

SONI decisions and actions can influence a range of different outcomes. Outcomes can be thought of as high level objectives which SONI should deliver for the benefit of consumers, customers and stakeholders. The impacts of its decision making can be long term as well as short term in nature. As the needs and priorities of SONI's consumer, customer and stakeholder base are diverse, they can be affected by SONI's services in different ways.

SONI's customers and stakeholders may be affected by a range of outcomes which relate to their ability to participate in markets or processes effectively. For example, the ability for demand side response stakeholders to participate in the markets effectively.

SONI's consumers can be affected different outcomes (directly and indirectly). For example, these may relate to tariffs which SONI can influence. Consumers may be

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<sup>10</sup> <https://www.sem-o.com/documents/EirGrid-and-SONI-Balancing-Market-Principles-Statement-V2.0.pdf>

concerned with lower energy costs, network costs and constraint costs, as well as other types of costs. They may also be affected by service quality related outcomes which SONI can influence. For example, security of supply and lower carbon emissions.

# 3 Our approach and expectations for services and costs

## 3.1 Overview of key approach and expectations, consultation responses and our consideration

A key part of our approach and expectations for services and costs is our proposals for a framework to incentivise and bring accountable for delivery of TSO performance. Another key aspect are our proposals to adapt existing cost structures to better balance incentives for SONI to invest and spend where it needs to, while continuing to encourage it to seek efficiencies. Finally, we propose an approach to align risk and return.

Most stakeholders broadly agreed with our proposals, or certain aspects of them. SONI welcomed the scope for further incentivisation and also said that it will continue to strive to deliver a high quality service, with well justified and stretching outcomes.

Some of the other main points on our approach and proposals were:

- Our performance framework and performance commitments should also be carefully designed, set and measured, well justified and not overly burdensome.
- test area guidance should not be or lead to an unduly prescriptive approach and/or be too generic (should be tailored to current circumstances)
- approach to financeability should not have an overly narrow focus.

We welcome that most stakeholders broadly agree with the proposals and that SONI will strive to deliver a high quality service, with well justified and stretching outcomes.

We agree that incentives and performance commitments will need to be designed, set and measured in a careful way. Our framework proposals are designed to bring accountability (or sufficient balances and checks) to guard against risks to the contrary. SONI will also have a critical role in this regard through its proposals in the business plan and on an on-going basis during the price control period and beyond.

We also agree that the framework will have to be developed so as to avoid unnecessary burden and so we will continue to give this point careful consideration during the price control process as proposals are further developed.

The guidance is deliberately generic and non-prescriptive. But we disagree that it is not tailored appropriately to correct circumstances. It will be for SONI to demonstrate its case as part of its business plan and during the forward look. We expect it to robustly and critically self-evaluative (with engagement from others) where it has discretion to adapt service and performance accordingly. We respond to specific aspects of the response in our annex where we feel we can, at this point, give an appropriate and proportionate expectation. But we feel it is too premature to comment further on SONI's response points in this respect before assessing its business plan submission.

We do not agree with the comment that our financeability proposals are disproportionately focussed on the particulars of an overly narrow interpretation of the financeability question. But we recognise that there may be a role for benchmarking SONI's overall returns with suitable comparators.

### **3.2 Delivering services and outcomes**

We want SONI to deliver high quality service and performance over time. We expect SONI to deliver service outcomes which are well-justified, stretching and achievable. The framework for supporting better service under the 2015-20 TSO price control is relatively under-developed. We propose developing a framework which reassures consumers, customers and other stakeholders that they will receive the service quality they expect (at a reasonable price).

#### **SONI service outcomes and performance commitments**

Service outcomes can be thought of as high level objectives which benefit consumers, customers and other stakeholders. We expect SONI to be responsible for developing these outcomes.

These are a key part of the service quality and performance framework, as they will to some extent shape the type and level of SONI service quality. Customers and other relevant stakeholders must, therefore, have a role inputting into their development. The service outcomes should also be reflective of consumer interests. We will also work with SONI to provide our view, as and when is necessary, through development. We want SONI to explain and justify the outcomes which matter to the TSO price control and how these are influenced by the range of services which it proposes to provide.

SONI must also support and justify the service proposals which it plans to provide over the 2020-2025 period. It should do so in way which recognises that the

electricity system is in transition. It should take account of its duties and obligations, its stakeholder engagement, and identified outcomes. It should also challenge itself on whether and how service needs to adapt, the changes to the regulated framework that are necessary to allow it to adapt and what the impact might be on consumers and customers. For example, whether service needs to scale back in some areas or expand in others. In summary, we expect SONI to be receptive and responsive to change, where this is expected as part of its role and is in the interest of NI consumers.

Performance commitments can be thought of as the commitments which SONI makes about services, performance and service levels. These should provide confidence to consumers, customers and stakeholders about SONI's contribution to the desired outcomes. Performance commitments are, therefore, more detailed than outcomes but should flow from them.

The existing framework does not typically define the quality of service provision associated with activities or define the nature of SONI's services in detail. We expect SONI to define and determine its performance commitments. These could, for example, be quantitative KPIs or metrics in some cases, but in other cases, qualitative explanation of proposals in areas such as outcomes, services and outputs may be more appropriate.<sup>11</sup>

Plans regarding performance commitments must be well justified, evidenced and stretching. For the purposes of accountability, they should also allow verification and monitoring of SONI's delivery and performance against its business plan. We expect SONI to define and justify performance commitments based on, for example, a combination of:

- appropriate insight and evidence from customers, consumers and other stakeholders to identify the service levels customers need and value.<sup>12</sup>
- SONI actionable data which currently exists and upon which operational decisions are based.
- Identifying and assessing where SONI's proposals go beyond the minimum required for compliance with its duties, obligations and other constraints. SONI should justify the case for any extra cost to consumers from enhanced service levels and additional services.

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<sup>11</sup> For example, specifically defined outputs to be measured against in terms of timescale, costs and delivery e.g. IT capex projects or a methodology or process which improves service.

<sup>12</sup> For example, through engagement or customer satisfaction targets e.g. net promoter scores (NPS).

## System wide thinking and development

Stakeholders at SECG indicated that good performance by SONI involves a system-wide perspective and decision making, rather than a narrow focus on costs directly incurred by SONI as a TSO. For example:

- effective working interface with NIE Networks and/or DSO.
- taking account of new market participant needs in its decision making (e.g. demand side response).

SECG stakeholders also recognised the role of SONI in the evolution and development of the system. They suggested that good performance by SONI may involve it being a swift and effective enabler of developments which system users seek. For example, stakeholders gave examples relating to:

- contestability in transmission connections; and a
- process for achieving changes to the Transmission Interface Agreement.<sup>13</sup>

We expect that there are and will be many other relevant examples. We see system-wide thinking and development becoming more material, and manifesting itself in many different ways, as the energy system transition picks up pace.

Issues such as transparency and participation processes will continue to be important for system development. This is because they can provide a means for customers and other stakeholders to contribute and operate effectively across the electricity system. We expect SONI to explain how it plans to involve stakeholders in its decision-making on an ongoing basis, and its vision for how stakeholder participations can continue to evolve over time to keep pace with best practice.

We propose that SONI demonstrates that it will bring a system-wide perspective and approach across all parts of the NI energy system. We also expect it to demonstrate that it will support the ongoing development of the NI energy system. In doing so, it should continue to improve system outcomes and better meet the needs of system users and energy consumers, while building on the recent reviews of the industry rules. This includes, for example, how it will meet the reasonable expectations of stakeholders for timely and effective progress on complex aspects of system

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<sup>13</sup> <https://www.nienetworks.co.uk/about-us/transmission-interface-arrangements>

development. This could, for example, be in the context of its role in the ISEM insofar as applicable to the SONI TSO control.

### **The need for framework arrangements to deliver accountability**

Stakeholders have told us that part of providing confidence to consumers and customers is reassurance that when they receive service, it is delivered as expected. They also considered that a framework needs to be sufficiently flexible to deal with uncertainty and not be overly complex. We agree with these points.

The way SONI delivers service across the system is important and is likely to grow in importance, but the price control regulatory framework is currently under-developed to deal with this change. We consider that there should be a stronger role for the regulatory framework to offer incentives to SONI to deliver high quality service. The framework should also provide confidence that SONI will deliver outcomes and achieve on-going improvements.

We also agree that there needs to be flexibility, which accounts for a price control period of 5 years, in the context of electricity system which is in transition. This is particularly where this transition could be affected by wider uncertainty. For example, we recognise that a new policy framework will need to provide direction after the DfE's Strategic Energy Framework comes to an end in 2020. With respect to cost uncertainty, we set our views on the sub-section below on our test area on 'securing cost efficiency and managing uncertainty'.

As part of scoping out our approach, we have considered precedent from other regulators. In particular, we feel that aspects of Ofgem's framework for regulation of the GB electricity system operator are relevant and could be adapted to our circumstances.<sup>14</sup> We have also reviewed the CRU's latest incentive framework for its TSO in Rol.<sup>15</sup>

The table below illustrates some of the broad areas of consideration where the framework for service and performance could evolve effectively. Many of these are not necessarily mutually exclusive.

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<sup>14</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/03/esori\\_arrangements\\_guidance\\_document.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/03/esori_arrangements_guidance_document.pdf)

<sup>15</sup> <https://www.cru.ie/wp-content/uploads/2018/05/CRU18087-Reporting-and-Incentives-under-Price-Review-4-Decision-Paper.pdf>

Different framework considerations		
Framework area	Options	
1. Incentive	Non-financial	Financial
2. Incentive setting and assessment	Evaluative	Mechanistic
4. Regulatory and stakeholder involvement	UR scrutiny, assessment and decision making	Stakeholder scrutiny, assessment and decision making
3 Application	TSO system wide activities	TSO discrete service activities
5 Process for involvement and implementation	'Incremental'	'Big bang'

### Incentives for performance commitments

We propose that a form of financial incentive structure would be appropriate. This should (a) support the accountability of SONI in relation to its performance commitments; and (b) enable higher quality service and performance than is currently provided for under the existing regulatory allowance (or will be than under our 2020 to 2025 baseline expectations).

Financial incentives would need to be carefully designed to mitigate against unintended consequences, whilst ensuring SONI is further motivated to deliver high quality service. A number of design considerations would also need worked through. For example, whether a symmetrical incentive with financial upside and downside, according to levels of performance, would be more appropriate, than a asymmetrical incentive with financial downside for poor performance only.

We propose that non-financial incentives will also be important and could be used where it is inappropriate for consumers to pay more for something which SONI is to deliver. This may also be the case where it is hard to design a financial incentive in a way which provides us with sufficient confidence that Northern Ireland consumers' interests will be protected. Incentives to promote transparency have an important role to play. There is a role for both us and SONI to promote and deliver greater transparency.

In terms of our role, comprehensive financial regulatory reporting is still in its infancy for TSOs (including gas) in Northern Ireland. Existing reporting is more focused on

costs without the corresponding detail on quality. We plan to introduce cost and service quality performance reporting for SONI's TSO activities. This can be developed in the light of SONI's business plan proposals.

As we note above, it is also important that SONI's customers are able to participate effectively in SONI led or influenced processes. We may ask SONI to undertake its own public reporting on delivery of performance commitments to meet service outcomes. We also recognise that some stakeholders at SECG asked for more visibility of certain areas. For example, they noted the importance of transparency on what is driving increases in Dispatch Balancing Cost levels and what actions SONI takes to deal with these.

### **Setting and assessing effective service outcomes and incentives**

A more mechanistic approach could be taken. Performance would be set and assessed according to targets which have been pre-determined by SONI, at the start of the price control. SONI's performance would then be rewarded or penalised during the period, depending on whether it has out or under performed. If designed properly, such an approach can offer more certainty to SONI but can risk unintended consequences. This is particularly the case at times of uncertainty. Further, the things that matter for consumers may not all be well-suited to quantitative targets.

Instead, we propose a more on-going evaluative approach. Performance would be evaluated on an ex-post basis. This would involve performance being rewarded and/or penalised by us instead of being based on pre-determined targets. Evaluation could be made against a set of evaluation criteria published in advance. The criteria could involve a mix of quantitative indicators and qualitative elements.

A key benefit of an on-going evaluative approach is the flexibility it may provide. This may be particularly relevant during periods of uncertainty and to take account of complexity of SONI's TSO role across the electricity system. It may also be better suited to some of the TSO's services, where good performance is difficult to capture simply through quantitative metrics. One potential downside, is that depending on how it is designed, there is a risk that such an approach could introduce revenue uncertainty for SONI. But this could be mitigated through design, such as regulatory guidance, opinion or other measures.

### **Regulatory and stakeholder involvement**

We would retain ultimate decision making responsibility for the setting, assessment and determination of incentives. This may include provision of guidance where

necessary. But we also propose a greater role for stakeholders to input into, assess and/or provide recommendations to us and to SONI, in order to improve its TSO performance. This could help inform our decision making, particularly given our initial preference for a more evaluative decision making approach. There are a range of different roles stakeholders could have to help hold SONI to account.

We could use independent and/or industry expert panels. For example, we are currently building experience of using an SECG to inform our regulatory expectations and challenge SONI's business plan. There are a range of functions which a panel could perform, from inputting into SONI's performance commitments to making recommendations on performance. The skills and capabilities of any such panel may be important. For example, an appropriate balance of technical and operational skills, as well as consumer, industry and regulatory policy making expertise, would be important.

We could also make use of formal processes to gather evidence and views from stakeholders. For example, using industry to provide insight on various aspects of SONI's performance against its performance commitments could be beneficial.

We and SONI's customers may also seek more confidence that effective decisions are being made for discrete activities. We are also conscious that certain service outcomes may be difficult to measure across discrete service areas. For example, it may be difficult to measure performance easily and robustly for a service outcome which relates to lower network costs. This is because how well the transmission network is designed may not become apparent for many years i.e. at the point at which the asset is built.<sup>16</sup> We may also want to have confidence that certain costs and service quality is reasonable, like in the area of procuring system support services.

There are a range of tools which could be used to provide confidence by supervising or exposing SONI's behaviour. Such tools could help break down the information asymmetry between us and SONI but also shed light on and encourage improvements which need to be made in SONI's processes over time. These could draw on input from stakeholders and external expertise. For example:

- independent expert audits on discrete company services or activities, to deliver transparency and validate processes; and/or

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<sup>16</sup> Even then there are difficult questions about counterfactuals against which performance is measured.

- specification and implementation of new technical policies and processes and/or independent technical advice. This could be offered by stakeholders, as noted above, or by other means.
- requirements on SONI to follow approved methodologies in certain areas (e.g. network planning); and to provide stakeholders with a high degree of transparency on the options it has considered and how it has assessed them.<sup>17</sup>

SECG noted advantages and disadvantages concerning some of these. We would expect SONI to rigorously assess the pros and cons of different methods and tools, and consider where they are appropriate.

### **Application and scope**

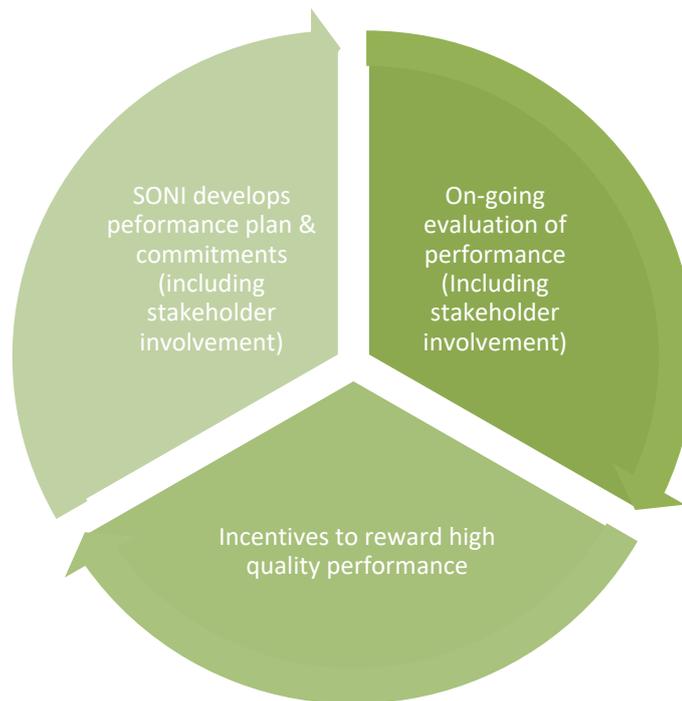
There is a question of how performance should be applied and scoped, given the complexity and interactivity of SONI's activities. We propose that, for the 2020-25 TSO control, we should take a more 'in the round' assessment to SONI's performance (rather than simply rewarding or penalising on a service by service basis for example). This helps to tackle the risk that SONI could face very strong incentives for its performance in some areas, at the risk to service quality in other areas.

### **Overview of proposed framework arrangements for delivering accountability**

Bringing the above considerations together, we are proposing a high level approach which includes the following:

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<sup>17</sup> For example, Ofgem's regulatory approach to National Grid's Network Options Assessment (NOA) methodology and reporting.



## **Performance process and implementation**

We will decide on the precise process and framework design during the price control determination period. We would plan to implement the framework from October 1 2020 (when the new price control takes effect).

We are conscious of the level of burden and resource on ourselves, SONI and other stakeholders in terms of how the framework would operate. We also recognise that a regulatory incentive framework may take time to develop. In making these points, we are conscious that other regulators, such as CRU and Ofgem, are at more advanced stages of developing performance frameworks. There may be scope for us to learn from the implementation of these. So we recognise that there may be some merit in staggering certain aspects whilst retaining sufficient momentum to ensure delivery. Overall, we aim to achieve a proportionate approach.

We anticipate that SONI's first performance plan of the next price control period could be strongly determined by the outworking of our final determination. We could, for example, set out expectations of what 'good' looks like in terms of service delivery in the final determination and then assess SONI's performance against this.

The approach we take will determine how the framework is introduced. We are interested in initial views on whether and how the framework could be introduced and

developed incrementally or more instantaneously. We are also interested in the level of accountability required for certain elements of the framework. We set out some of these considerations in the table below according to the different framework aspects discussed above.

Area	Examples of process and implementation considerations
<b>Incentive types</b>	If financial incentives are appropriate, how and when should these be introduced (e.g. staggered across the price control period or from 'year one')
<b>Incentive setting and assessment</b>	What type of performance evaluation cycle would be appropriate and proportionate? (e.g. an annual evaluative assessment: more or less frequent?). Note the potential overlap with our proposals in test area on 'securing efficiency and managing uncertainty'.
<b>Regulatory and stakeholder involvement</b>	At what point within the performance evaluation cycle should stakeholders be involved and how often during this cycle? Should the role of stakeholder scrutiny evolve as the framework matures or should there be certain aspects which are necessary from the beginning?

**Innovation**

Delivery of services and outcomes will also be linked to innovation. We expect SONI to consider in its business plan how it can innovate across its service portfolio to help improve overall outcomes. We also expect it to explain how it will adopt an innovative approach across the price control period.

In addition, we are minded to consider ways in which the price control framework can finance and support specific innovation initiatives. There are a number of options:

- Option 1: ex-ante allowance set at price control review for innovative projects or research initiatives.
- Option 2: ad hoc allowances on a case-by-case basis.
- Option 3: combination of Option 1 and 2.

We propose that Option 3 would provide the greatest flexibility to encourage innovation of the 5 year price control.

We would anticipate that SONI's business plan should detail how it believes any expenditure it seeks would work and how it can be incentivised to innovate. We would expect SONI to justify why certain projects should be treated as innovative and are distinct from SONI's broader service provision (which we expect to involve ongoing innovation).

Our criteria for assessment of SONI's rationale will follow that provided by us for NIE Networks. This should include, but may not be limited to, the following:

- Quantified and robust costs and benefits.
- Need for, or rationale in support of additional funding.
- How SONI arrived at its chosen bid for innovation(s) and how this interacts with other innovation investments.
- How such a bid was identified/prioritised and justified in consultation with consumers and wider stakeholders.
- Why there exists a barrier towards innovation which requires some form of regulatory action to progress and the consequences of innovation(s) not happening.
- What deliverables might be expected from research/development or trials.
- Proposed treatment of risk and rewards.
- Description of how successful innovation(s) would be efficiently rolled out and how the innovation strategy would be reviewed and updated.
- How innovation is different to anything that has occurred previously, whether within SONI or the wider energy industry.

### **3.3 Securing cost efficiency and managing uncertainty**

A key element of any price control framework concerns the incentives that the regulated company has to secure cost efficiency and manage uncertainty.

The costs which SONI recovers as part of our regulatory allowances typically represent 1% to 2% of the NI consumer electricity bill (excluding system services otherwise known as 'ancillary services').<sup>18</sup> But, as we note in the section above, the way SONI performs and delivers service can influence a much greater element of the total electricity bill, given its system wide influence.

It is helpful to consider cost efficiency alongside uncertainty given the strong links which exist between these two areas. We are also conscious of the interplay between securing cost efficiency and service quality in the case of SONI. This is particularly relevant given the measures we are exploring elsewhere to promote better service and performance.

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<sup>18</sup> See page 21 of <https://assets.publishing.service.gov.uk/media/5a09a73ce5274a0ee5a1f189/soni-niaur-final-determination.pdf>

We propose an approach to ensure that consumers are sufficiently protected from inefficiency and which deals effectively with uncertainty, but which supports good outcomes on performance and service quality. We would, therefore, expect the approach to also be coherent and work well with other aspects of the framework.

In the remainder of this sub-section we:

- set out the existing cost remuneration structure for securing cost efficiency and managing uncertainty.
- set out proposals for considering cost efficiency and managing uncertainty for the 2020 to 2025 period.
- bring these broad cost efficiency and uncertainty considerations together to provide some broad models for cost remuneration.

**Existing cost remuneration structure**

SONI has different types of regulatory cost treatment depending on the activity undertaken. Broadly speaking, there are three forms of cost remuneration structures to secure cost efficiency and manage uncertainty.<sup>19</sup> This is illustrated in the table below:

Existing structure	Allowance setting	Activity
Ex-ante baseline (with cost incentive mechanism)	At price control review	Capex and Opex e.g. staff, facility costs, corporate costs, telecommunications, IT and buildings capex spend etc.
Pass through <sup>20</sup>	During price control period	Ancillary services, TUoS and market operator costs recovered by the TSO
Regulatory approval processes	During price control period	Transmission Network Project Planning (TNPP), I-SEM implementation, ENTSO-E fees, licence fees etc.

Ex-ante baseline (with cost incentive mechanism)

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<sup>19</sup> The existing licence framework and revenue streams and how activities are mapped to revenues are detailed in Appendix A and B.

<sup>20</sup> There is also pass through costs which are subject to a DBC incentive mechanism. These are rewards or penalties of the incentive itself and not from incurring the work required to undertake dispatch and balancing. They are recovered under market operator tariffs, but the incentive pain/gain is applied to TSO revenues (via the *INCENT*<sub>t</sub> term).

Of the three broad cost remuneration structures, the existing structure is currently designed to have the strongest efficiency incentives. The ex-ante baseline is set at the start of the price control period and is designed to protect from inefficient cost rises. It also encourages efficiency (lower costs) and the revealing of efficient cost over a 5 year period.

The ex-ante baseline allowance also includes a cost incentive rate (sometimes referred to as a cost risk-sharing factor). This shares the balance of risk between consumers and SONI, by sharing the differences between SONI's outturn expenditure and that assumed when the price control was set. The current rate for SONI is set at 50 percent on costs under or over the ex-ante allowance.

It can help to simply illustrate how this cost incentive rate works by using an example. As set currently, it means that, on the one hand, SONI will earn 50p profit (before tax) for each £1 of outturn costs that it saves under its price control allowance during the price control period (with consumers saving the remaining 50p). On the other hand, SONI bears 50p of each additional £1 of outturn it spends over its price control allowance during the price control period (with consumers bearing the remaining 50p).

In theory, the higher the rate is set, the stronger are the efficiency incentives (lower costs) which the company faces. It is also the case that the risk of the company facing perverse incentives, such as to spend unnecessarily to grow the RAB, will be lower.

The lower the cost incentive rate is set, the weaker the efficiency incentives but the more protection can be afforded against risk. A lower rate means that the ex-ante baseline (which is a cost forecast subject to uncertainty made at the time of the price control review) has less weight in the overall remuneration of the regulated company; with more weight given to the amount of money it actually spends. This risk protection can help reduce the regulated company's financing costs, which need to be covered by the price control<sup>21</sup> and provide benefits which flow through to consumers. Put simply, a balance is needed between incentives for cost efficiency and the risk exposure that customers ultimately need to finance.

### Regulatory approval processes

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<sup>21</sup> e.g. remuneration for equity investors.

The existing cost remuneration structure means that we approve some expenditure, on case by case bases, during the price control period. SONI is remunerated for its actual costs up to a cap specified as part of each regulatory approval. When we set the cap we can add contingency (within the cap). If allowances are then exceeded, over and above this cap, there are provisions which enable SONI to request additional efficient expenditure.

The structure is designed to protect consumers from inefficiency. It ensures a level of cost control from, for example, a substantial cost rise. But it offers less direct financial incentives for encouraging efficiency (lower costs) as compared to an ex-ante allowance baseline coupled with a cost incentive rate approach. The approach also manages uncertainty during the price control period.

### Pass-through

A pass-through offers the weakest form of incentives for securing efficiency. In terms of the current framework, pass-through treatment is used for ancillary services which consist of payments to generators. This is largely due to the relatively uncontrollable nature of (some aspects) of these costs and also the variable nature of the costs associated with ancillary services. These costs are currently subject to review by SEMC and the tariffs paid to generators for their services are approved by the UR.

### **2020 to 2025 baseline expenditure cost remuneration structures**

We have considered a number of high level cost remuneration structures (which are not necessarily mutually exclusive of each other):

1. **ex-ante baseline (50% cost incentive rate):** this would be an ex-ante allowance with the current cost incentive mechanism. We would signal as part of our approach that we are strongly minded to retain the current balance of risk sharing associated with this mechanism.
2. **ex-ante baseline (lower cost incentive rate):** this would be an ex-ante allowance with cost incentive mechanism. We would signal as part of our approach that we are strongly minded to lower the current balance of risk sharing associated with this mechanism.
3. **Remuneration up to approved cap with indicative baseline:** this method would be more akin to the regulatory approval process we use today during the price control period. But instead, it would be set and applied at the price control review. It would involve setting:

- an approved cap on the level of expenditure that is to be remunerated under the price control, with SONI remunerated for actual spend up to this amount.<sup>22</sup>.
- an indicative baseline, set at the price control review, representing a central forecast or benchmark for what SONI might spend.
- the difference between the cap and the indicative baseline would represent an allowance for contingency.
- SONI's performance against the indicative baseline would provide information on its performance in terms of cost efficiency.
- but unlike the current approach, this would not be used mechanistically and in isolation to provide financial rewards and penalties for SONI.
- instead this could feed into a broad evaluative performance incentive scheme which provides for potential financial upside as well as downside according to cost/efficiency performance.
- we would not expect SONI to go beyond the approved cap, but the overall price control framework could allow the UR to make upward adjustments to the approved cap during the price control period.<sup>23</sup>

4. **Cost recovery without cap:** under this structure, SONI would recover costs actually incurred (excluding any DIWE<sup>24</sup>) without being subject to any cap. There could be potential for other regulatory provisions to encourage efficiency (e.g. transparency initiatives; expert review on an advisory basis).

We can see that the current framework involves several quite different cost remuneration structures for different areas of spend. So there is no reason why the same remuneration model should apply to the totality of costs covered by the SONI TSO control.

At the same time, there are potential downsides from regulatory approaches that treat different categories of costs in different ways (financially). There may be risks of distortions to efficient decision-making and regulatory reporting. Where boundaries exist between categories, these risks will tend to be lower if these are drawn between

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<sup>22</sup> 100% pass-through of actual expenditure excluding Demonstrably Inefficient Wasteful Expenditure (DIWE) up to the cap.

<sup>23</sup> But there could be other provisions during the price control to take account of uncertain expenditure.

<sup>24</sup> Guidance on the interpretation and application of the DIWE Provision, 27 July 2017.

<https://www.uregni.gov.uk/sites/uregni/files/media-files/Guidance%20on%20the%20interpretation%20and%20application%20of%20Demonstrably%20Inefficient%20or%20Wasteful%20Expenditure.pdf>

different services or activities of the TSO<sup>25</sup> rather than between different inputs for the same service.<sup>26</sup>

We propose to apply a mix of cost remuneration structures across SONI's activities, in a way which is tailored to the service and cost characteristics of each. Further to this, we propose that:

- Some of the activities currently falling under “ex-ante baseline (50% cost incentive rate)” should be treated under our new “Remuneration up to approved cap with indicative baseline” cost remuneration structure. This is particularly relevant where there is a lack of good information to use to set an ex-ante baseline and where there are risks that strong financial incentives on costs are realised at the expense of service quality. Instead SONI's cost performance can be taken into account as part of a broader evaluation of its performance, with potential upside (reward) and downside (penalty). To take one example, aspects of SONI's transmission system planning and network development activities may fall under the “Ex ante baseline (50% cost incentive rate)” approach at present but seem more suitable for the “Remuneration up to approved cap with indicative baseline” approach.
- For the remaining services which are to be subject to a mechanistic sharing of over and under spend against an ex ante baseline, the cost incentive rate should be reduced so that the risk exposure to SONI (which customers will need to finance) is no more than necessary to encourage efficiency. The current 50% rate does not seem tailored to the circumstances of SONI as an asset light business.<sup>27</sup>
- For costs relating to ancillary services, the cost remuneration structure involving “Cost recovery with no cap” might be most appropriate for the 2020-25 control. This could follow the current approach to ancillary services, but

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<sup>25</sup> e.g. system operation versus network planning

<sup>26</sup> e.g. example, opex versus capex inputs for system operation.

<sup>27</sup> There seems to be benefits to consumers of having a lower rate than 50 per cent through the need for reduced remuneration of financing cost (given consumers are effectively taking on more risk) and this could reduce risks regarding financeability as it would have the effect of SONI being less financially exposed than current. Because of the asset-light nature of the TSO, its overall profits tend to be much more sensitive to cost over or under spend than for a regulated network company, and the risk exposure we see for network companies (e.g. cost incentive rate of around 50%) is likely to be more than is needed to provide the TSO with a clear financial stake in controlling its costs and operating efficiently. Furthermore, some of the reasons for relatively high cost incentive rates used for network companies (e.g. overcoming historical risks of perverse incentives to spend capex unnecessarily to grow the RAB) are less severe or less relevant for the TSO.

there are likely to be opportunities for refinement and improvement in the approach to achieve better outcomes for consumers.

We recognise that there may be measures which could provide further accountability by bringing confidence and assurance. For example, demonstration that ancillary services are being procured efficiently and effectively and that costs will be kept to a minimum necessary.

## **2020 to 2025 uncertainty mechanisms**

There are a range of ways in which uncertainty could be managed during the price control period. In making proposals, what is crucial is that SONI ensures that these are well-justified and well-designed to the ultimate benefit of consumers. This means that mechanisms should be tailored appropriately to the circumstances and fit with the price control framework.

In its business plan, we expect SONI to:

- take account of the arrangements which have been developed as part of the existing framework when considering the benefits<sup>28</sup> and drawbacks<sup>29</sup> of different approaches.
- detail its views robustly on these issues and provide rationale for any proposed framework changes.
- reference its consideration of all the options and explain the relative merits of any proposed option(s).
- set out how its proposals affect their own risk levels and are to the ultimate benefit of consumers.
- consider how any changes fit cogently and coherently with elements of the framework proposed elsewhere.

If we were to set an ex-ante baseline allowance for the 2020 to 2025 period, there could be a range of broad ways to bring accountability. For example:

- **Mechanistic cost incentive rate:** the cost incentive rate (e.g. 50% or lower) at the price control review can provide risk protection to the company during the price control period itself; and/or

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<sup>28</sup> e.g. lower remuneration, financeability, consumer exposure to forecasting error because of cost uncertainty.

<sup>29</sup> e.g. framework complexity, resource burden, perverse effects, efficiency incentives, volatility of price.

- **Mechanistic uncertainty mechanisms:** costs adjust automatically according to some variable observed during price control period.<sup>30</sup> Another mechanistic type could be used where costs adjusts upwards or downwards by an amount specified at the price control review if a specified “trigger” event occurs.
- **Approval-based uncertainty mechanisms:** potential for upward revisions to baseline set at price control review, through UR approval process (revisions possibly restricted to certain activities and/or circumstances). The potential for any such adjustments could be considered as part of a structured annual process. Our proposal for an evaluative performance framework, as discussed above in ‘delivering service and outcomes’ test area, could be one such process.

We are minded of taking account of the considerable work which has been carried out to date under the existing framework. The mechanism for TNPPs, as is currently structured and designed, is likely to be broadly appropriate for the 2020 to 2025 period. This was subject to much revision during the CMA referral. For the 2020 to 2025 period, we propose treating TNPPs broadly as they are currently treated. This would protect against inefficiency whilst promoting good service delivery outcomes.

### Overarching cost recovery models

The table below brings the considerations above together to illustrate proposals for how cost recovery could be achieved.

Model	Ex ante baseline set a price control review	Potential uncertainty mechanisms applied during period	Overall recovery under SONI TSO control
A	Yes (with mechanistic cost incentive rate)	Mechanistic and/or approval based	Determined by combination of ex ante baseline (including any revisions to this under uncertainty mechanism) and actual expenditure (excluding any DIWE)  Weight attached to each element, and hence risk exposure of TSO and customers to ex ante baseline, determined by cost incentive rate or sharing factor (e.g. 25% or 50%)

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<sup>30</sup> Using an example from regulated network companies, allowed revenue could vary with number of connected customers, around a baseline with allowance per customer specified at price control review.

<b>B</b>	Yes: both indicative ex ante baseline and approved cap on maximum remuneration (cap would include some contingency allowance)	Approval-based process to consider upward revisions to caps (with potential for any such adjustments to be considered as part of a structured annual process to review performance rather than on an ad hoc basis)	Recovery of costs actually incurred up to approved cap only  Level of costs incurred vs indicative baselines taken into account as part of broad evaluative performance incentive scheme
<b>C</b>	No (focus at price control review is on determination of set of services or activities to which this cost remuneration model applies)	Provision for the UR, during the price control period, to expand scope of services or activities for which costs are covered by this model	Recovery of costs actually incurred (excluding any DIWE)  Potential for other regulatory provisions to encourage efficiency (e.g. transparency initiatives; or expert review on an advisory basis)

We recognise that there may be variations of these models. For example, some form of mechanistic cost incentive rate to set an ex-ante base-line could be set with some form of more evaluative performance incentive framework.

### Cost assessment

We propose that SONI should provide:

- a breakdown of costs as required by the business plan guidance.
- detail on historic cost movements, trends and atypical expenditure.
- well-reasoned, evidenced based supporting analysis of cost lines, whether projected to increase, remain stable or reduce.
- link between costs, service and/or activity levels.
- details of any benchmarking or analyses to support company plans.
- rationale and assumptions behind cost projections for IT projects.
- any company specific 'special factors' which affect costs (either positively or in a negative fashion).
- forecast of real price effects for the TSO.
- productivity and efficiency targets to be applied as a discount to projected costs.
- detail on how SONI will provide assurance that certain services are being procured efficiently and costs will be kept to a minimum

Business plans will be scrutinised by the UR. It should also be noted that historic spend is not necessarily a measure of efficient expenditure. Furthermore, setting

price control allowances simply on the basis of SONI's historical expenditure will tend to reduce its incentives to improve efficiency and control its costs during the price control period. As such, we expect SONI to support its cost proposals, and demonstrate cost efficiency of its plan using benchmarking.

We would anticipate a form of benchmarking and bottom-up cost assessment when setting allowances. We would expect SONI to provide benchmarking of its costs and performance, both at an aggregate level and for individual services/roles. The underpinning analysis should be transparent and understandable to stakeholders. It should also take account of differences between SONI and comparator companies used for benchmarking, where available. International, other energy sector, utilities or sector comparators may be relevant. What is appropriate may differ depending on the service or activity in question.

We would anticipate that less regulatory scrutiny will be placed on costs which are very well-evidenced and supported by reliable benchmarking and analysis. The opposite is likely to be true for poorly evidenced costs. We also expect greater analysis and evidence for more significant areas of expenditure.

### **3.4 Aligning risk and return**

Section 3.2 above considers the remuneration of SONI for its operating expenditure and its capital expenditure. In addition to these costs, the price control framework should remunerate SONI for the costs of financing its activities, including the costs of any debt finance<sup>31</sup>; and the remuneration of SONI's equity investors.

Our policy proposal is that, taken together, the price control for SONI should represent a "financeable" package, which covers reasonable remuneration for SONI's:

- operating and capital expenditure;
- debt finance;
- equity investors; and its
- corporate tax liabilities.

The appropriate level of remuneration for debt finance and equity investors will depend heavily on the scale of financial risk that SONI faces. This, in turn, is dependent on the design of the regulatory framework.

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<sup>31</sup> e.g. bank loans or funding from corporate debt security markets

But rather than simply considering what remuneration investors need for the risks they bear, we are interested in a more preliminary question. This question is, what risk should the SONI bear, taking as given that the price control package will provide reasonable remuneration for the risk it faces?

We expect SONI to provide a clear justification for the nature and risk exposure it would face under its business plan proposals as part of its responses to test areas 2 and 3, discussed in sections 3.1 and 3.2. In doing so, it should take account of the benefits and costs of exposing SONI to financial risk in achieving desired outcomes. We are not seeking to insulate SONI from risk, but we want to be confident that the scale and nature of risk is proportionate.

With this in place, we can turn to the question of “Aligning risk and return”. This is about considering the returns needed to remunerate investors, taking as given the risk established as part of the wider price control framework.<sup>32</sup>

### **High-level approach to financeability**

We consider it helpful to draw a distinction between the following broad areas of analysis and assessment:

1. **Assessment of whether the price control is financeable.** This concerns the overall assessment of whether the price control package would enable the TSO to finance the activities which are the subject of its obligations under the regulatory framework (taking account of all other aspects of the framework).
2. **Remuneration of equity capital and debt finance.** This concerns the allowances and provisions that are included in the price control package to remunerate the TSO (and its investors) for the equity capital and debt financing costs associated with its activities.
3. **Analysis of potential scenarios for returns on regulatory equity (RoRE).** This concerns analysis of the potential downside and upside scenarios for the return to equity holders under the proposed price control package, consider both shorter-term and longer-term impacts,
4. **Debt financeability analysis.** This concerns analysis of financial ratios, of the type considered by credit rating agencies, which can provide insight on the debt aspects of possible financing assumptions made for the purposes of setting the SONI TSO price control.

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<sup>32</sup> e.g. reflecting the SONI’s proposals on service quality, incentives etc.

5. **Assessment of the financial resilience of the actual licensee.** This concerns analysis of the ability of SONI (the actual TSO licensee) to deal with potential downside scenarios under the proposed price control determination.

The first of these is an overarching question. We will need to make an assessment of it by looking across different aspects of the price control package. We will also be looking for SONI to provide assurance to us that its business plan represents a financeable package.

The second element covers what is often seen as work on the “allowed return” or “cost of capital” for a price control determination. But for SONI it is important to think broadly about the various financing costs it may face. The third and fourth elements are potential inputs to this work. We consider the third of these important, especially for understanding how risks arising from other parts of the price control package may affect SONI (or a notional efficient TSO). Whether the fourth element is relevant will depend on whether we assume any material debt finance for a notional efficient TSO).

The fifth element highlights that, apart from providing reasonable remuneration for SONI under the price control package, we are looking for confidence that SONI has sufficient financial resilience over the 2020-25 period. This is important given its actual/planned financial structure, and recognising the risks of detriment to customers from financial distress of SONI.

### **Remuneration of equity capital and debt finance**

Considerable progress has been made through both our price control process and the CMA appeal process to help tailor the 2015-2020 price control framework to the features of SONI.

The approach to the remuneration of the SONI’s equity capital and debt finance for the 2015-20 control period reflects a combination of our final determinations and a number of specific amendments from the CMA remedies. We envisage taking this approach as our starting point for work on the SONI TSO price control for the 2020-25 period. Regulatory frameworks and approaches evolve over time, and there may also be opportunity to make some well-justified improvements.

Some of the main aspects of our proposed approach for the SONI TSO price control are as follows:

- remuneration be determined for a “notional efficient TSO licensee” rather than the actual TSO licence (drawing on extensive regulatory precedent for this approach).

- linking the TSO’s requirements for debt and equity finance to the various different services it provides and the activities it undertakes.
- building on the approach emerging from 2015-20 TSO control and the CMA appeal so as to identify, and make allowance for, all layers of capital employed or needed to enable and support the notional TSO activities. This includes making use of different methods and sources of evidence to inform the determination of allowances for different layers of capital (e.g. WACC\*RAB approach for some core activities plus margins approach for revenue collection activities).
- drawing on an understanding of the risks faced by the TSO, including through RoRE analysis of upside and downside scenarios.
- recognising the role of equity within assumed capital structure in providing a buffer to enable the TSO to accommodate the risks it faces under price control framework. This includes potential role of a parent company guarantee (PCG) in providing additional equity buffer beyond equity investment in RAB.
- use of CAPM to provide estimates of the cost of equity, potentially drawing on adjustments for “operational gearing” (or similar) when applying data from other benchmark companies to the case of SONI. We also would consider the case for adjustments to CAPM estimates for any asymmetric risk.
- switching from RPI indexation to either CPI or CPIH indexation of the SONI RAB and revenue control for the 2020-25 period (without prejudice to what inflation measure is to be used for subsequent SONI price controls or for the price controls for other companies we regulate). As part of this approach, we welcome views from stakeholders on whether we move to CPI or to CPIH indexation as part for the 2020-25 SONI price control.
- remuneration of corporation tax liabilities though an approximate uplift on cost of capital allowances (e.g. pre-tax WACC approach) rather than using separate and detailed financial modelling of corporation tax liabilities.

In the course of our work towards the initial proposals set out above, we considered a number of alternatives for specific aspects of the overall approach to remuneration of equity capital and debt finance.

In the table below we summarise some of the main alternatives we considered and their potential benefits and drawbacks. Our initial view is that the benefits of these alternatives are not likely to outweigh their drawbacks. However, it is possible that we have overlooked significant points.

Alternative considered	Benefits of alternative	Drawbacks of alternative
Pure RAB*WACC	Less complex	Not tailored to activities and circumstances of the TSO
<b>Under this approach there</b>	Lower risk of errors from	

<p>would be a single allowance for remuneration of the TSO's equity capital and debt finance, calculated on a WACC*RAB basis, with a potential uplift to WACC to allow for any differences (e.g. operational gearing) between TSO and comparator companies used to inform equity element of WACC</p>	<p>interactions between the various different allowances for TSO financing costs (e.g. double-counting risks)</p>	<p>Not consistent with outcome from CMA SONI appeal</p> <p>Constrains evidence base for estimating some layers of capital</p>
<p>Pure margins approach</p> <p><b>Under this approach there would be a single allowance for the remuneration of the TSO's equity capital and debt finance, calculated by applying a margin benchmark (%) either to a measure of the TSO's costs or to a measure of the TSO's revenues</b></p>	<p>Less complex</p> <p>Lower risk of errors from interactions between the various different allowances for TSO financing costs (e.g. double-counting risks)</p>	<p>Not tailored to activities and circumstances of the TSO</p> <p>Not consistent with outcome from CMA SONI appeal</p> <p>Constrains evidence base for estimating some layers of capital</p> <p>Weak evidence base for margin benchmarks in setting allowances for the totality of the TSO's activities</p>
<p>Do not consider potential WACC adjustment for asymmetric risk</p> <p><b>Under this approach there would be no analysis or review of asymmetric risk in the price control framework and no role for adjustments to the remuneration of the cost of equity for perceived asymmetric risk or returns (whether upside or downside)</b></p>	<p>Less complex</p> <p>Price controls for other UK regulated companies typically do not involve WACC adjustments for asymmetry</p> <p>Argument that there will be a multitude of sources of asymmetric risk, which would take a long time to analyse properly, and which may cancel out overall without significant net impact</p>	<p>Not consistent with outcome from CMA SONI appeal</p> <p>Not supported theoretically</p> <p>This was found a material issue for the 2015-20 CMA appeal; it does not seem credible to ignore it for the 2020-25 control</p>
<p>Maintain RPI indexation</p> <p><b>The approach set out above would involve a switch from RPI to CPI or CPIH indexation of the TSO RAB</b></p>	<p>Consistency with approach taken to TSO price control in the past</p> <p>Avoids work to implement a new approach and take decision on what inflation measure to use (e.g. CPI vs CPIH).</p>	<p>RPI is discredited as a measure of inflation and not classified as a national statistic</p> <p>Unless otherwise corrected for, RPI indexation may lead to unfair balance of charges over time, unduly push TSO's profit recovery into the future and artificially depress TSO profits in the 2020-25 period</p> <p>In the main, UK regulators have moved, or are moving, away from RPI to CPI or CPIH; an RPI-linked price control could be outdated in</p>

		2020-25
<p>Cost of debt indexation mechanism</p> <p><b>The framework could include a mechanism so that the allowances to the TSO to cover any debt finance that it is assumed to need (in a notional efficient financial structure) are adjusted over the duration of the price control period to take account of latest information on debt costs from corporate debt markets</b></p>	<p>Provides risk protection to investors and customers to help protect against uncertainty faced by regulator in forecasting efficient costs of debt finance over price control period, which will vary according to market conditions and monetary policy</p> <p>Other regulators such as Ofgem and Ofwat use cost of debt indexation mechanisms for their RAB-based price controls</p>	<p>Time and effort to develop mechanism and implement it for the TSO control</p> <p>Greater complexity</p> <p>No useful role with TSO price control framework if notional efficient licensee is assumed to be financed with 100% equity and no corporate debt (the assumption for 2015-20 on which CMA determination rested)</p>
<p>Modelling of corporation tax</p> <p><b>The calculation of the price control would include separate allowances for corporation tax liabilities, calculated using modelling of corporation tax liabilities, rather than making an approximate allowance for corporation tax as part of the allowances for the TSO's equity finance (e.g. pre-tax WACC)</b></p>	<p>Greater accuracy in estimation of corporation tax liabilities and, in turn, TSO revenue requirements</p>	<p>Substantial increase in resource requirement and complexity</p> <p>Possible transitional issues with risks of unfairness, arising from change from the existing approach</p>
<p>Develop options for applying Ofgem's fair returns failsafe tools to TSO and review case for these</p> <p><b>In initial work on its RIIO-2 framework Ofgem outlined a number of options that could help address its concerns about unfair/excessive returns to the companies it regulates</b></p> <p><b>We could seek to take Ofgem's ideas and develop well-specified options that could be applied to the TSO and consider the pros and cons of these</b></p>	<p>May lead to the identification of tools that could help to reduce the risk that price control allowances for remuneration of TSO's equity finance are excessive</p>	<p>Time and resource required to progress this complex work</p> <p>Such tool are likely to be quite controversial, with significant risks and drawbacks to consider</p> <p>Lack of established regulatory precedent</p> <p>Questions about proportionality of developing new approach in this area for TSO given small proportion of energy bills</p>

We provide further explanation of our proposed approach, and the rationale for it in the separate working paper by Reckon LLP, published alongside our December 2018 approach consultation.

Overall, we would expect that the SONI's business plan to be consistent with the proposed approach set out above and elaborated on in the Reckon LLP working paper (subject to any revisions or refinement set out in our Approach Decision, following review of stakeholder responses).

We want SONI to put forward analysis and proposals that represent compelling value for money for customers in this area. As part of this, benchmarking of proposals against those made by other UK regulators and by regulated companies is an important part of the evidence base. We recognise that there are areas in which the TSO is different, but the CMA appeal also confirmed the applicability of the WACC\*RAB approach which allows for comparisons across various UK regulated sectors.

We want SONI to consider, for example, the proposals on WACC from English and Welsh water companies as part of September 2018 business plan submissions to Ofwat, where companies seem to have taken initiative to propose significant reductions in WACC as a means to provide better value for money to customers.

In Appendix C we set out the specific test questions which we propose that SONI would need to address as part of its business plan.

## **4 Our approach and expectations for trust in delivery**

### **4.1 Overview of key approach and expectations, consultation responses and our consideration**

We set out a range of proposals and expectations for SONI in engaging customers, consumers, and other stakeholders, ensuring resilience and governance, accounting for past delivery and securing confidence and assurance.

Stakeholders had views on the breadth, depth and/or type of stakeholder engagement, and some commented that it should be targeted and/or that consumer views would need to be accounted for.

We require SONI to focus on the quality of its engagement, how well its engagement has improved its plan, and how it will be incorporated on an on-going basis. We agree that it should be broad enough to ensure that SONI's wide range of stakeholder views are accounted for and should be targeted and proportionate, providing a platform for future improvements during the 2020-2025 control period (and the subsequent period). We would note that there is nothing to prevent SONI from using stakeholder engagement to seek to develop positive change to ways of working, which are within its control, even if they require UR approval or code changes.

Some stakeholders asked for clarity on the separate review of approach to SONI governance and its relationship with the price control. Our work on governance is ongoing and it is our intention to publish proposals for consultation in Q2 of 2019. If there are additional costs created through from the implementation of any proposals, any such TSO costs can be considered later within the price control process via some form of uncertainty mechanism. We are happy to engage with SONI further on this at the appropriate time. We also provide further expectation below about the relevance of this governance review in informing SONI price business planning, so as to further assist SONI in its business plan development for this price control.

### **4.2 Engaging customers, consumers and other stakeholders**

As part of this price control review, we are placing more importance on SONI to continuously improve its engagement with customers, consumers and other stakeholders. Having trust in SONI's ability to deliver a high quality plan is also, in part, determined by the effectiveness of its stakeholder engagement.

The onus is on SONI to engage with its stakeholders to ensure their needs and priorities are met as effectively as possible. We do not view this as something which should be carried out at one point in time. Rather, engagement with stakeholders is an on-going process which can have enduring benefit.

SONI has a particularly diverse set out customers, consumers and other stakeholders, with different needs and requirements. We want SONI to demonstrate that it has effectively identified the range of people and organisations to engage with and on the issues which matter to them.

We are conscious that a new government policy framework will be required to provide direction after the DfE's Strategic Energy Framework comes to an end in 2020. We, therefore, see the DfE as a key stakeholder whose input is vital.

SONI should also demonstrate the quality of its engagement and how well it is incorporated into the business plan and ongoing operations.

### **4.3 Ensuring resilience and governance**

We see the concept of resilience as something which is relevant to SONI as a TSO given the nature of its role. We see resilience as being about how SONI helps avoid, cope with, and recover from, disruptions to its business. For example, how it makes decisions and acts with respect to:

- governance processes and assurance (e.g. corporate);
- finances (e.g. financial)
- performance across its business operations (e.g. operations)

We also expect SONI to ensure that the governance procedures it has in place, more generally, are fit for purpose and appropriate.

These factors are intertwined and so we expect SONI to consider them holistically. Proper resilience and governance means not only considering the 2020-2025 price control period, but also beyond that.

In addition to this price control process, the UR is developing its approach to SONI governance. This is an area that will be subject to separate consultation. The expectations within in this test area as noted above are relevant irrespective of our approach taken as part of this separate programme of work.

The intent of the separate UR governance review will be to review how SONI is governed i.e. who controls and directs activities of the system operator company, and therefore on the independence of the Board of the company and the governance of decision making in the organisation.

In this context, we would, therefore, expect the business plan for 2020 to 2025 to provide for a level of resource to enable SONI to be able to control and direct its licensable activities (including at SONI Board and management level) to deliver high

quality outcomes for Northern Ireland consumers. We may refine our expectations, as they develop, in this test area further to account for our expectations as part of our approach to SONI governance.

#### **4.4 Accounting for past delivery**

As part of its business plan submission we expect SONI to:

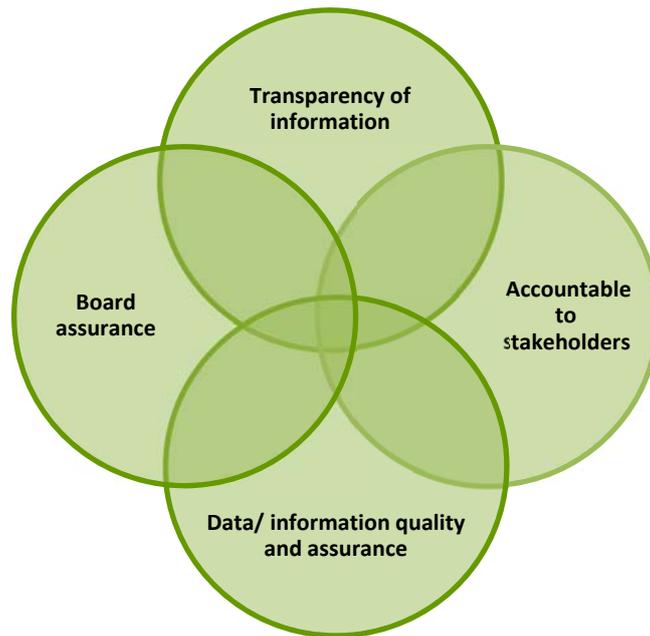
- explain the areas of strength and weakness in the company's performance in relation to the 2015-20 period. Taking these into account, demonstrate how well has it put measures in place to ensure confidence that it can successfully deliver its 2020-25 business plan and fulfil stakeholder expectations. SONI's response must explain findings from stakeholder engagement on strength and weaknesses.
- provide evidence for, and explain, any financial adjustments required as part of the maximum revenue allowances under the 2020-25 control, in relation to its costs or performance during the 2015-20 control period. Any such adjustments must be clearly mapped to the relevant provisions of the 2015-20 TSO control.
- explain the levels of its outturn costs and performance that feed into any such adjustments.

We are introducing SONI TSO cost reporting RIGs for the 2015 to 2020 period. We expect SONI's first submission to us in April 2019.

#### **4.5 Securing confidence and assurance**

Well justified and high quality business plans are built up from robust, clear and transparent data. They should also be properly assured and exhibit effective accountability to stakeholders.

This is important for SONI's stakeholders to support effective decision making and participation in SONI's TSO processes. It is also important for us to bring confidence and accountability in price control decision making, and to support smooth processes. Giving confidence in this way can promote trust in service delivery.



## **Board and governance assurance**

SONI as a company should demonstrate quality and effectiveness in its approach to assuring the plan. Its Board should also be challenging its management and providing comprehensive assurance to ensure all elements of the plan add up. We expect to see evidence of how and why it feels its business plan is high quality and deliverable in this context (including external assurance if deemed appropriate<sup>33</sup>).

SONI's Board should provide clear evidence that its plan is financeable on both an actual and a notional basis.

SONI's Board should demonstrate that its governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term.

## **Data quality**

SONI should demonstrate that its data is:

- reliable and accurate

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<sup>33</sup> There may be a range of ways this could be done, for example, from professional audit assurance to other means of independent expert scrutiny. SONI will be best placed to consider what approach (or combination) of approaches may work.

- clear
- consistent
- assured
- provided in a timely way

There are a range of situations where this could apply. Ensuring price bases are correct, cost allocations are well-justified and clear, and across data tables more generally, are just some relevant examples.

We also expect SONI TSO to demonstrate a strong track record of producing high-quality data and reliable submissions as part of processes associated with its economic regulation. SONI should be demonstrating that it takes the quality of the information it provides and its governance processes seriously all the time and not just in the price control business plan preparation.

Accordingly, we are interested in whether stakeholders have views on whether we should consider assurance ‘in the round’, and if so how we should do this in a proportionate way. For example, should we be taking into account information and evidence provided to us by SONI as part of other regulatory submissions and activities (e.g. network codes or ten year development plan), which sit outside of the process but are relevant to delivering trust.

### **Effective accountability to stakeholders**

Effective accountability to stakeholders is important. We expect SONI to demonstrate that its proposals, including performance commitments and incentives, provide an effective and robust way to hold it to account for delivery over the five-year price control period.

We will be looking for assurance that SONI faces effective accountability for the business plan proposals. This might include some kind of stress-testing. For example, considering whether a profit-seeking and short-termist TSO monopoly business could exploit the overall package in a way that leads to worse outcomes than envisaged; or whether the package robust to this scenario.

### **Transparency of information**

We expect that the quality of SONI’s price control business plan would be improved if it is published and available to all stakeholders. This will also help stakeholder engagement in the price control processes and enhance wider stakeholder participation in SONI’s TSO activities.

We note that other regulators (e.g. Ofwat) now require companies to publish full business plans (including supporting appendices and data tables), and that many companies have met this requirement (with only minor redactions).

We see no reason why this principle cannot also apply to SONI TSO. We expect it to publish full business plans. If SONI TSO seeks to redact for publication, we would expect strong supporting reasoning.

More generally, we expect a well-presented plan. This could, for example, be in a hierarchical format offering different levels of detail. This means it could include an:

- executive summary which should be accessible to a wide range of stakeholders;
- the main business plan containing the full set of business plan proposals and which address all of our test questions; and;
- appendices providing supporting evidence and analysis (clearly signposted to relevant parts of the main business plan).

We are also taking steps to publish more material as part of the price control process where this is in the consumer interest. We welcome any views on how we can be more transparent as part of the price control process.

### **Business plan templates**

We expect that the starting point for these will be the 2015 to 2020 RIGs templates, but adapted to take account of our approach for the 2020 to 2025 price control review.

We published a version of the business plan templates alongside this approach decision. This follows constructive engagement with SONI. We remain open to receiving targeted refinements to the templates from SONI at the earliest point possible before business plan submission, where necessary and appropriate.

# 5 Business plan expectations and assessment approach

## 5.1 Overview of key approach and expectations, consultation responses and our consideration

We proposed to take a scorecard approach with incentives and opportunity for lower regulatory intervention to support SONI in taking more ownership to deliver a high quality plan. We said that there was a case for a proportionate financial incentive and proposed different options (reward and/or reward/penalty). We explained that the overall approach would also help us structure and clarify our expectations to SONI and support us in taking a proportionate approach to business plan assessment.

Stakeholders supported our intention to provide clearer regulatory expectations to SONI on its business plan. But in doing so SONI noted that some of the test area expectations are generic/not appropriate for SONI's circumstances and welcomed engagement to remove any perceived ambiguity. Power NI cautioned against being too prescriptive or burdensome in our approach.

We welcome that stakeholders agreed with having clearer expectations. As noted in our December 2018 consultation, the test areas are deliberately generic (not least so it could also be applied or compared to other sectors and price controls). We disagree that these are not relevant to SONI's circumstances. We have engaged with SONI since the consultation to understand its views and clarify ours. We have also responded to its detailed points/examples offered in our stakeholder response annex published alongside this document. We remain of the view that there is no reason to believe that any of the test areas or test questions are inapplicable to SONI.

We have also further clarified our guidance on the overall business plan assessment. This is especially in relation to the interactions between the Appendix C material and the main categorisation. We now clarify that Appendix C provides guidance on what an "excellent response" to each test question would be. We also clarify that the overall assessment across the four categories depends on extent of excellent responses, and where responses are not excellent, how far short they are from excellent.

But going further than this risks distracting from ours and SONI's aims and introducing a 'box-tick' approach to developing a business plan. Once we assess SONI's business plan, we will then categorise it and consult on as part of our draft determination. We will provide information on why we have come to our view, including reasoning on where areas are less than 'excellent' (if this is the case). SONI and other stakeholders will have an opportunity to respond to this.

Respondent views on the case for and design of a financial incentive were mixed. SONI agreed with the concept of a financial incentive (on a reward only basis).

Power NI, while not being explicitly for or against one, said the price control allowance should provide for a 'reasonable allowance for delivery'. Mutual Energy Ltd said it would not normally see the need for a financial incentive but recognised there may be a case for one in this instance. SECG also provide mixed views and in some cases questioned the need for and effectiveness of a financial incentive.

We now propose not to have a financial incentive. As noted above, stakeholder views on having the financial incentive were mixed. We have listened to and taken on board these views, in light of the finely balanced pros and cons of having a financial incentive. We also recognise the fact that this is the first time we are undertaking this broad expectation and assessment approach. We, therefore, propose instead to rely on the other non-financial incentives which we consulted on.

## 5.2 Introduction

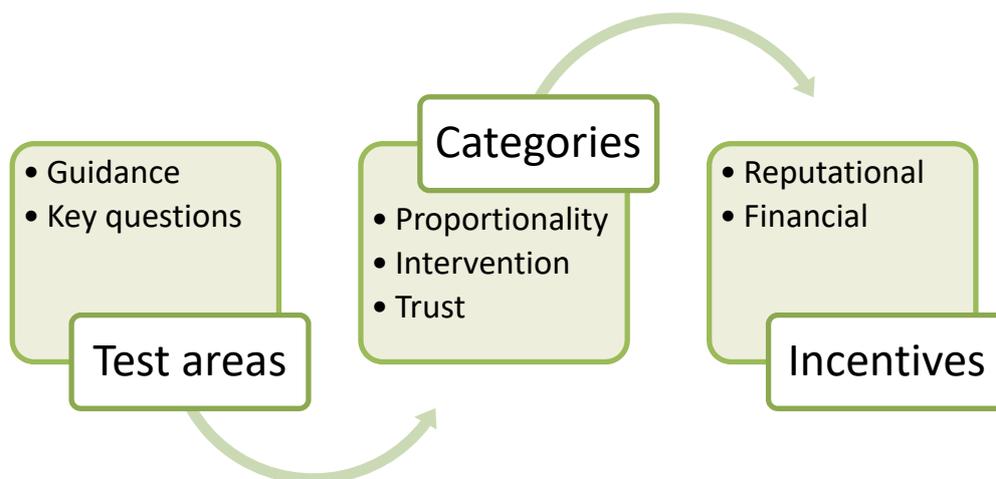
We want SONI to deliver an exceptional business plan for NI customers, consumers and other stakeholders. This is important given the key role which SONI has in managing electricity system change during a time of system transition.

Our approach will provide clearer regulatory expectations to SONI. At the same time it puts the onus on SONI to own its business plan. SONI's business plan should be challenging, well evidenced and high-quality, but also be achievable. We feel such an approach can also help us focus where and how to challenge SONI's business plan once received.

In coming to a proposed approach, we have reviewed regulatory precedent. We have considered and adapted elements of Ofwat's approach used as part of its PR19 methodology. We consider that this provides helpful precedent as it offers useful insights for providing and structuring clear regulatory expectations and assessing the business plan, during the approach phase. For example, the practice of structuring of information around test areas, the use of guidance, and categorisation, seems helpful in the case of SONI given our experiences to date of mostly relying on provision of information requirements with relatively limited use of expectation. We have, however, tailored precedent to our own circumstances to ensure appropriateness and proportionality. We have received broad support for the overall approach from stakeholders with whom we have discussed the model with at SECG.

## 5.3 Our approach

We set out below our approach to assessing SONI's business plan. Our proposed approach consists of areas which we will test (test areas), categories we will place SONI's business plan in, and incentives which we will subsequently apply. The illustration below summarise the process and key features of the approach.



## Test areas

Test areas can provide a strong basis for us to provide clear regulatory expectations and also policy priorities. They can also help us to work out how and where we dedicate assessment time, when we receive the business plan from SONI. We are also asking SECG to provide insight and challenge to SONI's business plan. We, therefore, expect that these features will be important given the time constraints involved in the price control process.

As set out in preceding sections of this document, the test areas have been structured according to three areas:

- Contribution to good outcomes
- Services and costs
- Trust in delivery

In coming to the number and type of test areas, we are conscious of balancing the need of having enough distinct areas of key importance, whilst ensuring there are not too many such that overall focus is diminished. We also recognise that, such is the cross-cutting nature of a price control and the way businesses function, there will be links across many of the different test areas.

We have designed areas to take account of linkages, as far as is practicable and where we feel it is important to do so. We have also taken account of issues which we feel are specific to SONI, and which reflect some of our policy priorities. But we have done so to allow our approach to be sufficiently generic in many cases, so that it could also be applied to other sectors and price controls.

We feel that our view provides a picture of our expectations of what is important. In coming to our view, we have received and taken on board helpful input and

suggestions from SECG on design. But we understand that other stakeholders may have different views. We welcome views on the test areas and how they fit together.

We have set out our guidance for how we would assess SONI's business plan below. We expect these to be instructive to SONI but leave enough flexibility for it to take ownership for its business plan. We reserve our right to consider different factors where necessary.

## Categories

When we receive SONI's business plan we will assess how it has performed and place it in one of four categories: **Exceptional, Good, Meeting basic expectations and Poor**.

This categorisation will be built up from an assessment of each of the test areas. We explain our planned approach to business plan assessment and categorisation below. Following feedback from stakeholder responses to our consultation in December 2018, we have sought to clarify several aspects of the approach (e.g. on the importance of test area 1 in the overall assessment).

A key part of our assessment of which category the plan falls under will be based on the extent to which, across the test areas, we find SONI's responses to be "excellent".

We want SONI to provide an **excellent response** to all test questions in all test areas. We provide further guidance on what might constitute an excellent response for each test question in Appendix C. For the purposes of our assessment we will consider whether responses to test questions fit with our guidance for an excellent response and, if not, the extent to which the response falls short of this: specifically, whether the response **falls somewhat short of excellent** or whether it **falls substantially short of excellent**.

We will exercise judgment in combining the assessment of responses to the individual test questions in a given test area to form an assessment of whether the overall response in that test area is excellent, falls somewhat short of excellent, or falls substantially short of excellent.

In addition to the assessment of responses to test questions and test areas, we will take account, more broadly of: (a) the extent to which we find that the business plan submitted by SONI requires regulatory intervention to translate it into an acceptable price control package; and (b) the implications of the business plan for trust in SONI's delivery over the 2020-2025 period.

Taking each of our four proposed business plan categories in turn, the table below sets out our views on the features of a business plan that would fall within that category.

Category	Features
A: Exceptional	<p>Exceptional and stretching business plan with limited regulatory intervention to translate to price control package and a relatively high degree of trust in the company</p> <p>Excellent responses in test area 1 (delivering value for money) and in across most other test areas with responses in the remaining test areas somewhat short of excellent</p>
B: Good	<p>Good plan but falling short of being an exceptional and stretching plan with greater regulatory intervention and less trust than category A</p> <p>Excellent responses in some test areas with responses in the other areas generally somewhat short of excellent</p>
C: Meeting Basic Expectations	<p>Plan does not evidence how best to serve customers and stakeholders with greater regulatory intervention and less trust than category B</p> <p>Lack of excellent responses and/or responses across some test areas that are substantially short of excellent</p>
D: Poor	<p>Extensive regulatory intervention to translate business plan to price control package, with severe concerns about trust in company's ability to deliver good outcomes for stakeholders</p> <p>Responses to test areas generally fall substantially short of excellent</p>

SONI's business role, services and activities should be well aligned with the interests of customers, consumers, other stakeholders and the wider energy system. We feel that our approach to the assessment and categorisation of the business plan, when coupled with our framework and other expectations/guidance on business plan:

- allows SONI to take ownership of its plan. It should also be answerable to stakeholders for what follows from it.
- clarifies that lesser regulatory intervention can be expected in SONI's business plan if it is of higher quality.
- gives SONI greater opportunity to shape its role over the price control period, what activities and level of service is funded through the price control, and aspects of the regulatory framework.
- clarifies that there will be a higher degree of trust in SONI if its business plan is of higher quality.

## **Incentives**

We propose proportionate and appropriate incentives to support a high quality business plan, which we have confidence that SONI will deliver for customers, consumers and other stakeholders.

We propose to use reputational incentives arising from regulatory assessment of business plan quality. We do not feel, at this stage, that some of the procedural incentives used by other regulators (e.g. 'fast tracking') are appropriate for or proportionate to SONI.<sup>34</sup>

Reputational incentives will arise from the publication of our categorisations of SONI's business plan, as part of our draft determination publication planned for December 2019. The challenge applied by stakeholders as part of our SECG initiative may also apply some reputational pressure. We also note that factors such as ownership of plan and interventions may act as motivating factors to submit a high quality business plan.

In terms of a financial incentive, we set out reasons in support and against of having such an incentive in the December 2018 consultation.<sup>35</sup> We also set out that, on balance, there could be a good case for a proportionate financial incentive relating to the outcome of the business plan assessment. We also provided some options for symmetric (reward only) and non-symmetric (reward or penalty) options to provide a small yet meaningful financial incentives for SONI business plan quality. We asked for stakeholder feedback on having a financial incentive and these options.

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<sup>34</sup> For example, because of the time constraints involved in this price control review and also the fact that we are regulating one electricity TSO for Northern Ireland (as opposed to many).

<sup>35</sup> See pages 55 to 57 of the December 2018 consultation approach for values/level and design we proposed for the financial incentive.

Reasons in favour of a financial incentive	Reasons against a financial incentive
Quality of the business plan is important for achieving good outcomes (especially given time constraints)	Complex to make assessment for a single TSO
Strategic fit with expectation of significant change in nature and quality of the business plan	No close yardstick to compare SONI with and given novelty of approach in NI
Time and money required to develop a high quality business plan	Potential distraction from other reasons for the TSO to submit a high-quality plan
Reputational (and other motivational) factors strength is unclear	Little value if already incentivised to produce a good plan

We now propose not to have a financial incentive. Our December 2018 consultation proposal recognised that having a financial incentive was finely balanced in light of the reasons for and against as set out above. As we note in chapter one, we are considering insights from other regulators, whilst focusing on what is achievable and effective for the SONI TSO control in Northern Ireland. This the first time we have taken this particular business plan expectations and assessment approach (within this or our other sector price controls). After listening to stakeholder views (including taking views at SECG) we note that there was not support for the proposal.

We therefore propose, in this instance, to rely on the natural incentive SONI should have to submit a high quality business plan, along with the reputational incentive for any company wishing to be seen to be operating exceptionally (including threat of regulatory intervention). We consider these non-financial incentives are sufficient, taking account of the balance of reasons for and against the financial incentive, and in light of our view of the points raised by stakeholders.

# 6 Price control review process and stakeholder engagement

## 6.1 Phases and milestones

The broad phases of the price control are illustrated below.



The key milestone timings are areas follows:

- We are currently in the approach phase. We welcome response to the consultation by 24 January 2019. We plan to publish our approach decision at the end of February 2019 (along with our business plan templates).
- We expect SONI to submit its business plan by the end of July 2019.
- We will publish our draft determination at the end of 2019.
- We will publish our final determination along with our licence modification consultation at the end of May 2020.<sup>36</sup> This will follow extensive engagement

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<sup>36</sup> The current price control period is for 2015-2020. Section 5 of Annex 2 of the SONI TSO licence deals with the duration of SSS/TUoS Charge Restriction Condition, and it states in paragraph 5.1 that if no modifications to apply any different restrictions with effect from 1 October 2020 are made then, until any such modifications are made, the licensee shall not increase (in nominal terms) any of the tariffs or charges contributing to its Regulated SSS/TUoS Revenue above the levels applicable on 1 October 2019, except where the increase is approved by the Authority. The current Annex 2 within the 2015-2020 period, shall apply so long as the Licence continues in force however the Licensee may deliver to the Authority a "Disapplication Request". If a disapplication request is made we will aim to follow the process as set out in Section 5 of Annex 2 of the Licence. It is the prerogative of

with licence modification proposals with SONI. We plan to dedicate sufficient time to this to ensure the process runs smoothly and there are ‘no surprises’.

- The price control will come into effect on October 1 2020. The implementation period will be 5 years from this date.

We welcome stakeholder engagement during the process. This could include stakeholder engagement on our work during stage 3 (see diagram above).

## 6.2 Ways of working with SONI TSO

Having a healthy working relationship with stakeholders is necessary to ensure price control processes can run as smoothly as possible. SONI is an important stakeholder as part of this review and so we have developed ways of working principles with SONI set out in the table below. These place some principled expectations, along with some examples, on us and SONI, to help further effective engagement with each other. We hope these can play a part in clarifying expectations and build trust.

<b>Clear and reasoned views</b>	SONI and UR communications should be clear and comprehensive.
<b>Transparency and empowerment</b>	We will promote an environment for SONI to input on proposals, engage effectively and improve its justification as early as possible; and will make available sufficient information to facilitate activities.
<b>Streamlined, timely and targeted exchanges</b>	<p>We expect SONI to be straightforward and flexible in engaging and providing information.</p> <p>We will be targeted in gathering information/communicating and be clear on purpose. The level and type of evidence we require will be appropriate and proportionate.</p> <p>We will share discussion point and actions of bi-lateral meetings with SONI and ask for its comments.</p>

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the Licensee if they wish to follow the Disapplication Notice process and if one is submitted it may be withdrawn by the Licensee at any time prior to the Disapplication Date.

<p><b>No surprises</b></p>	<p>We will give SONI a clear expectation of our views, team role/structure, approach as early as is possible. If we are changing position we will be clear why and on what basis (in light of evidence).</p> <p>SONI should give us clear expectations of its view as early as is possible in light of the evidence provided to minimise drip feed.</p> <p>We expect SONI to respect process once prescribed and agreed (e.g. timelines)</p>
<p><b>Self-evaluation and responsiveness</b></p>	<p>SONI should be open to alternative ways of seeking the goal (proactively offering best available information available if something doesn't exist, considering merits and drawbacks of different policy options fully)</p> <p>We are open to new thinking, will proactively and transparently consider best practice, ensure we meet UR 'best practice regulation' principles and statutory duties, and will respond to new information and evidence revealed in a timely way as the review progresses.</p>

### 6.3 Stakeholder Expert Challenge Group (SECG)

We want to strengthen the use of stakeholder engagement as part of this review to further our aims of bringing more accountability and transparency. One way we have done this is to develop and set up SECG. This group comprises UR, SONI, individual expert stakeholders, and the Department for the Economy (as an observer).

We feel that a group of individual expert stakeholders who can exercise a sufficient level of independent insight and challenge on SONI and UR can help. In particular, it can help with our aim of ensuring that SONI's price control business plan aligns with consumer interests, and meets the needs of SONI's users.

Enhanced engagement is a well-recognised feature used by other sectoral regulators, and we have used various other forms of partnership type enhanced engagement in other sectors we regulate.<sup>37</sup> This type of partnership approach has a track-record in bringing benefits.

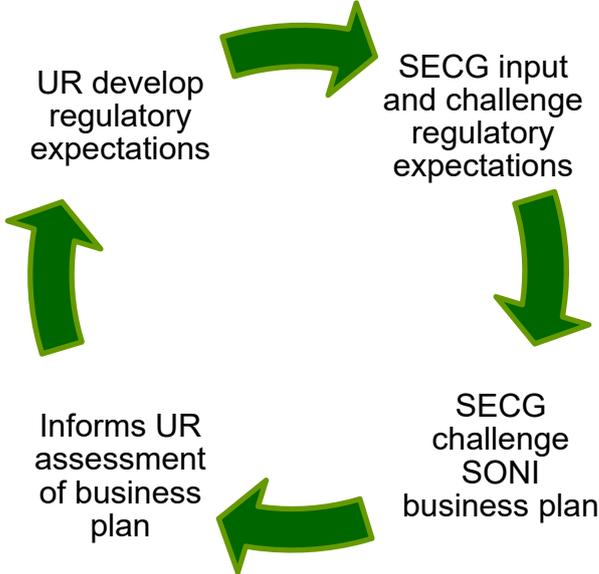
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<sup>37</sup> For example, Consumer Engagement Advisory Panel approach used in RP6 and stakeholder groups in water regulation.

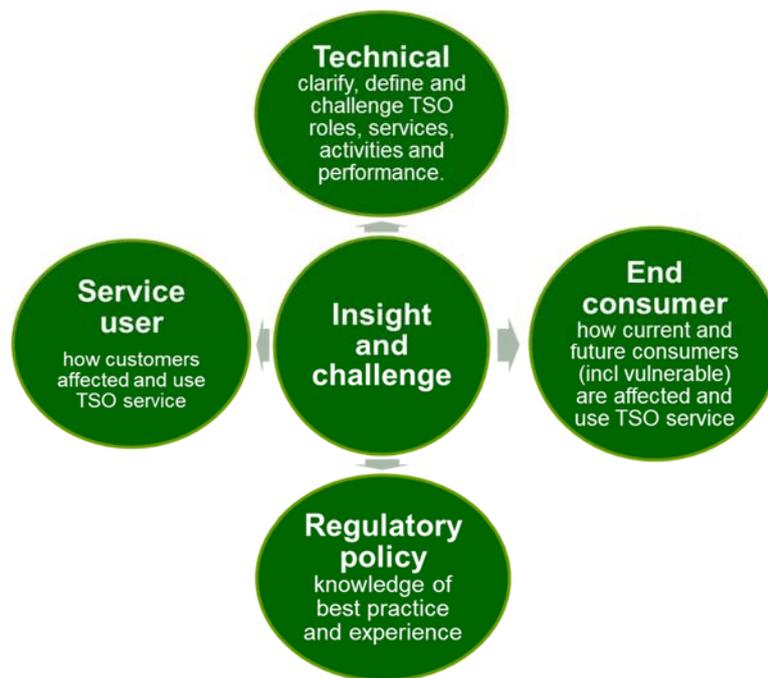
We feel that this concept is particularly suited to the SONI TSO price control. This is partly because of the difficulty in applying the same pressures which are available in some of our other price controls (e.g. comparative cost and performance benchmarking). It may also be suitable because much of SONI's customer base is reasonably well-resourced and concentrated. Put another way, the group may be able to usefully apply some customer and expert type pressure to compensate for a relative lack of competitive pressure on SONI.

We feel that the group can support a number of benefits:

- facilitate effective regulatory policy.
- encourage a high quality and well justified SONI business plan.
- support our assessment of the business plan.



The group has a wide range of skills and expertise which will continue to be useful for the purposes above. These skills are illustrated in the table below. We see the core role of the group as providing insight and challenge by using their skills and experience.



We have published guidance on how the group should operate and challenge the business plan which we will update, as and when is necessary.<sup>38</sup> We have also published wider material presented at the group along with meeting notes for transparency purposes.<sup>39</sup>

#### 6.4 Wider stakeholder engagement

We are conscious of consulting more widely to ensure all stakeholder views are captured. We are open to bi-laterals during the remainder of our approach phase and beyond. We welcome any views on how we can further engage effectively.

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<sup>38</sup> <https://www.uregni.gov.uk/sites/uregni/files/media-files/SECG%20guidance%20and%20ToR.pdf>

<sup>39</sup> <https://www.uregni.gov.uk/stakeholder-engagement-challenge-group>

# Appendix A: Overview of existing price control framework

## Legal Framework

The framework governing the regulation of electricity transmission activities in Northern Ireland is principally set out in two pieces of legislation: the Energy (Northern Ireland) Order 2003 and the Electricity (Northern Ireland) Order 1992.

The Energy Order establishes the UR and sets out its objectives, powers and duties. Article 12(1) of the Energy Order states that the principal objective is;

*“to protect the interests of consumers of electricity supplied by authorised suppliers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity.”<sup>40</sup>*

In carrying out this function, Article 12 also states that the UR must, amongst other things, have regard to;

- Ensuring that all reasonable demands for electricity are met.
- Licence holders are able to finance their obligated activities.
- The interests of certain vulnerable customer groups are considered.
- The promotion of efficiency and economy on those licensed to participate in the transmission of electricity.
- Dangers arising from the activity of generating or conveying electricity.
- The security and sustainability of energy supply.
- Promotion of research and development of new technologies within the industry.

SONI is the holder of a transmission licence, issued pursuant to article 10(1)(b) of the Electricity Order. The general duties of the TSO as defined by legislation include:

- Ensuring the development and maintenance of an efficient, co-ordinated and economical system of electricity transmission.
- Contribute to security of supply through adequate capacity and system reliability.

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<sup>40</sup> <https://www.legislation.gov.uk/nisi/2003/419/article/12>

- Facilitate competition in the supply and generation of electricity.<sup>41</sup>

Decisions with respect to the price control are taken within this legal framework

### Price Control Framework

The existing framework (post CMA decisions) consists of a number of different elements and results in the following licence revenue formula:

$$M_{TS0t} = A_{TS0t} + B_{TS0t} - BI_t + D_{TS0t} + K_{TS0t} + INCENT_t + N_{TS0t} + PCR_t + AB\_PC_t + Z_t$$

The formula represents the maximum regulated revenue ( $M_t$ ) and is made up of the following components:

- 1)  $A_t$  term – Ancillary services, sundry items and TUoS.
- 2)  $B_t$  term – opex and capex.
- 3)  $BI_t$  term – 50/50 risk reward share for BAU costs.
- 4)  $D_t$  term – Re-openers for unexpected, uncertain or uncontrollable costs over £40k.
- 5)  $K_t$  term – Correction factor between collected and allowed revenues.
- 6)  $INCENT_t$  term – Incentive scheme for dispatch balance costs (DBC).
- 7)  $N_t$  term – Decisions arising from the CMA referral.
- 8)  $PCR_t$  term – Return on pre-construction projects.
- 9)  $AB\_PC_t$  term – Revenue to cover abandoned projects.
- 10)  $Z_t$  term – Re-openers for unexpected, uncertain or uncontrollable costs over £40k of a capital nature.

Besides this revenue, SONI also has the role of collecting monies associated with the Moyle Interconnector (known as the  $CAIR_t$  term). UR has set out an explanation of each licence term below.

### Pass-through

The  $A_t$  term consists of three elements; ancillary services, TUoS and market operation costs not covered by that licence.

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<sup>41</sup> <https://www.legislation.gov.uk/nisi/1992/231/article/12>

With respect to TUoS, SONI describes its role as granting third party access to the transmission network, with associated decision making control (this role includes charging suppliers and generators for use of the system).

Ancillary services consist of payments (at rates approved by the UR) to generators for;

- Capability to provide electricity at various speeds and with charges for non-delivery.
- Entering into local reserve service agreements.
- Fuel switching and sundry activities.

These costs are treated on a pass-through basis. This is due to the uncertain nature of the requirement for ancillary services and the uncontrollable nature of aspects of these costs. Consequently, they are not subject to any incentive at present.

### **Ex-ante baseline (with cost incentive mechanism)**

The  $B_t$  term refers to certain opex and capex costs. It represents the main element of UR price control decisions. Cost categories include:

- Operational staff (100+) excluding connections.
- Facilities costs e.g. buildings, rates, insurance etc.
- Pension costs.
- Telecommunications.
- Professional fees.
- Recharges for corporate functions e.g. HR, audit, Board costs etc.
- Costs for capital projects such as IT systems and building maintenance.

These costs are treated on a symmetrical basis. Ex-ante allowances are set for the price control period based upon benchmarking and bottom-up analysis.

The  $BI_t$  term is a mechanistic calculation for certain opex and capex. At present it is set on a 50:50 basis. This means that consumers share 50% of any outperformance but will pay 50% of any cost over-runs for these cost items.

### **Regulatory approval process**

The  $D_t$  term is a re-opener for unforeseen, uncertain or uncontrollable costs over £40k (the £40k is currently referred to as 'the de minimus level').

Costs which fall under this term broadly cover three areas:

- 1) Unknown – new obligation or change of law.
- 2) Uncertain – known activity but elements of costs may be uncertain.
- 3) Uncontrollable – TSO has no control over materiality of costs; or little control (e.g. ENTSOE fees).

As a result of the CMA referral, there now exists extensive guidance, processes and templates relating to uncertain cost claims. Allowances are typically set on an ex-ante basis with actual costs being remunerated up to the cap. Opportunity to raise the cap is available. This results in asymmetric risk which is remunerated under a separate licence term.

Ex-post adjustment is available by virtue of the DIWE (Demonstrably Inefficient and Wasteful Expenditure) review.

The  $Z_t$  term is a re-opener in a similar vein to the  $D_t$  uncertainty mechanism. The difference with this term is that it allows for capital treatment (i.e. depreciation and returns) rather than provision for costs incurred within year.

The  $PCR_t$  term is a return on Transmission Network Pre-Construction Project (TNPP) spend. Pre-construction activities (i.e. planning consents, studies, landowner engagement) became the responsibility of SONI in 2014.

Much like the  $D_t$  uncertainty mechanism, TNPPs are now subject to detailed guidance, process and templates. Allowances are typically set on an ex-ante basis with a return on actual TNPP costs up to the cap. This results in asymmetric risk which is remunerated under a separate licence term. Unlike the  $D_t$  term, the PCRt for TNPPs does not have a de minimis level.

On pre-construction completion, the project transfers to NIE Networks for construction. NIE Networks will purchase the Regulatory Asset Base (RAB) based on actual costs up to a cap. Return on the RAB will be retained by SONI.

Ex-post adjustment is available by virtue of the DIWE review.

### **Correction Factor**

The  $K_t$  term is a standard correction factor which recoups or returns under / over recoveries due to differences between forecasts and actuals. It operates with a two year time lag.

### **Incentive Mechanism**

The  $INCENT_t$  term is a payment/penalty system devised by the SEM Committee for dispatch balancing cost performance. The activity is market operator focused but revenues are provided for in the TSO licence.

### **CMA Decisions**

The  $N_t$  term resulted from the CMA deliberations on the SONI referral. It consists of revenues related to three separate areas.

- 1) Parent Company Guarantee (PCG) – return for the parent providing financial assurance calculated on the basis of £10m \* 1.75%.
- 2) Asymmetric risk – return for taking asymmetric risk on TNPP and  $D_t$  projects set at £220k p.a. (based on 3% return on estimated costs).
- 3) Collection agent function – return for performing the collection agent role. Calculated on the basis of (TUoS + DBCs + Ancillary Services) \* 0.5%.

The framework requires the UR to take decisions regarding percentage allowances for the activities in question.

### **Abandoned Projects**

The  $AB_{PC}_t$  term is a payment for capital costs on a TNPP project which is subsequently abandoned. As NIE Networks do not purchase this project RAB, this term allows for SONI to recover efficient costs incurred.

# Appendix B: SONI TSO roles and services

SONI has identified four key roles it fulfils in delivering these duties. These include the following:

- 1) System operation and balancing.
- 2) Transmission network planning.
- 3) Acting as a commercial interface.
- 4) Providing independent expertise.

Specific activities and key requirements are often codified as a licence obligation. For example (not exhaustive):

- 1) Condition 16 requires the preparation and maintenance of the grid code.
- 2) Condition 22A requires the periodic audit of the scheduling and dispatch process.
- 3) Condition 29 requires the TSO to purchase system support services from the most economical sources.
- 4) Condition 29 requires upon request the production of a document setting out the principles and criterion used in procuring system support services.
- 5) Condition 30 requires the production of charging statements.
- 6) Condition 33 requires the publication of a ten-year transmission forecast statement (TYTFS) for capacity.
- 7) Condition 35 requires the preparation of a seven-year generation capacity statement.
- 8) Condition 40 requires the development of a transmission development plan for Northern Ireland (TDPNI).

The table below details a list of services and activities which SONI has identified as being associated with the four key roles which it has identified. We have mapped these activities to existing revenue streams (as set out in Appendix A).

TSO Roles	TSO Service Scope	TSO Activities Scope	Existing Licence Revenue Stream	
System Operation and Balancing	System Balancing	System Security (continuous analysis & system service requirements).	Bt	
		Priority Dispatch (wind & solar forecasts) – cost impact on DBCs.	Bt	
		Least Cost Dispatch (forecasting, merit order, physical notifications).	Bt	
	Generation and Network Availability	Generation and Network Availability	Outage Planning & System Restoration.	Bt
			Capacity Market Delivery.	Currently Dt
			Generation Capacity Statement.	Bt
			Energy System Analysis.	Bt
			System Services Implementation and Procurement Activities.	Bt / Dt
			System Service Payments.	At
	Industry Governance	Industry Governance	Grid Code Management.	Bt
			Network Code Implementation.	Bt / Dt
			Transmission System Security and Planning Standards (TSSPS).	Bt
			Operating Security Standards.	Bt
Commercial Interface for Transmission Network	Contractual Interface	Moyle interconnector (Market registration, Error Account, Revenue Shortfall).	Dt	
		Transmission Revenue (All-island GTUoS, NI Supplier TUoS, tariffs).	Bt	
		Banker/Insurer (MO shortfalls, Tariff Deviation, CRM 'hole in the hedge').	Nt	
		Collection agent function.	Nt	

TSO Roles	TSO Service Scope	TSO Activities Scope	Existing Licence Revenue Stream
Transmission Network Planning	Assess & Communicate System Needs	Future Scenarios.	Currently Dt
		Ten Year Transmission Forecast Statement.	Bt
		Transmission Development Plan NI (SEA & public consultation).	Currently Dt
		Transmission Investment plan (Joint working with NIE Networks).	Bt
	Planning Network Development	Assessment of Options (stakeholder engagement, Technical assessment, CBA).	Bt + PCRt
		Preferred Option (stakeholder engagement, Technical Assessment, CBA).	Bt + PCRt
		Project Consenting (Planning Permission, Landowner Consents, Route and Site Selection, Environmental Assessment).	PCRt
		Handover to NIE Networks (Confirm CBA, Contractual Documentation).	PCRt
	Connection and Use of System	Connection Offers (Contracts with NIE or Contestable Offer, Grid Code Testing, Telemetry, Connection Offers/Agreements and Bonding).	Connection Fees (Out of scope of licence revenue)
		Access Rights (FAQ Assessment, Assess System impact of customer).	Connection Fees / Bt
		Use of System (Tariffs, TLAFs, Access Rights (TUoS agreement)).	Connection Fees / Bt
	Independent Expertise	Independent Engagement and Advice	Security of Supply.
Market Outcomes.			Bt
Network development.			PCRt
Support Government (DfE) Strategy.			Bt
European Issues e.g. ENTSO-E, CORESO etc.			Bt / Dt
Special project implementation / uncertainty mechanism.			Dt

## Appendix C: Business plan assessment test area questions

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
<b>Test 1: Delivering value for money</b>		
How well has the company demonstrated that its proposed services and tariffs provide value for money?	This is an overarching question that brings together different elements of the business plan	The plan offers an exceptional and compelling proposition overall
How well has the company assessed how its business plan proposals contribute to desired outcomes and affect different parties?	Response should take account of diversity across customer base for TSO services, how its services feed through to energy bills and how they contribute to environmental objectives (among other things)	A firm understanding of how aspects of the price control (and its decision-making) can affect different groups of customers and stakeholders Compelling evidence and analysis that the plan achieves good outcomes overall Strong evidence that the plan represents a fair package across different groups
How well has the company demonstrated that its projected tariffs for the 2020-25 period and beyond will allow for a fair balance of charges between current and future customers?	Response should take account of price control indexation policies and the company's proposals on RAB depreciation (among other things)	A firm understanding of how aspects of the price control package can affect fairness between current and future customers Strong evidence of fairness over time from the proposed package Strong evidence that the plan does not seek favourable near-term impacts at the expense of fairness for future customers
<b>Test 2: Delivering services and outcomes</b>		
To what extent has the company set out	Should include any services provided by	Focus on services rather than simply

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
and clearly described, in an accessible way, the full range of services that it proposes to provide and which of these are to be funded through the TSO control?	TSO to other entities within same corporate group (e.g. any working capital or insurance services provided to SEMO JV)	<p>activities</p> <p>Clear and comprehensive explanation of what services are covered by TSO control, and what activities of the company fall outside its scope</p> <p>Accessible explanations of TSO services which are tailored for different audiences (e.g. domestic energy consumers; electricity industry practitioners)</p> <p>A high-degree of granularity provided in the explanation of proposed services</p>
How well has the company explained and justified the outcomes which matter to the TSO price control and how these are influenced by the services that it can provide? How well has the company supported its proposals on the services that it proposes to provide over the 2020-25 period?	<p>Response should take account of the TSO's duties and obligations, its engagement and the identified outcomes</p> <p>Response should consider innovative options for scaling back its services in some areas (potentially with third parties playing a greater role) as well as for enhancing services in other areas</p>	<p>Plan brings a genuinely fresh perspective on how the TSO can contribute to good outcomes through the services it provides</p> <p>No presumption that the TSO is best-placed to do what it does</p> <p>Plan explores opportunities for variations in the service obligations it faces (e.g. current licence obligations) where this could improve outcomes</p> <p>Innovative but practical proposals on its service portfolio that reflect stakeholder engagement</p>
How appropriate, well-evidenced and	Response should include performance	Comprehensive package of performance

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
<p>stretching are the company's proposed performance commitments and service levels?</p>	<p>commitments that cover the full range of services proposed</p> <p>Should be consistent with the UR's Approach</p> <p>Performance commitments should be genuinely stretching and give confidence that company's proposal do not provide an easy opportunity to out-perform</p> <p>Response should identify where company's proposals go beyond minimum required for compliance with its duties, obligations and other constraints and justify the case for any additional costs to customers from enhanced service levels</p>	<p>commitments that marks a step-change from current TSO price control framework</p> <p>Strong evidence that performance commitments are stretching</p> <p>Role for quantitative and qualitative performance commitments, with these clearly explained in terms of their relationship to desired outcomes and to stakeholder engagement</p>
<p>To what extent do the arrangements proposed by the company for holding it to account and/or influencing its incentives over the price control period give confidence that it will meet its proposed performance commitments and achieve ongoing improvements?</p>	<p>Should be consistent with the UR's Approach</p> <p>These arrangements should provide an effective and robust way to hold the company accountable for delivery of its business plan proposals</p> <p>Should take account of developments from other regulatory tools (e.g. Ofgem's work on new ESO incentives and on the</p>	<p>Firm understanding of the need for the UR and stakeholders to be confident that the TSO will be sufficiently accountable for, and exposed to, its performance against commitments and clear thinking on the best ways to achieve this</p> <p>Innovation in how the TSO can be held to account in a way that supports good outcomes</p>

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
	NOA) insofar as is relevant under the UR's Approach	Coherence with other aspects of price control package (e.g. cost remuneration) Comprehensive package that ensures that success in one area does not come at the expense of performance in other areas
To what extent do the company's proposals for services demonstrate that it will bring a system-wide perspective and approach across all parts of the NI energy system?	Should include, but not be limited to, need for system-wide approach in context of: <ul style="list-style-type: none"> <li>• Choices and trade-offs between network and non-network expenditure</li> <li>• Choices and trade-offs over time</li> <li>• Choices and trade-offs between generation-side and demand-side solutions</li> </ul>	Firm understanding, with practical examples, of what a system-wide perspective involves Appreciation of factors (e.g. habit, regulatory framework, institutional structures) that pose risks to a system-wide perspective and worse outcomes overall Credible plan for adopting a system-wide perspective across its services and activities
How well has the company demonstrated that it will support the ongoing development of the NI energy system (and the Single Electricity Market insofar as applicable to the TSO control) in a way that improves system outcomes and	Should explain how its proposed performance commitments and accountability / incentive arrangements provide confidence about the quality of its services in relation to system development	Clear exposition of the involvement of the TSO across different aspects of system (and market) development, highlighting priority areas, drawing on stakeholder engagement and linking to desired outcomes

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
better meets the needs of system users and energy consumers?		Effective arrangements in place to ensure it meets customer needs, including in relation to timescales, transparency, stakeholder participation and adaptation over time
<b>Test 3: Securing cost efficiency and managing uncertainty</b>		
How well has the company justified its proposals for the approach to the price control remuneration of different elements of its costs (including associated incentive structures) and given confidence that these will deliver good outcomes?	<p>Should be consistent with the UR's Approach</p> <p>Should include full supporting evidence and analysis (in appendices where appropriate)</p> <p>Should include a granular mapping between the proposed TSO services and the proposed cost remuneration structure to apply in each case, explaining differences from the structure for the 2015-20 control and alignment with the UR's Approach to the 2020-25 control</p>	<p>Builds on UR Approach to propose framework that should improve overall outcomes from the TSO control</p> <p>Compelling proposals for remuneration of different elements of its costs, taking account of benefits and drawbacks of different approaches and interactions across different aspects of price control package</p> <p>A clear, well-reasoned and robust mapping between service/activities and the proposed cost remuneration structures</p>
How well-evidenced and well-explained are the company's proposals for the efficient costs of delivering its proposed services?	<p>Should be consistent with the UR's Approach</p> <p>Should include a granular mapping between proposed services and the</p>	<p>Cost proposals supported by range of different sources of evidence, including well-explained benchmarking analysis</p> <p>High-quality analysis, with clear</p>

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
	<p>projected costs</p>	<p>explanation of data sources and assumptions</p> <p>Firm understanding of the benefits and weaknesses of different sources of evidence and of the uncertainties involved in making cost projections</p> <p>Insight and careful judgement used to draw together evidence into cost proposals</p> <p>Mapping between costs and services provides stakeholders with high degree of cost transparency and a basis for ongoing engagement</p> <p>Well-presented and understandable supporting analysis included in appendices spreadsheets as part of submission</p>
<p>How ambitious and challenging are the company's proposals against the aim of securing cost efficiency to the benefit of NI customers?</p>	<p>There will be uncertainty about the level of efficient costs for a set of services over a five-year price control period, given limitations in data availability and uncertain future developments</p> <p>The business plan should provide an ambitious offer to customers against the</p>	<p>Compelling evidence that proposals on costs are ambitious and challenging, putting the long-term interests of customers ahead of any near-term opportunities to enhance returns (or risk protection) for investors</p> <p>Strong evidence that the company's cost</p>

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
	background of this uncertainty	proposals have been through an effective and influential process of challenge and review to improve the offer to customers
How well has the company demonstrated innovation that contributes to greater cost efficiency?	Should recognise innovation and improvement over time as an enabler of efficient business operations	Credible examples of customer benefits from innovation alongside effective arrangements to ensure ongoing innovation to the benefit of customers
To what extent is the set of price control uncertainty mechanisms proposed by the company well-justified and well-designed, as a means to provide cost risk protection to the ultimate benefit of consumers, taking the benefits and drawbacks that uncertainty mechanisms may bring for consumers?	Should be consistent with UR Approach Should provide clear explanation of how proposed mechanisms would work and their scope	Well-targeted and innovative improvements, building on the uncertainty mechanisms established for the 2015-20 TSO control  Firm understanding of benefits and drawbacks of proposed mechanisms Coherence and consistency with other parts of proposed price control package (e.g. services and performance commitments, approach to cost remuneration)
<b>Test 4: Aligning risk and return</b>		
To what extent has the company explained and justified its assumed capital structure for a notional efficient TSO licensee over the 2020-25 period?	Response should include explanation of its proposed mix of equity and debt finance, and any parent company guarantees, for the notional efficient licensee	Fresh perspective on notional capital structure, with clear and comprehensive explanation of assumptions  Excellent analysis of relationship between notional capital structure and

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
	<p>Response should explain how the need for different elements of the assumed capital structure relate to the different services it proposes to provide</p>	<p>various services provided by the TSO</p> <p>Notional capital structure makes clear contribution to quality of quantitative analysis that is built on it, taking account of data availability</p> <p>Evidence that proposed notional capital structure has been tested against possible alternatives, taking account of cost to customers and other factors</p> <p>Well-presented and understandable supporting analysis included in spreadsheets as part of submission</p>
<p>Has the company put forward a clear set of remuneration channels for equity and debt finance under notional financial structure that fits with UR expectations?</p>	<p>Channels should be consistent with UR approach, including an allowed WACC on TSO RAB is one remuneration channel that should be used</p> <p>Other channels might include a margin for financing costs relating to revenue collection activities</p> <p>Response should explain link between remuneration channels and TSO services</p>	<p>Clear explanation of remuneration channels for equity and debt finance under notional capital structure, and how these relate to the proposed TSO services</p> <p>Full alignment with UR expectations unless compelling case made an for alternative being better for customers</p>
<p>To what extent has the company demonstrated a good understanding and well-evidenced scenario analysis for the</p>	<p>Should take account of the cost incentives and cost exposure, performance incentives and uncertainty</p>	<p>High-quality analysis</p> <p>Clear explanation of modelling assumptions</p>

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
range of upside and downside risks for the notional efficient licensee?	<p>mechanisms proposed</p> <p>Should include analysis of return on regulated equity (RoRE) which recognises both near-term and long-term impacts on revenues on costs</p>	<p>Well-presented and understandable supporting analysis included in appendices spreadsheets as part of submission</p> <p>Clear evidence that scenario analysis has fed into the development of proposals for other aspects of the price control package (e.g. strength of incentives) to improve overall outcomes, recognising benefits and costs to customers of variations in risk exposure</p>
To what extent has the company justified its proposed allowances for each of these remuneration channels? Has the company provided confidence that there is not any double-counting across channels?	<p>Should be consistent with notional financial structure and scenario risk analysis</p> <p>Response should take account of the implications for customer tariffs and value for money, expected market conditions for 2020-25 and the evidence and assumption of other UK regulators and regulated companies (amongst other things)</p> <p>Inclusion of debt financeability analysis if this is relevant and informative for the notional capital structure</p>	<p>Compelling evidence that proposals on allowances are ambitious and challenging, putting the long-term interests of customers ahead of any near-term opportunities to enhance returns (or risk protection) for investors</p> <p>Strong evidence that the company's financing proposals have been through an effective and influential process of challenge and review to improve the offer to customers</p>

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
<p>To what extent has the company justified its proposed allowances for corporation tax liabilities and provided confidence that its tax arrangements are supported by customers and stakeholders?</p>	<p>Must be consistent with approach to corporation tax in the UR's published Approach decision document</p> <p>Should include consideration of potential role for a targeted and proportionate uncertainty mechanism in relation to uncertainty about future rates of corporation tax</p>	<p>Consistent with UR approach</p> <p>Strong evidence to support proposed allowances for corporation tax liabilities</p> <p>Evidence of proportionate stakeholder engagement on aspects of corporation tax that matter to stakeholders and stakeholder support for proposed approach</p> <p>Well-justified proposals in relation to uncertainty about future tax rates</p>
<p>What confidence has the company given about its financial resilience under its business plan proposals?</p>	<p>Should include explanation of how planned financial structure differs from assumed notional efficient financial structure</p> <p>Should include similar scenario risk analysis as used for notional efficient licensee</p>	<p>Clear explanation of planned financial structure for 2020-25 period and why it differs from notional efficient financial structure</p> <p>High-quality scenario analysis and stress-testing</p> <p>Strong evidence of financial resilience under planned financial structure</p>
<p><b>Test 5: Engaging customers, consumers and other stakeholders</b></p>		
<p>What is the quality of the company's engagement?</p>	<p>Engagement expected to include, but not be limited to:</p>	<p>Demonstrates a clear understanding of different stakeholders to engage with and</p>

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
	<ul style="list-style-type: none"> <li>• Energy consumers</li> <li>• Generators</li> <li>• Suppliers</li> <li>• Prosumers</li> <li>• Network infrastructure company</li> <li>• Consumer representatives</li> <li>• Environmental stakeholders</li> <li>• NI Government</li> <li>• Independent experts with knowledge of the energy system, system operation and/or monopoly regulation</li> </ul> <p>In each case, engagement should recognise diversity within each broad category and develop engagement to accommodate this</p>	<p>the issues which are likely to matter most to them, and how stakeholder engagement can be used effectively across the plan</p> <p>Excellent engagement initiatives across a range of diverse stakeholders, using a variety of approaches</p> <p>Engagement tailored to the TSO's services, but drawing on tools and approaches from other regulated sectors and elsewhere</p> <p>Engagement targeted and proportionate, which provides a platform for future improvements during the 2020-25 control period and for the subsequent control period</p>
<p>How well has the company demonstrated that findings from its engagement have been incorporated into its business plan proposals?</p>	<p>Sections of business plan covering test areas 1, 2, 3 and 4 (in particular) should be informed and improved by stakeholder engagement, and the company should provide a clear explanation of this</p>	<p>A clear mapping of how its proposals across its plan have been shaped by engagement</p> <p>Compelling evidence that engagement has made a real difference across the business plan, in a way that will improve outcomes</p>

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
		Recognition of benefits and drawbacks of evidence from different types of engagement and demonstration of sound judgement in using engagement to inform the plan
How well has the company demonstrated that its engagement will be incorporated into ongoing activities?	Include explanation of how engagement used in the past and commitments for the incorporation of engagement as part of plans for the future	Plan gives confidence that engagement with stakeholders lies at the heart of the company's approach to providing services  Ongoing engagement used in an effective way, with genuine influence on TSO
<b>Test 6: Ensuring resilience and governance</b>		
How well has the company demonstrated that it has effective governance arrangements in place to deliver on its business plan?	Should draw on insight from other sectors and corporate best practices  Should include assessment of risks of conflict of interest (direct, indirect, perceived) arising from ownership structure or investors' interests and how any risks will be mitigated	Compelling evidence of effective governance arrangements  Compelling evidence that governance arrangements are focused on the expectations and needs of NI customers
How well has the company demonstrated an understanding of the range of risks that could impact on its delivery, service quality, performance and costs?	This question concerns the risks that the company cannot deliver on the service and cost proposals provided in response to test areas 1 to 4	High-quality risk analysis covering a diverse range of risks

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
How well has the company demonstrated that it has effective arrangements in place to mitigate and manage those risks?	Should cover risks identified in previous section Level of detail provided should be proportionate to materiality of risk to stakeholders	Strong evidence of effective risk mitigation arrangements Clear explanation how these arrangements support overall value for money Transparency on residual risks
<b>Test 7: Accounting for past delivery</b>		
What are the areas of strength and weakness in the company's performance in relation to the 2015-20 period? Taking these into account, how well has it put measures in place to ensure confidence that it can successfully deliver its 2020-25 business plan and fulfil stakeholder expectations?	Should include explanation of findings from stakeholder engagement on strength and weaknesses, as well as from company's own internal reviews and knowledge	Compelling evidence that company has learned from both positive and negative experiences from the past, taking account of stakeholder views, to make a real step forward for the 2020-25 period
How well has the company given evidence for, and explained, any financial adjustments required as part of the maximum revenue allowances under the 2020-25 control, in relation to its costs or performance during the 2015-20 control period?	Any such adjustments must be clearly mapped to the relevant provisions of the 2015-20 TSO control and complemented with high-quality supporting evidence	Clear explanation and strong evidence for any adjustments proposed
How well has the company explained the levels of its outturn costs and	Level of detail provided should be	Clear and well-evidenced explanation

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
performance that feed into any such adjustments?	proportionate to materiality of adjustment	
<b>Test 8: Securing confidence and assurance</b>		
How well has the company provided confidence that it will actually deliver effectively on its proposals for services and costs?	<p>Response should consider the risks to under-performance and under-delivery of the proposals set out under test areas 1 to 4, and explain how these are mitigated effectively</p> <p>Should consider role of proposed incentives and arrangements for accountability and potential risks to their effectiveness (e.g. perverse incentives, performance measurement issues, etc).</p>	<p>High-quality analysis of the robustness of the proposed price control package in terms of ensuring delivery (e.g. effective incentives and accountability arrangements for performance commitments)</p> <p>Evidence of effective process for testing and challenging the robustness of the package to delivery risk</p>
To what extent has the company's Board provided comprehensive assurance to demonstrate that all the elements add up to a business plan that is high-quality and deliverable, and that it has challenged management to ensure this is the case?	Should include full explanation of the Board's approach to assurance of the plan	<p>The Board will own the overall strategy and direction of the plan and take collective responsibility for its assurance.</p> <p>The Board will provide a statement of why it considers all the elements (including supporting data) add up to a business plan that is high-quality and deliverable, providing strong evidence of where and how it has challenged company management.</p>
Has the company's board provided a		Clear statement by the Board that the

Questions organised by test area	Further guidance on question where applicable	Guidance on potential features of an excellent response to the question
clear statement that its plan is financeable on both an actual and a notional basis?		plan is financeable on both an actual and a notional basis, with robust supporting evidence
To what extent has the company's Board demonstrated that its governance and assurance processes will deliver operational, financial and corporate resilience over the?		Clear demonstration by the Board that its governance and assurance processes will deliver operational, financial and corporate resilience
To what extent does the company have a good track record of producing high-quality data and reliable submissions as part of processes associated with its economic regulation?		Evidence of exceptional track record across different regulatory processes
How consistent, accurate and assured are the company's business plan data tables, including the allocation of costs between services/activities (and between companies within the same corporate group), and the assurance and commentary provided?		High-quality and well-explained business plan data tables, with effective assurance that provides a high degree of confidence in the data provided