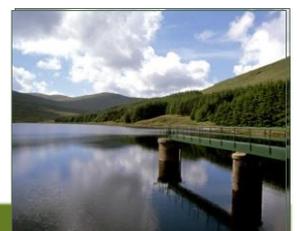


Requirements and Guidance on Transmission Network Pre-construction Projects and on excluded SSS/TUoS costs

Consultation Document
20 December 2017



About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our Mission

Value and sustainability in energy and water.

Our Vision

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

Our Values

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

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

This paper sets out the Utility Regulator's (UR's) proposed process for cost recovery of TNPPs (Transmission Network Pre-Construction Projects) and uncertain revenue (D_i) applications by the electricity transmission System Operator for Northern Ireland (SONI).

The process has been formalised to implement the Competition Markets Authority (CMA)'s decisions on the SONI Price Control 2015-2020 appeal. The focus of this consultation is to ensure that the process and guidance proposed by the UR reflect the CMA conclusions and ensure transparency of cost recovery for SONI.

Audience

This document is likely to be of interest to SONI, NIE Networks, other regulated companies in the energy industry, government and consumer groups with an interest in the energy industry.

Consumer impact

It is not anticipated that these changes will have any impact on consumer bills. The proposed formal pro-formas and reporting requirements have been instituted following the CMA decisions.

We do not consider that the reporting will result in increased regulatory burden or need for additional resource as the templates simply formalise information which should already be collected/exist within the organisation.

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1. Introduction and Context

- 1.1 This document contains the UR's proposed requirements and guidance on the processes by which SONI can recover costs for Transmission Network Pre-construction Projects (TNPP) and costs subject to the D_t mechanism under its price control.
- 1.2 No up-front allowances were provided for these projects and costs in SONI's price control. Instead processes are available for SONI to apply to recover these costs during the price control.
- 1.3 These requirements and guidance are being put in place to codify these processes in compliance with the Order of the Competition and Markets Authority (CMA), following SONI's appeal of its price control (further described below). We welcome comments from stakeholders on the proposed requirements and guidance.

SONI's 2015-20 price control and CMA's final determination

- 1.4 SONI's current price control covers the period from 1 October 2015 to 30 September 2020. We published a final determination in February 2016¹ and a subsequent decision on modifications to SONI's transmission system operator licence in March 2017.² These licence modifications took effect on 9 May 2017.
- 1.5 On 12 April 2017, SONI appealed the price control decision to the CMA.³ As part of that appeal, SONI contended, that it faced uncertainty as to whether it could recover costs associated with fulfilling certain of its functions and licence obligations where no upfront allowance had been set as part of the price control.
- 1.6 It argued that such uncertainty would have an important bearing on its financeability (referred to as 'the Revenue Uncertainty Ground').
- 1.7 In November 2017, the CMA published its final determination⁴ and order⁵ partially allowing SONI's appeal on the Revenue Uncertainty Ground. The

¹ [Final Determination to the Price Control 2015-2020 for the Electricity System Operator for Northern Ireland \(SONI\)](#), 22 February 2016, Utility Regulator.

² [Decision on the Licence Modifications for the Price Control 2015-2020 of the Electricity System Operator for Northern Ireland \(SONI\)](#), 14 March 2017, Utility Regulator.

³ [SONI Notice of Appeal](#), 11 May 2017.

⁴ [SONI Limited v Northern Ireland Authority for Utility Regulation: Final determination](#), 10 November 2017, CMA.

⁵ [Order](#), 10 November 2017, CMA.

CMA found that we had failed to codify and specify clearly the mechanisms through which SONI is to recover its efficiently incurred TNPP costs.

- 1.8 It also found that the D_t mechanism, as presently implemented, results in significant uncertainty for SONI so as to adversely impact its financeability⁶.
- 1.9 The CMA's remedy for these two errors is to "*codify an effective process for review of (TNPPs) and projects subject to the D_t mechanism.*" (Para 11.2 of the CMA's final determination).
- 1.10 The CMA concluded this codification will require some changes to SONI's licence but that much of the codification should be in the form of rules and guidance which sit outside of – but take effect through – the licence⁷.
- 1.11 In Chapter 11 of its final determination and Annex B of its order, the CMA set out, at a high level, its minimum requirements as to the matters to be addressed in the TNPP and D_t requirements and guidance.
- 1.12 Those minimum requirements comprise the following:
 - a) **Timelines** – SONI should submit applications for TNPPs and the recovery of D_t costs at least 6 months ahead of project initiation. The UR should approve applications within four months of receiving the required information. Consideration should be given to reducing these timelines where circumstances allow.
 - b) **Project specification** – a detailed process for pre-approval of TNPPs and D_t projects should be agreed and codified, including the information to be provided by SONI. The UR will set an initial budget cap for each project.
 - c) **Ongoing reporting** – SONI should report on progress at least annually, using a template proposed by the UR following consultation with SONI.
 - d) **Project variation** – to recover costs above the initial budget cap, SONI should evidence why additional (efficient) costs are required, providing agreed information for variations to project specification. The UR should in any case approve or reject applications in no longer than four months following receipt of the required information, but sooner if circumstances allow.
 - e) **Transfer of investments into the capital base** – including the codification (in the licence) of a 'side-RAB' for TNPPs on which

⁶ CMA final determination, 10 November 2017, CMA, para 6.300.

⁷ CMA final determination, 10 November 2017, CMA, para 11.8.

SONI will earn a return (equal to the Weighted Average Cost of Capital, WACC). The UR should consult on and agree a mechanism for the transfer of TNPPs to NIE Networks under the Transmission Interface Arrangements (TIA), and on other methods by which SONI can recover TNPP costs if it exercises step-in rights or if a third party takes on construction.

1.13 The CMA determined that some of this codification should be contained in SONI's licence, as already noted. These changes are the subject of a separate (statutory) licence consultation⁸. Key proposed licence conditions and terms in that consultation, relevant to the procedural guidance consulted on in this document, are:

- a) A separate term (PCR_t) within SONI's revenue allowance for a return on a 'side-RAB' for TNPPs.
- b) Obligations on SONI to comply with the requirements and have regard to the guidance in respect of the TNPP and D_t mechanisms which is the subject of this consultation document.

1.14 We recommend that respondents to this consultation also read our consultation on amendments to SONI's licence so as to fully understand the framework through which SONI is remunerated under the TNPP and D_t mechanisms.

Scope of this document

1.15 The purpose of this document is to consult on the UR's proposed requirements and guidance to apply for, vary and recover the costs of projects remunerated under the TNPP and the D_t mechanisms. The two mechanisms cover different types of projects and separate requirements and guidance have therefore been developed for each mechanism.

1.16 This document does *not* consult on the codification for these two uncertainty mechanisms in SONI's licence. That codification, amongst other matters, is the subject of a separate statutory consultation, published alongside this consultation⁹.

1.17 Also, this document does *not* consult on changes that may be required to the Transmission Interface Arrangements (TIA) which govern the transfer of TNPPs from SONI to NIE Networks, as part of the CMA's required codification. Amendments to the TIA will be the subject of a separate, future,

⁸ <https://www.uregni.gov.uk/consultations>

⁹ <https://www.uregni.gov.uk/consultations>

consultation.

1.18 The remainder of this document is structured as follows:

- a) Section 2 details our proposed requirements and guidance on the cost recovery process for TNPPs. Subject to the outcome of this consultation (and the licence modification consultation) we expect to publish this section as a separate document (with supporting Annexes).
- b) Section 3 details the context behind the proposed D_t mechanism and why it is structured in this particular fashion.
- c) Section 4 details our proposed requirements and guidance on the cost recovery process for projects subject to the D_t mechanism. As for TNPPs, subject to the outcome of this consultation (and the licence modification consultation) we expect to publish this section as a separate document (with supporting Annexes).
- d) Section 5 lists consultation questions.
- e) Section 6 discusses next steps.
- f) Annex A contains our proposed pro-forma for SONI to complete for its TNPP applications.
- g) Annex B contains our proposed pro-forma for ongoing reporting of TNPPs.
- h) Annex C contains our proposed pro-forma for SONI to complete for its D_t applications.

2. Requirements and Guidance on the Cost Recovery Process for TNPPs

2.1 The following requirements and guidance apply to applications by SONI for the approval of costs in relation to Transmission Network Pre-Construction Projects (TNPPs).

2.2 A TNPP is defined in paragraph 1.1 of Annex 1 to SONI's electricity transmission licence¹⁰ as follows:

'a transmission network project:

- (a) identified, by the Licensee or the Transmission Owner, as a project which is necessary for the purposes of developing the transmission system;*
- (b) in respect of which the Licensee is, as the Transmission System Operator, responsible for carrying out activities required to progress the project from the conceptual design stage to, but not including, the construction stage; and*
- (c) which has been approved by the Authority, following a claim by the Licensee for such approval in accordance with paragraph 9.1 of this Annex.'*

2.3 Under paragraph 9.1 of Annex 1, SONI may apply to the UR, in accordance with these requirements and guidance, for the approval of activities which:

- a) it has or will carry out in respect of a project which is necessary for the purposes of developing the transmission system, and
- b) were or are required to progress the project from the conceptual design stage to, but not including, the construction stage.

2.4 Under paragraph 9.2 of Annex 1, SONI may make a claim to the UR, in accordance with these requirements, for the approval of an amount of costs incurred, or to be incurred, by it in undertaking those activities.

2.5 Paragraph 10.2(b) of Annex 1 requires SONI to provide to the UR all information specified in this document.

2.6 This document sets out the information that must be provided by SONI in an

¹⁰ Note: the text presented in this section (and references to licence conditions) is based on the licence modifications currently being consulted on.

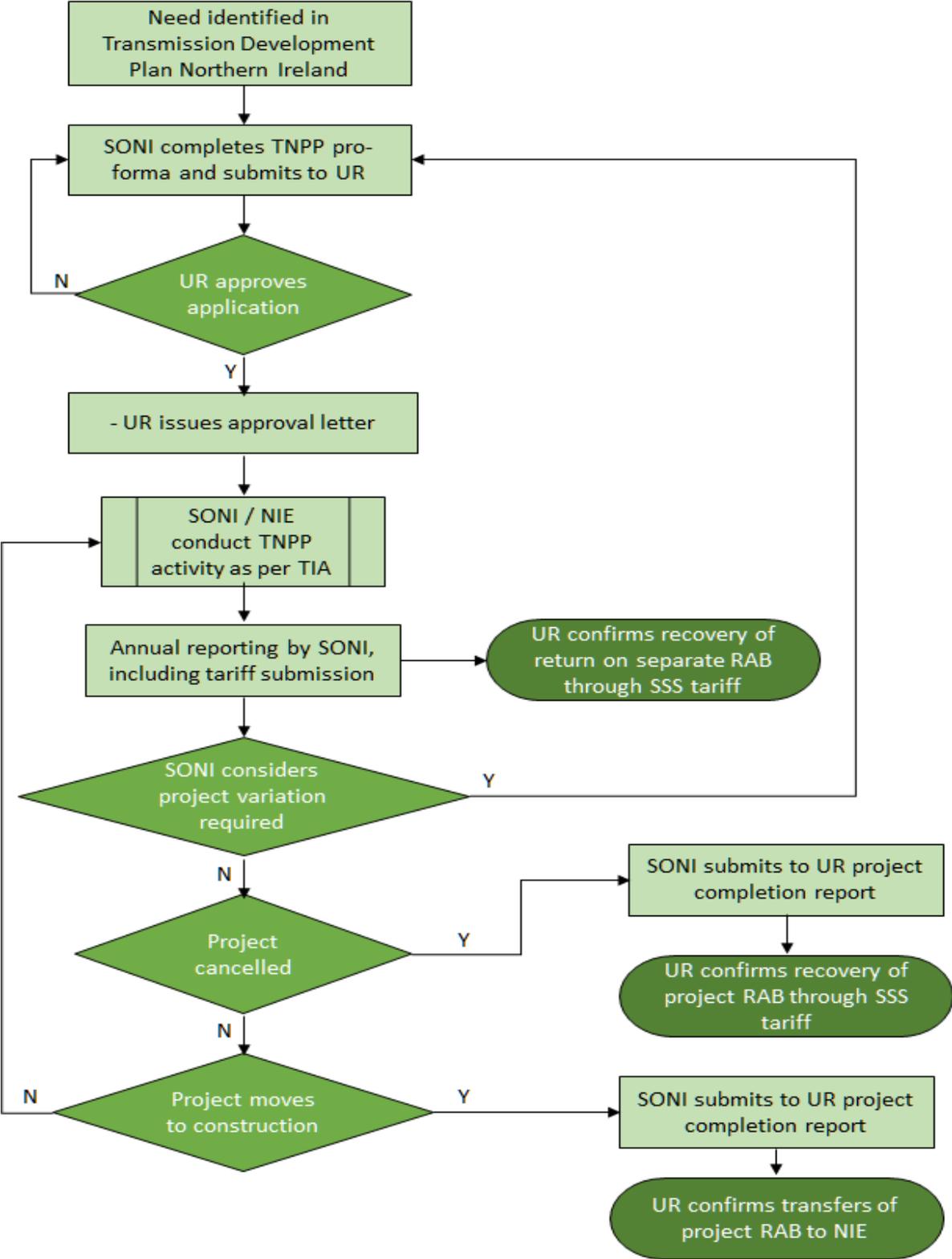
application for approval of each TNPP and the costs associated with it, and the process which the UR will follow in deciding on that application.

- 2.7 It also sets out the information that SONI is required to provide during the life of a TNPP and the process for applying for variation to the cost cap approved for each TNPP. Finally, this document provides guidance on the UR's approach to reviewing the costs of approved TNPPs.

Overview of cost recovery process for TNPPs

- 2.8 An overview of the process for SONI's recovery of its TNPP costs is shown in Figure 1. This identifies the key steps in the process. Further details and additional steps within the process are described in this document further below.

Figure 1: Overview of TNPP cost recovery process



Ex-ante approval of pre-construction projects

SONI's application for pre-approval

- 2.9 SONI will identify the need for the development of the transmission network through the Transmission Development Plan Northern Ireland (TDPNI) – as required under Condition 40 of SONI's Transmission Licence. This requirement for SONI to develop, consult on and publish annually a ten-year TDPNI came into effect on 30 November 2017.
- 2.10 The TDPNI should identify efficient measures to guarantee the adequacy of the transmission system and security of supply, within the context of SONI's licensed activities. SONI is expected to publish a draft of the plan for consultation in early Q1 of each year and a final version, following approval by the UR, in early Q2 of each year.
- 2.11 Where SONI has identified the nature of a project(s) to address a need, and expects to start incurring pre-construction costs in the next year, it should apply to the UR for pre-approval. That application must take the form of the submission to the UR of the pro-forma for TNPPs appended to this document, and discussed further below.
- 2.12 The costs of SONI's initial activities in developing and completing the pro-forma for TNPPs are covered by its ex-ante opex allowance. Following approval by the UR, TNPP costs (not including the costs of its application for approval) are remunerated through a return on and return of a side-RAB for TNPPs as set out in SONI's licence.

Timing of application

- 2.13 SONI can submit these pro-forma(s) at any time but should use its best endeavours to submit completed pro-forma templates:
- a) at least six months in advance of project initiation; and
 - b) by 1 April in each year if they are to be included in tariffs from the following October.
- 2.14 For applications submitted after 1 April and which do not have required approvals in place for the next tariff year, the UR may exercise discretion as to what can be recovered from tariffs in that year. Any difference between this and the UR's subsequent approval will be subject to the correction factor.

Format of application

- 2.15 The TNPP pro-forma that SONI must complete is contained in Annex A. Information provided by SONI in the pro-forma will inform the UR's assessment of the TNPP and our decisions as to whether to pre-approve the project (under paragraph 9.1 of Annex 1 of SONI's transmission licence) and associated forecast expenditure (under paragraph 9.2 of Annex 1).
- 2.16 For the avoidance of doubt, SONI need only submit a single application in respect of our approvals under paragraphs 9.1 and 9.2 of Annex 1.
- 2.17 The information will also provide the baseline against which progress can be monitored. We would expect this information to be available to SONI, in any case, as part of good corporate governance in the planning for and management of projects.
- 2.18 There are two main parts to the pro-forma for SONI to complete:
- a) *About the Transmission Project.* The purpose of this section is for SONI to provide the evidence to justify the need for a project and why the preferred solution is the most appropriate. Within this part, information is required on the following (with further details provided in the pro-forma):
 - Need and investment trigger
 - Project background
 - Objectives and constraints
 - Identify and shortlist options
 - Identification of preferred option.
 - b) *TNPP Details.* The purpose of this section is for SONI to provide available details as to the timing, estimated costs and risks of the proposed project to inform the UR's approval decision. Within this part, information is required on the following (again, with further details provided in the pro-forma):
 - Project Plan
 - Risks and opportunities
 - Budget.
- 2.19 The pro-forma is a general template covering the minimum requirements.

SONI should complete all sections, but may modify or enlarge the tables and sections, as required, to provide all necessary information to justify the project and the forecast expenditure.

- 2.20 This pro-forma should be used for all TNPPs, regardless of scale or complexity. However, we would expect SONI to be able to justify the need for expenditure on smaller and less complex TNPPs more briefly than for larger and more complicated TNPPs.
- 2.21 Ahead of SONI initiating the pre-construction activities, we recognise that there will be uncertainty around some of the information it is required to provide, particularly in relation to the details of the TNPP. Within its application SONI can address uncertainty in several ways:
- a) SONI is required to provide an assessment of the risks of the pre-construction activities, with the likelihood of the risk and the impact if it is realised informing the extent of uncertainty (for example, on costs or timelines).
 - b) In relation to its cost forecasts, SONI can include contingency. Allowances for contingency should be explained and justified by reference to the risks.
 - c) Once a TNPP has been pre-approved, if there are changes in the scope and/or costs of the project such that SONI considers it might exceed the budget cap we have set for the project, SONI can apply for a project variation. This part of the process is separately considered further below.

The UR's assessment and response

- 2.22 Through the TDPNI and other engagement with SONI, the UR would expect to be aware of the need for, and have some knowledge of, any proposed TNPPs ahead of SONI's application.
- 2.23 The UR will assess SONI's application in line with its duties. If the TNPP is considered a matter for the SEM Committee, the UR will forward the application to the SEM Committee for decision, and the process described herein will not apply.
- 2.24 At an early stage, the UR will review the completeness of the information provided by SONI. If required information is missing, the UR will request SONI to resubmit the application. Where appropriate, the UR will publicly consult on the TNPP in SONI's application. During the course of the assessment, and ahead of any decision, the UR may engage with SONI, NIE

Networks and other relevant stakeholders.

- 2.25 The UR will request clarification on, or expansion of, any information that is unclear or, potentially, inadequate. The UR will raise any potential concerns over the application (e.g. as to the choice of the preferred option or the forecast of costs) or objections with SONI during the assessment. The UR may decide to use external advisers to support assessment of SONI's applications.
- 2.26 The UR will confirm in writing to SONI the outcome of its assessment of the TNPP application within four months of receiving the required information. If circumstances allow, the UR will complete the assessment in less than four months. Circumstances which could facilitate a quicker assessment may include:
- a) Initial submission of the relevant information required to enable the UR to make a complete assessment.
 - b) Lower value projects (which could potentially be approved by the CEO, rather than the Board)
 - c) Less complex projects (which are more straightforward to justify and assess)
 - d) Projects which SONI have previously engaged with the UR on (in general, the UR would not expect TNPP applications or their broad content to come as a surprise).
- 2.27 For each approved TNPP, the UR will set a maximum amount of approved expenditure that can be recovered through tariffs. During the life of a TNPP, such expenditure will be remunerated through a return on side-RAB in line with paragraph 2.4 of Annex 1 to SONI's licence.
- 2.28 In the event that the UR is minded to not approve the project, the UR will confirm this in writing to SONI along with its objections and, if appropriate, issue a derogation under Condition 20(6) of SONI's licence¹¹.
- 2.29 The UR will publish the outcome of its assessments (both approvals and rejections) of SONI's TNPP applications. Ahead of publication, these will be shared with SONI, providing them the opportunity to identify any factual errors or matters of commercial confidentiality.

¹¹ Under Condition 20(6), the UR may relieve SONI of any obligations it has under the Transmission System Security and Planning Standards, the Distribution System Security and Planning Standards, the Grid Code or the Transmission Interface Arrangements (TIA).

- 2.30 In the case of project approvals, the UR would expect to include the maximum amount of expenditure that can be recovered through tariffs, but not detailed breakdowns of expenditure.
- 2.31 SONI can proceed with pre-construction activities ahead of our pre-approval, but will do so at risk. In practice, as a result of the TDPNI process and SONI's other engagement opportunities with the UR, this risk ought to be minimal.
- 2.32 However, for the avoidance of doubt, if SONI has conducted work and incurred efficient costs ahead of our decision, then such costs can be recovered, subject to the cap we set, if we approve the TNPP. Conversely, if SONI has conducted work ahead of our decision and we do not approve SONI's TNPP application, then these costs cannot be recovered through tariffs.

Reporting on approved TNPPs

- 2.33 SONI is required to report to the UR separately on each of its approved TNPPs. The reporting will take place annually (through written submissions) and bi-monthly (through oral updates).

Annual reporting

- 2.34 SONI must report to the UR annually on the progress of ongoing TNPPs, through completion of the pro-forma at Annex B to this document. The completed pro-forma will provide an overview of the progress in the past year and a comparison to the original baseline. SONI needs to provide in this pro-forma:
- a) Commentary on the progress and status of the project, including review of the cost benefit analysis of the project.
 - b) An up to date project plan, including commentary on changes.
 - c) An up to date risk log, including commentary on changes.
 - d) Costs incurred in the year and reasons for any divergences from forecasts.
- 2.35 In approving the original TNPP we may identify additional reporting requirements if we consider this appropriate. This may be the case, for example, with large projects, or those of particular significance.
- 2.36 SONI should provide this annual report for each of its approved TNPPs by 1

April of each year.

- 2.37 The UR will review SONI's annual reports. Any costs assessed at that point to be demonstrably inefficient or wasteful (DIWE) will not be included in the side-RAB for TNPPs. This review will be conducted in line with the guidance and procedures published by the UR on DIWE.¹²
- 2.38 Consideration may be given to further information requests being made to the TSO. The UR may also employ a third party to conduct an audit of the relevant detail.
- 2.39 Should we have concerns around DIWE, these will be raised with SONI who will be given opportunity to respond. This response will be considered prior to any decision being made.
- 2.40 In the event that reductions are sought we will write to SONI and advise of the rationale and materiality of said adjustment. The intention is that this decision will generally be published.
- 2.41 The UR will also review staff costs to ensure that a boundary is maintained between network planning staff funded through ex-ante opex allowances and those funded under the TNPP uncertainty mechanism.

Bi-Monthly oral updates

- 2.42 SONI should provide oral updates every two months on progress with TNPPs, highlighting any emerging risks or issues. On the basis of these updates the UR may request further information from SONI; for example, where projects are delayed, costs are escalating (and the pre-approved level of spend is close to being breached) or risks increasing, or where a project variation is likely to be submitted.

Project variation

- 2.43 The UR recognises that pre-construction activities costs can be uncertain. Accordingly, in the event that SONI considers that the approved cost cap set for a TNPP will be breached, it may submit an application to increase the cap. SONI can make such project variation requests at any time, but should endeavour to do so in advance of the cap being exceeded.
- 2.44 To apply for a project variation, SONI should resubmit the TNPP pro-forma in Annex A to this document, along with an explanation, supported by

¹² [DIWE guidance](#).

evidence, as to why additional spend is both efficient and necessary. The TNPP pro-forma should cover the full costs of the project (not just the additional costs subject to the project variation application). Although SONI should resubmit the whole pro-forma, the following are the key sections that SONI will need to revisit:

- a) Part B, Section 5: Cost and Benefits Analysis & Identification of Preferred Option. SONI should review the Cost Benefit Analysis (CBA) for the project and confirm that it remains the preferred option.
- b) Part C, Section 6: Pre-Construction Project Plan. SONI should provide an updated project plan, alongside a commentary on the changes from the plan in the original submission and why these are needed. For example, these changes may relate to additional activities or extension of existing activities to address changes in scope.
- c) Part C, Section 8: Pre-Construction Project Budget. SONI should provide an updated cost forecast, noting the changes from the original forecast and why these are needed. For example, these changes may relate to additional activities required to address changes in scope, or to increases in costs outside of SONI's control. This commentary can be provided by putting comments against individual cost items in the spreadsheet accompanying this section of the pro-forma, and / or in the comments section in the pro-forma itself. To the extent that actual costs have been incurred, these should be included in the cost spreadsheet.

2.45 Our assessment of the project variation will follow that for initial TNPP applications. That is, we will review the completeness of the submission, engage with SONI (if necessary) for any clarifications, review the cost forecasts (reserving the right to call on external support), and confirm the outcome of our assessment (including a revised budget cap) in writing to SONI. We will publish our decision on each project variation application, as with each new TNPP application.

2.46 As with the initial TNPP application, we will assess SONI's TNPP project variation applications within four months of the receipt of the required information, but sooner if circumstances allow.

2.47 There may be some circumstances in which SONI is required to incur costs beyond its approved cap on an urgent basis. Where SONI cannot make an application to increase its cost cap in advance of incurring costs, it may make an application for variation on a retrospective basis.

2.48 Where it does so, we will expect SONI to make an application for variation as soon as possible, and, as part of that application, to justify why costs needed to be incurred urgently.

2.49 We would not however ordinarily expect to receive such a retrospective application where a degree of contingency has been included in the initial cost cap.

Ex-post process for review of approved TNPPs

2.50 The outcome of each TNPP will be a preferred construction option with a completion report detailing the:

- a) Project plan and timelines
- b) Detailed construction designs
- c) Detailed capital cost assessments
- d) Relevant technical assessments
- e) Completed site activities such as:
 - Planning compliance
 - Environmental constraints
 - Permits
 - Wayleaves/easements
- f) Full detail of the pre-construction cost phase.

2.51 Following completion of the TNPP, SONI should submit to the UR its completion report, and a breakdown of costs incurred (as a minimum, the breakdown of costs should be as in Section 4 of the ongoing reporting proforma in Annex B).

2.52 SONI should provide sufficient information for the UR to adequately perform its review. The UR will engage with SONI if it considers the information provided is unclear or, potentially, inadequate.

2.53 To the extent that the information is contained in the Transmission Project Instruction, that SONI is required to provide to NIE Networks under the TIA, or the Transmission Project Agreement, agreed under the TIA, then SONI may submit this to the UR.

- 2.54 The UR will review the costs with a view to determining the final pre-construction RAB associated with the project. In conducting the review, the UR will confirm that the amounts are below the approved cap (including any variations) and that none of the expenditure is demonstrably inefficient or wasteful. The UR may decide to use external advisers to support its review.
- 2.55 Any transfer of monies between SONI and NIE Networks must comply with the requirements set out in the TIA.
- 2.56 Where SONI decides to cancel a previously approved TNPP it must submit to the UR a report detailing the reason for the cancellation, the work undertaken, and a breakdown of the costs incurred (as a minimum, the breakdown of costs should be as provided for in Section 4 of the ongoing reporting pro-forma in Annex B).
- 2.57 SONI should provide sufficient information to enable the UR to review whether any expenditure was demonstrably inefficient or wasteful. The UR will engage with SONI if it considers the information provided is unclear or, potentially, inadequate.
- 2.58 The UR will review these costs and determine the amount that SONI may recover through the SSS tariff under paragraph 2.2(a)(iv) of Annex 1 to its licence. The UR may decide to use external advisers to support its review.

Regularising past TNPPs

- 2.59 SONI has been undertaking work on TNPPs. In order to recover costs in respect of these currently ongoing projects, SONI must submit TNPP applications using the pro-forma in Annex A to this document for each of its ongoing TNPPs. This may include actual and forecast spends, but should be completed in a consistent price base.
- 2.60 In addition, SONI should submit for each of its ongoing TNPPs a breakdown of actual spend in each year to date. As a minimum, the breakdown of costs should be as in the cost spreadsheet in Section 4 of the ongoing reporting pro-forma in Annex B.
- 2.61 For these purposes, SONI may complete the spreadsheet in Section 4 of Annex B, but SONI does not need to complete the rest of the ongoing reporting pro-forma. For the avoidance of doubt, SONI will have to comply with ongoing reporting for these projects in subsequent years.
- 2.62 The UR will review the submissions for ongoing TNPPs, following the

process described above, issuing approvals as appropriate. Once approved, the costs incurred on ongoing TNPPs will be added to the side-RAB and SONI will earn a return on those costs.

Review of and amendments to these Requirements and Guidance

- 2.63 This document applies to the process for SONI's applications for TNPPs in the current price control period, which ends in 2020. The first year in which tariff approvals will be informed by revenues related to actual TNPPs, applied for under this document, will be 2018/19.
- 2.64 The UR may update this document, in consultation with SONI, in the light of experience. The UR will also decide, subject to consultation, whether the same overall process for TNPPs should be applied in the next price control, which is due to take effect from 1 October 2020.
- 2.65 This document does not cover any future process for the recovery of costs associated with TNPPs that a party other than NIE Networks takes on construction. To the extent that the current process for TNPPs changes to accommodate SONI exercising step in rights under the TIA (or an additional process is introduced following approval from the UR), or a third party taking on construction, the UR may amend this document accordingly.

SONI's remuneration of approved TNPPs

- 2.66 Under paragraph 2.4 of Annex 1 to its licence, SONI may recover a return on the efficient costs that it actually incurs on each TNPP up to the cost cap approved by the UR.
- 2.67 Where a TNPP proceeds to construction, SONI will be able to recover the value of its efficiently incurred costs up to the approved cap from NIE Networks under the TIA. The value of those costs will be removed from the TNPP side-RAB and SONI will not earn a future return on them.
- 2.68 NIE Networks will be entitled to depreciation of and a return on the value of the RAB that is transferred to it, which can be collected through the TUoS tariff, subject to approval of NIE Networks' related D5 construction submission.
- 2.69 Where a TNPP is cancelled either by SONI or by the UR, SONI will be able to recover the value of its efficiently incurred costs up to the approved cap through the SSS tariffs. Again the side-RAB will reduce by a corresponding amount.

3. Dt Applications – Context

Overview

- 3.1 Paragraph 8 of Annex 1 to SONI's TSO licence provides a mechanism – the D_t term – through which it may apply to recover defined categories of costs for which no ex-ante allowance has been granted in its price control.
- 3.2 The D_t mechanism covers a variety of cost categories, as set out in paragraph 8.1 of Annex 1 of the licence. These include the following:
 - Costs which are new/exogenous and are not provided for in the price control i.e. a change of law (paragraph 6 of Annex 1 of the licence) or departmental policy resulting in a new obligation.
 - Costs of implementing certain defined projects for which expenditure is not known at the time of the final determination i.e. I-SEM.
 - Activities which may be known but for which costs cannot be reasonably controlled i.e. ENTSOE fees.
- 3.3 The D_t mechanism is subject to a £40k (nominal terms) de-minimis threshold. Any cost below this must be borne by SONI.
- 3.4 The existing D_t process can be described as a managed pass-through. Typically the UR will approve the recovery of costs up to the allowance specified cap. Any underspend against the cap is remunerated to consumers via the K-factor in paragraph 2.2(e) of Annex 1 to SONI's licence in subsequent years.
- 3.5 The CMA agreed with the principle of pre-approval being required for these costs. They did however find that the process for cost recovery should be better defined and more transparent. The guidance in Chapter 4 attempts to address these issues.

Treatment of different applications

- 3.6 The D_t term in the licence has been used for a wide variety of projects and costs. Within the CMA remedy hearings, SONI identified this as a potential issue. They suggested different treatment depending on the nature of the project to avoid under or over scrutiny. The three categories suggested by the TSO includes:
- Large capex and associated incremental opex;
 - Recurring opex; and
 - Smaller opex and capex.
- 3.7 Whilst we accept the different nature of costs and materiality, similar categories of detail is effectively required for each project i.e. background, need, outputs, costs and risks. This is plain from the TSO remedies paper¹³.
- 3.8 Consequently we have developed a “one size fits all” template for formal submission (at Annex C). This is similar in nature to the TNPP pro-forma.
- 3.9 The template should be completed for every D_t project and submitted for formal approval. However, it is recognised that large projects may require more in-depth justification and supporting documentation. This should be submitted alongside the template for the UR’s consideration.
- 3.10 For small and recurring costs, many sections of the template will simply require very short responses or indeed nil returns i.e. where no option analysis is required.
- 3.11 At this stage, for this price control period, it is not anticipated that any D_t approvals will result in changes to the B_t term of the licence (which is subject to a pain/gain mechanism). This is expected to be the case for a number of reasons including:
- a) Some costs are uncontrollable and unsuited to incentive mechanisms.
 - b) For the purposes of transparency, the UR would wish to monitor performance against the regulatory contract of a price control.
 - c) To re-open the price control (as changes to the B_t term would) could provide a perverse incentive to overstate the cost requirement,

¹³ In response to the CMA Provisional Determination, SONI submitted a response paper on 28 September 2017. This included an Annex on Ground 2 remedies (Annex 02(b)) which is referenced above, paragraphs 14.10 and 16.5.

particularly where a company is underperforming against targets.

3.12 It is however anticipated that recurring controllable opex will form part of Bt revenues in the next price control decision.

Bespoke Arrangements

3.13 The next chapter details proposed requirements and guidance which will typically occur. However, in consultation with SONI, the process may be tailored on certain occasions.

3.14 The SEMC (Single Electricity Market Committee) have undertaken just such an approach in relation to the Integrated Single Electricity Market (I-SEM) implementation costs.

3.15 Existing projects which are already subject to bespoke arrangements (for example I-SEM implementation) would be expected to follow the process as set out between TSOs and the SEMC.

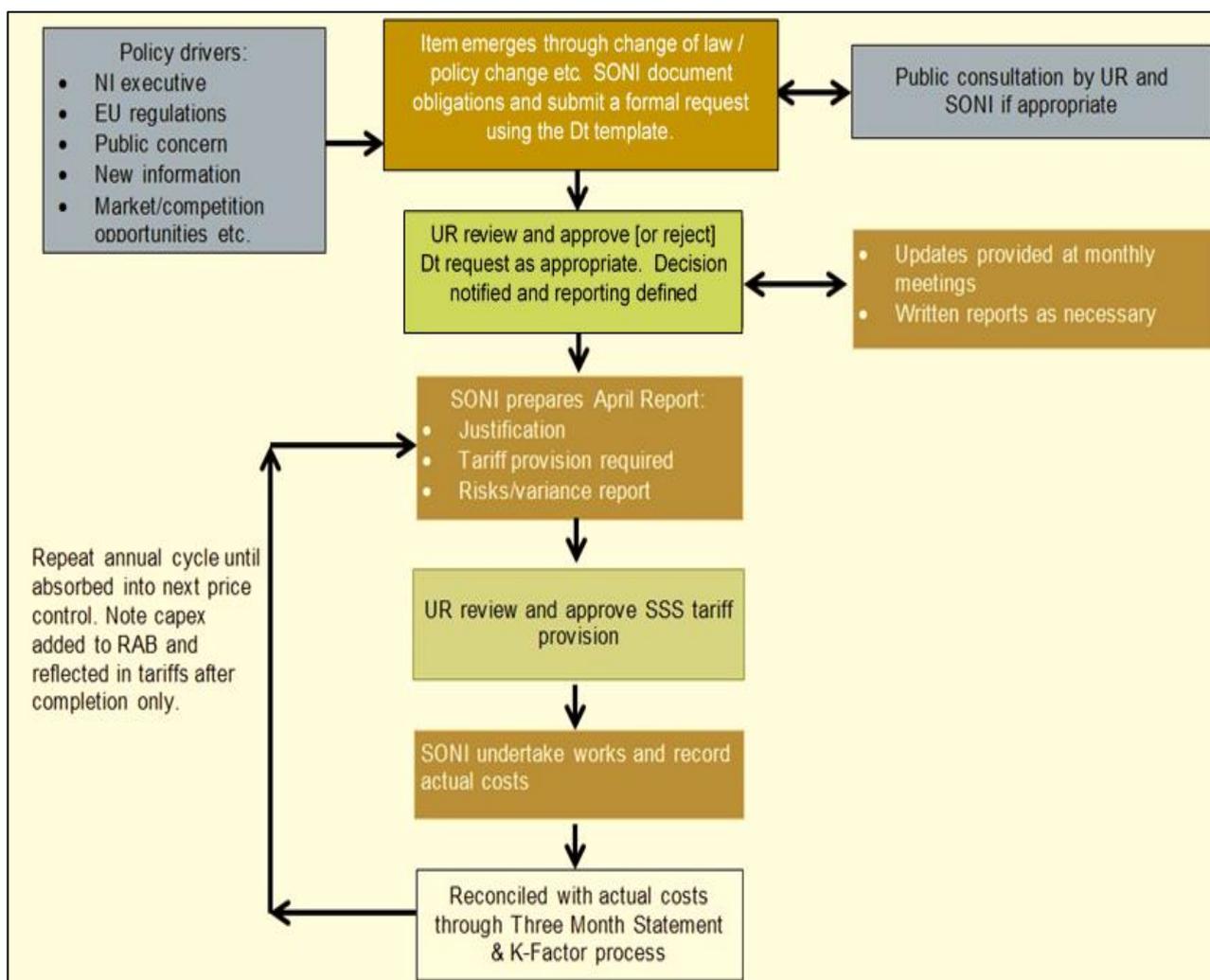
4. Requirements and Guidance on the Cost Recovery for Dt Applications

Overview of cost recovery process for Dt submissions

4.1 SONI must make a Dt application under paragraph 8.1 of Annex 1 to its licence. The template should be completed for every Dt project. However, it is recognised that large projects (over £1m) may require more in-depth justification and supporting documentation. This should be submitted alongside the template for the UR's consideration.

4.2 The basic process is similar to that proposed by SONI for small projects. This is set out as follows:

Figure 2: Overview of Dt cost recovery process



4.3 In summary this can be defined as follows:

- Step 1 – Issue identified. Consult with stakeholders as necessary.
- Step 2 – SONI submit formal D_t request using template.
- Step 3 – The UR review and approve (or otherwise) a capped amount.
- Step 4 – Decision published and reporting requirements set.
- Step 5 – Approved amounts included in tariffs.
- Step 6 – SONI undertake work and report actual costs.
- Step 7 – SONI detail the K-factor in event of underspend.

4.4 Given the differences between projects and spends, it is likely that bespoke reporting arrangements will be required. We intend to notify SONI of our expectations around reporting at the time of decision publication.

Ex-ante approval of D_t spends

4.5 As identified above, SONI must apply to the UR for approval for each D_t by submitting required information (e.g. on need, costs, timelines and risks) as defined in the template.

4.6 Within four months of the UR receiving the submission, we will either approve the application (and set an initial budget cap for the project) or reject it (setting out the reasons).

4.7 If the submission does not contain the required detail, the UR will request this from SONI. In certain circumstances the UR may request a re-submission in which case a decision will be taken on the updated application within the allotted timeframe.

4.8 For smaller projects it is anticipated that the approval time could be reduced to two months, though the formal four month timeframe will apply.

Circumstances which could facilitate a quicker assessment may include:

- a) Lower value projects (which could potentially be approved by the CEO or Director, rather than the Board).
- b) Less complex projects (which are easier to justify and assess)

- c) Projects which SONI have previously engaged with the UR on (i.e. the UR would not expect applications or their content to come as a surprise).

Timing of application

- 4.9 Ideally submissions should be made six months ahead of project initiation. Submissions can be received at any time throughout the year. However any proposal received after the 1 April in any year may not have the required approvals in place for the next tariff year.
- 4.10 In these circumstances the UR may exercise discretion as to what is allowed through tariffs in the following year. This may in any event be different from the approved cap and would be subject to K-factor adjustment accordingly.

Format of application

- 4.11 Formal submission should be made using the attached template. Supporting detail may also be required for more complex projects or where different options are considered. This detail should be submitted at the same time as the formal template, though the UR may request clarifying material.
- 4.12 Additional detail might include:
- NPV analysis (if costs being incurred over a number of years);
 - Cost Benefit Analysis (CBA);
 - Supporting justification / calculations;
 - Cost profile (if being incurred over a number of years); or
 - Option / Risk analysis.

The UR's assessment and response

- 4.13 The UR will assess SONI's application in line with its duties. At an early stage, we will review the completeness of the information provided by SONI.
- 4.14 If required detail is missing, the UR will request SONI resubmit the application or provide further data. Where further data is requested, we would anticipate that SONI should be able to facilitate any requests within ten working days in order to aid timely approval of submissions.
- 4.15 Where appropriate, the UR and/or SONI will publicly consult on the D₁ application, though this is unlikely to be required in most circumstances.

- 4.16 During the course of the assessment, and ahead of any decision, the UR may engage with SONI regarding the application. For example, to request clarification on, or expansion of, any information that is unclear or, potentially, inadequate.
- 4.17 The UR will raise any potential concerns over the application (e.g. as to the choice of the preferred option or the forecast of costs) or objections with SONI during the assessment. We may also decide to use external advisers to support assessment of SONI's applications.
- 4.18 Confirmation will be provided in writing to SONI as to the outcome of the assessment. For each approved application, we will set a maximum amount of expenditure that can be recovered through tariffs.
- 4.19 Approved expenditure is recoverable in the first instance through tariffs. Subsequent adjustments are then made using the K-factor for actual expenditure that is properly and necessarily incurred (up to the capped maximum). The D_t approval letter will also be published on the UR's website.
- 4.20 In the event that the UR is minded to not approve the project, this will be confirmed in writing to SONI along with supporting rationale. Decisions will be published on the UR website, subject to SONI views on redactions.

Reporting on approved costs

- 4.21 SONI must provide reports to the UR in such a format, and by such times as specified by the UR as part of its approval decision.
- 4.22 It is our intention to advise and agree reporting requirements with SONI on approval of any costs.

Annual reporting

- 4.23 Proposals for ongoing reporting largely reflect those detailed by SONI in their remedy paper. This will include:
- 1) The April Submission (before 1 April each year) consisting of:
 - Information relating to current D_t projects and those expected in the next 18 months.
 - Completed formal D_t requests for the upcoming year.
 - A summary of outturn for the previous year.
 - Latest best estimate of current D_t project spends.

2) The Three Month Statement (before 31 December each year) consisting of:

- Actual cost data for any D_t items in the completed year.
- K-factor adjustments for the previous tariff year.
- Auditor's Report.

4.24 The UR will review actual spend and consider whether the amounts are below the cap and that none of the expenditure is demonstrably inefficient or wasteful (DIWE).

Project variation

4.25 The UR recognises that some D_t costs can be uncertain. In the event that the approved cost cap will be breached, SONI may submit an application to increase the cap. SONI can make such project variation requests at any time, but should endeavour to do so in advance of the cap being exceeded.

4.26 To apply for a project variation, SONI should resubmit the pro-forma in Annex (c) to this document identifying that it is a variation on an existing cap. This should be provided alongside an explanation, supported by evidence, as to why additional spend is both efficient and necessary.

4.27 The pro-forma should cover the full costs of the project (not just the additional costs subject to the variation application). The UR will evaluate and approve (or reject) in line with the process detailed above.

4.28 The TSO is also free to submit further requests above the £40k threshold at any time during the year using the template.

4.29 Overspend without approval will not be allowed in tariffs. The risk of overspend of uncertain allowances is recognised. However this has been separately remunerated and accounted for by the CMA and the UR in the revised licence N_t term.

Ex-post process for review of approved D_t costs

4.30 The UR will review actual spend as reported in the Three Month Statement. In conducting the review, the UR will consider whether the amounts are below the cap and that none of the expenditure is demonstrably inefficient or wasteful (DIWE). This review will be conducted in line with the guidance and

procedures published by the UR on DIWE.¹⁴

- 4.31 Consideration may be given to further information requests being made to the TSO. The UR may also employ a third party to conduct an audit of the relevant detail.
- 4.32 Should we have concerns around DIWE, these will be raised with SONI who will be given opportunity to respond. This response will be considered prior to any decision being made.
- 4.33 In the event that reductions are sought we will write to SONI and advise of the rationale and materiality of said adjustment. The intention is that this decision will generally be published and changes factored into the K-factor calculation for future tariffs.

Review of and amendments to this Guidance

- 4.34 These requirements and guidance apply to the process for SONI's applications for D_t items in the current price control period, which ends in 2020.
- 4.35 The UR may update this document, in consultation with SONI, in the light of experience. The UR will also decide, subject to consultation, whether the same overall process should be applied in the next price control, which is due to take effect from 1 October 2020.

¹⁴ [DIWE guidance](#).

5. Consultation questions

TNPP proposals

5.1 We welcome feedback on any aspect of this paper. However it may be useful to structure responses in line with some of the key issues. As such, respondents may wish to consider the following questions on TNPPs:

- 1) Do you consider the TNPP submission pro-forma to be appropriate?
- 2) Do you consider the TNPP ongoing reporting pro-forma to be appropriate?
- 3) Do you agree with the project variation process?
- 4) Should anything else be included/excluded in this guidance?

Dt Proposals

5.2 For the D_t process the following questions should be considered:

- 5) Do you consider the D_t pro-forma to be appropriate?
- 6) Do you consider that a “one size fits all” template is acceptable?
- 7) Do you agree with the project variation process?
- 8) Should anything else be included/excluded in this guidance?

6. Next steps

Consultation responses

- 6.1 The deadline for responses to the issues raised in this paper is 5pm on 23rd January 2018. Responses should be sent to:

Jody O'Boyle
Utility Regulator
Queens House
14 Queen Street
Belfast
BT1 6ED

Jody.OBoyle@uregni.gov.uk and SONIUREGNI@uregni.gov.uk

- 6.2 The Utility Regulator's preference would be for responses to be submitted by e-mail to the above email addresses.
- 6.3 We welcome feedback on any aspect of this paper. Individual respondents may ask for their responses (in whole or in part) not to be published, or that their identity should be withheld from public disclosure.
- 6.4 Where either of these is the case, the Utility Regulator will also ask respondents to supply the redacted version of the response that can be published.
- 6.5 As a public body and non-ministerial government department, the Utility Regulator is required to comply with the Freedom of Information Act (FOIA). The effect of FOIA may be that certain recorded information contained in consultation responses is required to be put into the public domain.
- 6.6 Hence it is now possible that all responses made to consultations will be discoverable under FOIA, even if respondents ask us to treat responses as confidential.
- 6.7 It is therefore important that respondents take account of this and in particular, if asking the Utility Regulator to treat responses as confidential, respondents should specify why they consider the information in question should be treated as such.

6.8 This paper is available in alternative formats such as audio, Braille etc. If an alternative format is required, please contact us and we will be happy to assist.

Decision document and implementation

6.9 This consultation document on the wording for the requirements and guidance for the recovery of costs on projects remunerated under the TNPPs and the D_t mechanisms is published alongside a consultation on licence modifications. We will publish our decisions on these consultations and implement them.

6.10 In relation to the requirements and guidance, subject to responses to the licence modification consultation and this consultation, and what we subsequently decide, we expect to publish:

- a) A document on requirements and guidance on the cost recovery process for TNPPs (as currently proposed in Section 2 of this document), with supporting Annexes (as proposed in Annexes A and B of this document).
- b) A document on requirements and guidance on the cost recovery process for D_t applications (as currently proposed in Section 4 of this document), with supporting Annexes (as proposed in Annex C of this document).