

SONI: TSO Price Control Changes

Draft Decision

16 August 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 and to promote the short and long-term interests of consumers.

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

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

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

Our Mission

Value and sustainability in energy and water.

Our Vision

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

Our Values

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

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Abstract

This is a Draft Decision on changes to the pension allowances and change in law provisions for electricity transmission System Operator for Northern Ireland (SONI) following a Consultation in April 2017.

Audience

Regulated Companies, Consumer Groups, Industry and Statutory Bodies.

Consumer impact

SONI has a critical role in 'keeping the lights on'. Both the effectiveness and efficiency of SONI is key to industry and consumers. SONI's allowable revenue is passed through to end users as a System Support Services (SSS) tariff. The items contained in this paper form part of this allowable revenue. Any increase in allowable revenue directly results in an increase in tariffs for both Domestic and Large Energy Users.

Executive Summary

On 11 April 2017 the Utility Regulator issued a consultation on certain matters relating to the 2015-2020 price control for SONI that closed on 26 May 2017.

The consultation related to matters concerning SONI's defined benefit pension scheme, SONI's defined contribution pension scheme and the change of law provisions in Annex 1 (the price control conditions) of the Licence.

This paper outlines our draft decision on these matters. Responses to this draft decision should be received by 5.00pm on 14 September 2017.

Defined Benefit Scheme draft decision

Deficit cut-off

A pension deficit cut-off date of 31 March 2019 in respect of the SONI defined benefit pension scheme.

Defined Benefit Scheme Summary of Allowances

We propose to amend the current allowances for pension deficit and ongoing contributions in respect of the Defined Benefit Scheme such that they reflect the following:

Existing allowances as compared to Draft Decision allowances	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000	Total £'000
Existing Deficit Repair	189	189	189	189	189	945
Existing Ongoing Contributions	400	400	400	400	400	2,000
Total	589	589	589	589	589	2,945
DD Deficit Repair	268	71	71	71	71	550
DD Ongoing Contributions	692	679	581	490	462	2,906
Total	960	750	652	561	533	3,456

Defined Contribution Scheme draft decision

The allowances for the SONI defined contribution scheme will remain as per the existing allowances

Change in law draft decision

The change in law provisions in the SONI Licence will be amended in line with the modifications proposed in the 11 April 2017 consultation

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1. Introduction

1. SONI Limited (SONI) is authorised by licence to participate in the transmission of electricity (the Licence) and is the licensed Transmission System Operator (TSO) for Northern Ireland. In this capacity it is subject to a regulated price control as set out in Annex 1 of the Licence. The current price control specifically relates to the period 1 October 2015 – 30 September 2020 (and is referred to in this document as the '2015-2020 price control').
2. The Utility Regulator (UR)'s Final Determination¹ on the SONI 2015-2020 price control was published on 24 February 2016 and the UR's Decision to proceed with the making of relevant licence modifications (namely to modify Annex 1 of the Licence) was published, under and in accordance with Article 14(8) of the Electricity (Northern Ireland) Order 1992 (the Order), on 14 March 2017.²
3. In its response to the Final Determination, SONI raised some concerns in respect of the UR's consultation process with regard to the proposed licence modifications on matters relating to Pensions and the Change of Law provisions. Following a review of the issues raised the UR decided to consult further on these specific topics.
4. Accordingly, on 11 April 2017, the UR issued a further consultation³ on certain matters relating to the 2015-2020 price control for SONI (the Further Consultation).
5. More specifically the Further Consultation related to matters concerning SONI's defined benefit pension scheme, SONI's defined contribution pension scheme and the change of law provisions in Annex 1 (the price control conditions) of the Licence.
6. The Further Consultation closed on 26 May 2017. We received two responses to this consultation - from SONI and the Consumer Council Northern Ireland (CCNI) respectively.
7. Having given due consideration to the responses received⁴ and also taking account of further specific information requested and received from SONI with regard to pensions, we now set out in this paper (which we refer to as the 'draft decision') and consult, under and accordance with Article 14(2) of the Order, on our final proposals on both matters (i.e. pensions and change of law).

¹ <https://www.uregni.gov.uk/publications/decision-2015-2020-price-control-soni>

² <https://www.uregni.gov.uk/news-centre/soni-price-control-2015-2020-licence-modifications-published>

³ <https://www.uregni.gov.uk/news-centre/soni-price-control-2015-2020-further-pensions-consultation>

⁴ Which we have also published alongside this 'draft decision' consultation.

8. The proposed licence modifications accompany this draft decision. Representations with respect to the proposed modifications may be made by 14 September 2017. The UR's currently anticipates that if it decides to proceed with the making of the proposed licence modifications it will publish its decision, together with the final licence modifications in late September 2017.

2. Background

9. In its response to the Final Determination SONI made a number of written and verbal representations on matters relating to the UR's proposed allowances for SONI's pension costs, in particular that the allowances for its defined benefit pension scheme were inadequate. SONI also made representations in respect of the UR's consultation process relating to revised Change of Law provisions
10. Following a review of the issues raised the UR decided to consult further on these specific topics (pensions and change of law). We now set out, and consult (under Article 14(2) of the Order) on, our draft decision on these matters.
11. A significant amount of new information on the SONI Defined Benefit pension scheme (the DB Scheme) has been made available by SONI since the Final Determination. The Final Determination was based upon the March 2013 actuarial valuation of the Scheme and a March 2015 'desktop valuation'⁵.
12. Formal actuarial valuations of the DB Scheme are undertaken on a tri-annual basis and we are now in receipt of the full formal actuarial valuation of the DB Scheme as at 31 March 2016.
13. We have also received the following additional information from SONI to aid our analysis:
 - SONI's response to the Further Consultation which included a (confidential) report from Punter Southall examining the defined benefit element of the pensions allowance within the 2015 – 2020 price control.
 - Actual figures for 2016 and approximate figures for 2017 from SONI on both the membership of the DB Scheme and level of contributions (on-going and deficit) of the DB pension scheme.
 - Actual figures for 2016 and approximate figures for 2017 from SONI on the level of contributions of the DC pension scheme.
 - Report of an error discovered by SONI in the 2010 actuarial valuation which materially understated the contribution rates for the DB Scheme for the period 2010 – 2013. This error understated the contribution rate by 6.2%. The 2010 valuation indicated a contribution rate of 28.1%, however

⁵ This is a term used by SONI which we assume to mean an estimate of the funding position based on an approximate roll-forward of the results from the previous valuation allowing for changes in market conditions and limited information regarding the scheme's cash-flows and assets as opposed to a formal valuation based on actual membership data, audited asset statements, and the most up-to-date experience and views on assumptions in light of changes in legal, demographic or economic circumstances.

it should have been 34.3%.

- Detailed information provided from SONI on the DB scheme in response to clarification questions from the UR including:
 - Profile of scheme membership;
 - Outline and justification of assumptions used for the valuation. Outline of changes in any of these assumptions since the 2013 valuation;
 - Actual retiree figures to June 2017 and number of active members that have indicated an intention to retire by December 2017; and
 - Copy of SONI Trust Deed (2009), SIPS Statement (2010) and Statement of Investment Principles (2012).

14. We also met with the SONI and its advisors on 6th July 2017 to discuss these matters further and to clarify our understanding on some of the information provided.

15. It is worth noting that SONI's pension allowance, including deficit allowance, represent nearly 10% of the overall OPEX allowance and as such we consider it material in the context of the overall price control.

3. Pension allowances draft decision

16. In section 4 we will outline the draft decision on the SONI Pension's allowance covering the following elements

- Defined Benefit Scheme draft decision
 - Deficit cut-off
 - Deficit repair allowance
 - Ongoing contributions
- Defined Contribution Scheme draft decision

4. Defined Benefit Scheme - draft decision

Deficit cut-off

17. The UR still considers that the general principles set out in its Pension Deficit Recovery Position paper of December 2014⁶ with regard to the recovery by price controlled companies of pension deficit costs to be appropriate especially when applying consistent treatment across all its regulated businesses. The

⁶ http://www.uregni.gov.uk/uploads/publications/UR_Position_Paper_-_Pension_Deficit_Recovery_v1_0.pdf

policy is that any pension deficit attributable to pensionable service prior to a particular date as determined by the UR is recovered from consumers and that any incremental deficit in respect of liabilities earned after that date is funded by the licensee.

18. The rationale for this policy position is to incentivise active management of the relevant pension scheme in order to minimise the incremental deficit on the basis that the relevant licensee would benefit directly from eliminating any unnecessary costs relating to inefficiencies in scheme funding and investment.
19. To date the UR has applied and implemented this policy to all NI licensees that are subject to a price control but not to SONI and in each case has determined that the pension deficit cut-off date is 31 March 2015. The Further Consultation invited representations on the application of the policy to SONI.
20. In their response to the Further Consultation, CCNI outlined that they are in favour of the pension deficit cut-off date policy applying to SONI.
21. In its response to the Further Consultation SONI made a number of points as to why the pension deficit cut-off policy should not apply to the DB Scheme including
 - i. The size of the SONI Regulated Asset Base (RAB).
 - ii. All members are 'Protected Persons' for the purposes of the Electricity (Protected Persons) Pensions Regulations (Northern Ireland) 1992.
 - iii. The SONI scheme is small in both membership and value and administration costs would increase 'exponentially with additional reporting requirements' of imposing a pension deficit cut-off date.
22. Considering these points in turn:
 - i. The size of the SONI RAB
23. We do not consider the size of the SONI RAB to be relevant in the assessment of the appropriateness of implementing a pension deficit cut-off date.
24. The relative size of the DB Scheme limits the potential downside to SONI. Based on the 31 March 2016 actuarial valuation and additional information provided by SONI's advisers, we understand the future service liabilities for benefits accruing after the valuation date were around £4.9m compared to past service liabilities for benefits accrued up to the valuation date of £34.0m. As such, future service liabilities as at the valuation date only represent around 10-15% of the total service liabilities and aggregate pension risks presented by the SONI DB scheme once benefits have been fully earned.
 - ii. All members are 'Protected Persons' for the purposes of the Electricity (Protected Persons) Pensions Regulations (Northern Ireland) 1992

25. We do not consider the fact that all members are 'Protected Persons' for the purposes of the Electricity (Protected Persons) Pensions Regulations (Northern Ireland) 1992 to be relevant in considering the application of a pension deficit cut-off date.
26. Ofgem has a similar policy in respect of pension deficit recovery and the majority of persons across all the regulated price controlled companies that may be subject to either Ofgem's or our policy (i.e. in GB and Northern Ireland) will have 'Protected Persons' status as these defined benefit schemes were borne out of the privatisation of the electricity market in the UK.
- iii. The SONI scheme is small in both membership and value and administration costs would increase 'exponentially with additional reporting requirements' of imposing a pension deficit cut-off date.
27. As outlined above SONI in its response to the consultation commented that the costs of imposing a pension deficit 'cut-off' date to a small scheme may increase administration costs on a disproportionate basis. We have sought to estimate the financial impact of this.
28. Benchmarked costs of doing such a split are not available however we asked the Government Actuary's Department ('GAD') to provide an estimate of these costs. GAD suggested these costs might be comparable with those incurred for an accounting exercise or annual funding update (if this were required for the SONI scheme). Following initial set up the attribution would only be done every three years to coincide with the scheme funding cycle, or possibly five years to coincide with price control periods.
29. On the basis a proportionate approach could be adopted or the attribution completed as part of the formal actuarial valuation we would expect the initial set up cost to be no more than £20k and the costs thereafter to be no more than £15k for each subsequent update.
30. We do not consider these costs to be prohibitive to setting a pension deficit cut-off date although they will increase the costs of running the scheme. We would welcome representations as to our estimated costs outlined.
31. The existence of a well-defined pension deficit cut-off methodology as outlined below will also minimise the administrative burden.

Cut-off methodology

32. Ofgem has set out a methodology⁷ for splitting pension deficits into

⁷ <https://www.ofgem.gov.uk/publications-and-updates/decision-letter-pension-deficit-allocation-methodology-applicable-our-funding-price-controls-network-operators%E2%80%99-pension-deficits>

‘established deficit’ and ‘incremental deficit’. The methodology was designed to be proportionate and transparent so that any company would arrive at broadly consistent results.

33. The methodology outlines that an actuarial valuation is conducted as at the cut-off date to determine the notional sub-fund in respect of pre-cut off date liabilities and the “established deficit” as at that date; and thereafter, regular valuation updates in order to attribute deficits to the notional sub funds for the pre and post cut-off date liabilities (the “established” and “incremental” deficits respectively).
34. We expect this process could be made more straightforward for a smaller scheme especially if it is incorporated into the formal Trustee actuarial valuation process. We do recognise there would be a set-up cost as well as on-going costs to regularly reassess the attribution of pension deficits.
35. The pre cut-off date funding and investment risks continue to be passed on to customers through pension deficit reduction allowances included in future price control periods and effectively spread over the relevant recovery period (the deficit allowances and recovery period are discussed at the beginning of this section). It is only the funding and investment risks in respect of liabilities accrued after the applicable pension deficit cut-off date that would be retained by SONI and not passed on to customers.
36. The UR has confirmed that any pension deficit cut-off date it may set for SONI will be a prospective date (i.e. a date which is no earlier than the date of its decision to apply a pension deficit cut-off date). On this basis it considers that the earliest date that a pension deficit cut-off date could be determined and effective for SONI would be a date after December 2017⁸.
37. The “incremental deficit” will initially be zero and any such deficit will only emerge in future as liabilities are accrued post the pension deficit cut-off date. In fact, if on-going contributions are more than sufficient to meet the costs of accruing benefits, it may be more likely a surplus will emerge in respect of the notional sub-fund for post cut-off date liabilities. Therefore, a significant proportion of the total pension deficit risks will continue to be passed on to customers even after a pension deficit cut-off date takes effect at least in the short to medium term and perhaps beyond.

UR Draft Decision

<https://www.ofgem.gov.uk/publications-and-updates/decision-of-gems-policy-funding-pension-scheme-established-deficits>

⁸ This is on the basis that the final decision is made and published in late September 2017 and licence modifications become effective 56 days thereafter.

38. The UR is minded to apply its pension deficit recovery policy in respect of the pension deficit relating to the SONI DB Scheme.
39. While it would generally be preferential to determine a pension deficit cut-off date from the earliest prospective date possible, the UR considers that on balance the date of 31 March 2019 is the most appropriate date due to the following characteristics of the SONI DB scheme:
- Valuations are conducted on a tri-annual basis therefore this date lines up with the next tri-annual valuation.
 - Aligning the pension deficit cut-off date to the next tri-annual valuation will assist SONI to manage the transition and further minimise the administrative burden.
 - Delaying the cut-off until 31 March 2019 (as opposed to a date in 2018) does not serve to dampen the incentive significantly, based on our assumption that approximately 1 member of the scheme will retire a year as discussed in paragraph 73
40. The UR considers that the principle of active management of the DB Scheme, in order to minimise the incremental deficit on the basis that SONI would benefit directly from eliminating any unnecessary costs relating to inefficiencies in scheme funding and investment, to be sound.
41. This accepted regulatory practice, is consistent with OFGEM's approach and has been applied to all other deficits of price controlled businesses in Northern Ireland.

Deficit repair allowance

42. A comparison of the current allowances and SONI's updated figures is as follows:

	DB deficit recovery allowance					
	2015/16	2016/17	2017/18	2018/19	2019/20	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Current allowance	189	189	189	189	189	945
SONI Submission	268	268	75	75	75	761

Table 1: Defined Benefit Deficit Recovery Allowance

43. We have historically allowed for the current deficit within the scheme to be recovered over a 10 year period. We consider this recovery period remains appropriate, consistent with the other price controlled businesses we regulate with DB deficit recovery allowances.

44. We now have the benefit of a revised deficit amount as determined by the

March 2016 actuarial valuation and consider it appropriate to recalculate the deficit recovery allowances to reflect this.

45. We are again reflecting the amount SONI actually paid in 2015/16 as this will have fed into the March 2016 valuation.

46. The 2013 valuation indicated a deficit of £1.146m as compared to a deficit of £706k in the March 2016 valuation. This reduction in deficit appears to have been due to a number of factors as follows;

- At the time of the transfer of planning there was a bulk transfer of 7 members which actually resulted in a surplus of £0.9m and contributions in excess of the cost of accrual resulted in a surplus of £50k. In 2015 there was a transfer of a function ('transfer of planning') from NIE to SONI and some staff that were part of the NIE DB scheme were transferred. The UR provided for £500k of the surplus to facilitate the transfer therefore these payments will have served to reduce the remaining deficit in the scheme.
- A change in financial conditions not matched by assets resulted in a deficit of around £2m, which we assume is the net impact of asset returns less increase in liabilities due to falling yields.
- It appears that changes to the assumptions reduced the deficit by around £1.2m, partially as a result of discussions between the Trustees and the Company. The UR particularly welcomes this as a demonstration of the company actively managing the scheme to achieve efficiencies.

UR Draft Decision

	DB deficit recovery allowance draft determination					
	2015/16	2016/17	2017/18	2018/19	2019/20	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Draft Decision Allowance	268	71	71	71	71	550

Table 2: Defined Benefit Recovery Allowance Draft Determination

47. This is reflective of the reduction of the deficit from £1.885m as at March 2015 to £706k as at 31 March 2016.

48. We do not consider it appropriate to provide for £268k of deficit recovery for the period 2016/17 as suggested by SONI in the submission we received in June 2017 as per Table 2. In our view this represents an excessive deficit recovery payment.

49. SONI may well consider that they would like to 'repair the deficit and de-risk' the pension scheme at an advanced rate. SONI are of course entitled to do this however the UR allowances look to the risks to consumers balanced with

the risk to SONI. With an aging scheme like SONI's there is a risk of 'trapped surplus' that cannot be returned to customers at some future date. The UR needs to mitigate the risk that 'trapped surplus' will emerge and we consider the allowances outlined above to be appropriate.

50. The £706k was the deficit amount as at 31 March 2016 after SONI contributed £268K in the financial year 2015/16. The UR draft decision allowance takes account of this £706k and allows for the recovery of this over a 10 year period to 2025/26.
51. SONI made a representation that the current allowances do not take account of the time value of money. This is not accurate as the allowances will be indexed in line with RPI as will all other OPEX allowances. Also, no allowance was made in the recovery plan for expected asset out-performance which would reduce the required payments all other things being equal. In addition the allowances will be re-calculated at the next price control based on the next (2019) valuation.

Ongoing contributions

52. As part of this consultation process SONI has provided us with a set of updated ongoing contribution figures as at June 2017. These include actuals for 2015/16 and approximates for 2016/17. SONI has confirmed that the 2016/17 – 2019/20 figures have been updated to reflect the March 2016 actuarial valuation contribution rate.
53. A comparison of the current allowances and SONI's updated figures is as follows:

	DB Ongoing Contributions					
	2015/16	2016/17	2017/18	2018/19	2019/20	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Current allowance	400	400	400	400	400	2000
SONI Submission	921	787	703	702	652	3765

Table 3: Defined Benefit Ongoing Contributions

54. The March 2016 actuarial valuation is on a prudent assumption basis, which is a requirement of existing Scheme Funding legislation as it applies to funded defined benefit occupational pension schemes. The March 2016 actuarial valuation indicates an ongoing employer contribution rate of 38.4% including an allowance for death in service benefits plus £7,625 per month as expenses for running the scheme.

55. SONI is required to agree its pension valuation on a prudent assumption basis, however this may not be considered 'efficient' from an economic regulation perspective. That is to say that given the assumptions are prudent this will naturally lead to a risk of 'over-recovery' which would be inefficient for consumers if the 'over-recovery' results in 'trapped surplus' that cannot be returned to customers at some future date. The UR needs to mitigate the risk that 'trapped surplus' will emerge.

56. In order to assess this risk of over-recovery we considered it appropriate to look at the actuarial assumptions and consider a range of 'neutral estimates' in order to assess at a high level the likelihood and materiality of over-recovery. 'Neutral estimates' in this context mean they are not intended to be deliberately prudent or optimistic.

57. This analysis provided by the Government Actuary's Department indicated a range of (rounded) contribution rates from 34% to 36% of pensionable pay might fall with a range that could be considered 'neutral estimates' accepting that there is no standard approach for determining what these might be.

58. Based on the salary roll as per the 31 March 2016 valuation these 'neutral estimates' result in the following contribution amounts -

	31 March Actuarial Valuation	Rounded GAD Neutral Estimates	
Contribution rate	38.40%	34.00%	36.00%
Contribution amount based on salary roll as at 31 March Actuarial Valuation (£)	784	694	735

Table 4: Neutral Estimate Contributions

59. The impact of the neutral estimate on ongoing contributions when compared to the 38.4% contribution rate calculated in the actuarial valuation was around 3-4% of pensionable pay. We therefore considered a more appropriate approach was to look at an assessment of actual and expected contribution amounts based on the actuarial valuation rate of 38.4% as discussed in the next section accepting that the margin for prudence in the contribution rate is not excessively prudent albeit in the normal course expected to result in a surplus.

Actuals assessment

60. We are in receipt of actuals for employer on-going contributions paid to March 2016, approximate actuals for employer on-going contributions to March 2017, actual retirees to June 2017 and an indication of retirees to December 2017.

61. We considered that looking at contribution amounts based on the actual scheme membership results in a more realistic assessment of costs and mitigates the risk of over-funding while still adequately remunerating SONI for its pension costs.
62. SONI provided us with actuals for 2015/16. These show a contribution amount of £921k as compared to the FD allowance for this period of £400k. This contribution appears generous compared to employee contributions and previous years' employer contributions and broadly equates to a 45% contribution rate. In this same period employees paid £103k and based on our calculations the 2016 contribution represents an overfunding of the scheme as follows:

2016 On-going Contributions - Actuals analysis	
	£'000
Employee Contributions @ 6% to March 2016	103
Equivalent Employer Contributions @ 40.3% (2015 valuation contribution rate)	692
Actual contributions made	921
Excess contribution in 2016	229

Table 5: 2016 On-going Contributions – Actuals Analysis

63. SONI indicated that the difference between the existing allowance and the actual contribution was provided by their parent company.
64. We consider it appropriate to provide an allowance to cover what the amount paid as calculated above. SONI appear to have paid an amount in excess of this by approximately £229k. We do not consider it appropriate to provide an allowance for this.
65. It is possible that a number of members aren't paying contributions even though they're still accruing benefits, having completed 40 years' service which may increase the employer contribution proportion. This would not however account for the large differential and given the propensity for employees to retire at their earliest retirement date (as discussed in the next section) does not seem to be the case.
66. It appears that SONI are basing their contribution amounts on the forecast of membership levels as per the actuarial valuation as opposed to the actual outturn membership levels. This is out of line with normal practice and we seek to address this for the forecast contributions in the next section.

67. Any amount paid over and above actual contribution amounts will serve as a deficit repair. As outlined at paragraph 49, SONI may consider that they would like to repair the deficit and 'de-risk' the pension scheme and at an advance rate, however it is not appropriate for consumers to bear this cost for the reasons outlined.

Actual Retirees and impact on forecast funding levels

68. SONI have provided us with forecast contribution amounts to the end of the price control period in 2020. They have confirmed that these are based on the 38.4% contribution rate as per the actuarial valuation applied to a forecast salary role (again as per the actuarial valuation) with no consideration of actual retirements taking place following the valuation date.

69. The actual contribution amount however will be the 38.4% contribution rate applied to the actual pensionable payroll over the price control period. Therefore an appropriate assumption to forecast contribution amounts should be based on the most up-to-date active membership and expected level of future retirees.

70. The March 2016 actuarial valuation assumes that members retire, on average, two years post their earliest allowable retirement date. Based on information we have received, the recent and expected future retirements is markedly different to this and will have a direct impact on the actual contribution amounts.

71. SONI provided us with the following information on actual retirees:

- As of 30 June 2017 there are 23 active members in the SONI DB scheme
- 5 Members have given an indication of their intent to retire within the next 6 months to 31 December 2017.

72. This compares to the assumption upon which the actuarial valuation is based which would indicate a membership of 25 for the 2016/17 period as compared to actual membership of 18 by 31 December 2017. This is in fact some 3 members less than what the actuarial valuation would have in service as at the conclusion of the price control period in 2020.

73. We therefore find it appropriate to apply a retirement profile which reflects the actual outturn as this is what contribution amounts should be based on. Our actual retiree profile assumption upon which we are basing our draft decision is as follows:

UR Actual Retiree Assumption				
Scheme Year	2016/17	2017/18	2018/19	2019/20
Average membership	24	20.5	17.25	16.25

Table 6: 2016 On-going Contributions – Actuals Analysis

74. We have applied a simple average for the years 16/17 and 17/18 based upon the information provided by SONI as set out in paragraph 72 and an assumed average 1 retiree each year after 31 December 2017.

UR Draft Decision

	UR Draft Determination					
	2015/16	2016/17	2017/18	2018/19	2019/20	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Contribution amount	692	672	574	483	455	
Expenses	0	8	8	8	8	
Total	692	679	581	490	462	2906

Table 7: Draft Determination Contributions

75. As with the pension deficit allowance we consider it appropriate to provide for the actual contribution amounts to March 2016 as these will have been taken into account in the actuarial valuation

76. Contributions for 2016/17 to 2019/20 are based on a contribution rate of 38.4% applied to UR actual retiree assumption at

77. Table 7 based on the salary role as at 31 March 2016.

78. We understand SONI's estimates allow for pensionable salary to increase over the price control period in line with the salary increase assumption used in the March 2016 valuation. The methodology set out in the price control allows for OPEX payments to be increased by RPI and allowing for salaries to increase in the forecast would effectively mean double-counting possible increases. We have not adjusted contribution amounts in the draft decision given they will be updated over the price control period in line with RPI.

79. It is important to consider that if contribution amounts for active members of the scheme are not adequate then this will serve to increase the 'established' deficit for which consumers will continue to provide even after the cut-off date becomes effective.

SONI Defined Benefit Scheme Allowances summary of Draft Decision

Existing allowances as compared to Draft Decision allowances	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000	Total £'000
Existing Deficit Repair	189	189	189	189	189	945
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DD Deficit Repair	268	71	71	71	71	550
DD Ongoing Contributions	692	679	581	490	462	2,906
Total	960	750	652	561	533	3,456

Table 8: Existing Allowance as Compared to Draft Decision Allowances

80. This draft decision represents an increase from the existing allowances of £511k.

81. The draft licence modifications reflecting this draft decision are set out in Appendix 1.

82. Given timings, namely that relevant years 2015/16 and 2016/17 are now in the past, the draft licence modifications do not reflect table 8 in absolute terms.

83. That is the allowed amounts for relevant years 2015/17 and 2016/17 will not be changed but the allowances for relevant years 2017/18, 2018/19 and 2019/20 will be amended such that the cumulative overall total allowance for the 2015-2020 reflects the totals in Table 8.

84. This translates into –

- a. a pension deficit allowance of £57k for each of the relevant years 2017/18, 2018/19 and 2019/20 and accordingly a modification to the current allowance of £189k for each such year as set out in Table A in paragraph 2.2(b) of Annex 1: Charge Restrictions of the Licence;
- b. an ongoing contribution allowance of £725k, £697k and £669k for relevant years 2017/18, 2018/19 and 2019/20 respectively and, as the allowed amounts for ongoing contributions are included within the allowances for 'Other Opex', a modification to the current allowed amount of £1,411k for "Other Opex" for each such year in Table A in paragraph 2.2(b) of the Annex. The amended allowance for "Other Opex" would be

Relevant Year T	1	2	3	4	5
Other Opex	1.411	1.411	1.783	1.692	1.664

Table 9: Other Opex

5. Defined contribution draft decision

85. We did not receive any representations on the allowances for the SONI defined benefit contributions. There is no evidence for a change in position. Our draft decision is that the allowances for the SONI defined benefit contributions will remain as follows:

Existing allowance

SONI Defined benefit ongoing contribution allowance	UR Decision					Total £'000
	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000	
	358	358	358	358	358	1792

Table 10: SONI Defined Benefit Ongoing Contribution Allowance

6. Other relevant pension cost considerations

Pension Costs of Transfer of Undertakings (Protection of Employment) Persons

86. In our Further Consultation we considered that all costs that relate to the CAPEX TUPED staff could be included within a Dt claim⁹. However, we also noted that it may not be possible or practical to separate out the pension costs for these staff, especially in relation to the DB scheme

87. Pension costs included in the allowances summarised in

Existing allowances as compared to Draft Decision allowances	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000	Total £'000
Existing Deficit Repair	189	189	189	189	189	945
Existing Ongoing Contributions	400	400	400	400	400	2,000
Total	589	589	589	589	589	2,945
DD Deficit Repair	268	71	71	71	71	550
DD Ongoing Contributions	692	679	581	490	462	2,906
Total	960	750	652	561	533	3,456

88. Table 8 cover all SONI pension costs. It is our draft decision not to separate

⁹ The "Dt" process is a process in their licence whereby SONI is free to seek additional allowances during the price control to adjust for unforeseen developments or uncertainties.

costs for TUPE staff. The majority of these staff are part of the DB Scheme.

Excluded SSS/TUoS Pension costs

89. Excluded SSS/TUoS costs are effectively additional allowances within Annex 1 of SONI's licence in a relevant year. In its Final Determination paper the UR outlined its proposals to remove the existing paragraph 8.1(d) from Annex 1 of SONI's Licence.

Subparagraph (d) covers *"the pension's costs (in relevant year t) of the Transmission System Operator Business to the extent reasonably approved by the Authority"*. SONI objected to this potential change.

90. It is our draft decision that paragraph 8.1(d) from Annex 1 of SONI's Licence shall remain, however given the comprehensive pension allowances set out in this paper we would consider this clause would only be invoked in very exceptional circumstances.

7. Change of Law

91. Within a price control there are various uncertainty mechanisms within the licence that provide the necessary flexibility to adjust allowances due to changes in law.
92. In the Final Determination¹⁰ paper the UR proposed licence modifications which had proposed changes to section 6 of the Annex 1, this also involved deletion of elements of Annex 1 and putting forward new drafting which involved the inclusion of Legal Requirement and Relevant Change of Law into the definitions table of Annex 1.
93. CCNI in their response to the Further Consultation state that they 'support strongly' the proposed modification to the change of law provisions and they consider it will 'ensure the interest of consumers are safeguarded if a change of law or regulation decreases SONI's revenue entitlement'.
94. In its response to the Further Consultation SONI put forward two key objections to the proposed change as follows:
- i. That UR's reasoning for this amendment were wrong and that the existing provision does not 'work one way'.
 - ii. That amending the provisions to delete existing paragraph 6.3 denies SONI a right of appeal which is currently available under that paragraph.
95. Taking each of SONI's points in turn:
- i. SONI state that UR's reasoning for this amendment were wrong and that the existing condition does not 'work one way'.
96. SONI say that UR has a statutory power pursuant to Article 14(1) of the Order to propose amendments to SONI's licence and to make a determination on same following a mandatory consultation process. Such licence modification can only take effect pursuant to a period of 56 days, beginning with the date of publication of the UR's decision.
97. It is not disputed that the UR has the statutory power pursuant to Article 14(1) of the Order to modify the conditions of the Licence. However, it is the case that the current provisions in the Licence do only work one way. The current provisions provide only for the UR to determine an amount for the DTSOt term in relation to change of law where SONI makes such a request. There is therefore no mechanism within the Licence by which the UR could make a

¹⁰ <https://www.uregni.gov.uk/publications/decision-2015-2020-price-control-soni>

change to the revenue entitlement for change of law without SONI having requested it to do so.

98. We consider that it right and appropriate that there should be asymmetry within the Licence and for the UR to determine, without the need for SONI to make a request, an amount for the DTSOt term in relation to a change of law. This is not only consistent with similar change of law provisions in the other electricity transmission licence but also reflective of the UR's non-discrimination duties.

ii. SONI state that the proposal to delete existing paragraph 6.3 denies SONI a right of appeal which is currently available under that paragraph.

99. SONI is mistaken in considering that the effect of paragraph 6.3 of Annex 1 is to provide it with a right of appeal under Article 14B of the Order. Paragraph 6.3 does not provide it with any such right of appeal – it only states that the condition is modified to give effect to a determination made by the UR and sets out how the effective date of the modification is established.

100. Where the UR makes a determination under paragraph 6.1, that determination has effect under the condition – a DTSOt amount is determined. The licence condition does not need to be and does not get modified to give effect to the determination. Existing paragraph 6.3 does not therefore add anything and is not required– hence the proposal to remove it.

101. Finally, SONI also submits that the reference, in the UR proposed new paragraph 6.3 (which in essence existing paragraph 6.1 with some minor amendments), to NIE Energy Supply Licence does not make sense and is not reasonable because it is a totally separate business to that of NIE and all other regulated NI entities. It then goes on to state that SONI has its own set of requisite arrangements which it considers should for the sake of transparency and clarity, be set out in its own licence, rather than by way of reference to a separate entity and separate licence.

102. SONI' concerns in this respect are not immediately apparent given that the "requisite arrangements" which are referred to are essentially the single electricity market arrangements. – Accordingly, they are the industry wide arrangements and not Power NI's own individual arrangements. Furthermore, that Power NI is a separate entity to SONI does not mean that the Licence cannot refer to a condition in Power NI's licence (indeed this is not the only reference in SONI's licence to Condition 60 of Power NI's licence).

UR Draft Decision

103. Our draft decision is that our initial proposals with regard to the changes to the change of law provisions in the Licence continue to be right and appropriate. Accordingly, we do not agree with SONI's view that there is

'no benefit to the UR amending the current licence to reflect its proposed Change of Law condition'. Removing the asymmetry in this provision has a clear benefit in protecting the interests of consumers.

8. Next steps

104. This Draft Decision will be open to consultation for 28 days and Representations may be made on or before 5pm on 14 September 2017 by writing to or by emailing:

Natalie Dowey
Utility Regulator
Queens House
14 Queen Street
Belfast
BT1 6ED
E-mail: Natalie.Dowey@uregni.gov.uk

And

E-mail: Electricity_Networks_Responses@uregni.gov.uk

105. Following consideration of any responses received we plan to publish a Final Decision on these matters in Q4 2017.

106. Draft Licence modifications to Annex 1 of the electricity transmission licence (the 'Licence') held by SONI Limited (the 'Licensee') are published alongside this Draft Decision. These are draft only and formal proposed Licence modifications will be published alongside the Final Decision.

9. Annex 1: Proposed Licence Modifications

ANNEX 1 Charge Restrictions

1 Definitions

1.1 In this Annex:

Achieved DBC	means, in respect of any Relevant Year, the actual Dispatch Balancing Costs incurred on an all-island basis in that Relevant Year by the Licensee and the Republic of Ireland System Operator and included in the Annual Out-turn Report.
Annual Out-turn Report	has the meaning given to it in paragraph 1 of Condition 39.
Applicable Exchange Rate	means the annual average exchange rate for the conversion of euro into sterling as published by Thomson Reuters.
Average Specified Rate	means one-year LIBOR (or such other bank as the Authority shall specify from time to time) current from time to time during the period in respect of which the calculation falls to be made.
Demonstrably Inefficient or Wasteful Expenditure	means expenditure which the Authority has (giving the reasons for its decision) determined to be demonstrably inefficient and/or wasteful, given the information reasonably available to the Licensee at the time that the Licensee made the relevant decision about that expenditure. For the avoidance of doubt, no expenditure is demonstrably inefficient or wasteful expenditure simply by virtue of a statistical or quantitative analysis that compares aggregated measures of the Licensee's costs with the costs of other companies.
Dispatch Balancing Costs	means costs relating to or incurred in respect of: <ul style="list-style-type: none"> (a) the constraining on or off (as the case may be) generation sets pursuant to the central dispatch and merit order systems and

	<p>processes established by the Licensee in accordance with Condition 22 or for the purposes;</p> <p>(b) the management of Energy Imbalances;</p> <p>(c) any Uninstructed Imbalance;</p> <p>(d) Testing Charges;</p> <p>(e) Other System Charges; and</p> <p>(f) any SO Interconnector Trade.</p>
Energy Imbalances	<p>means the imbalance(s) between (i) the payments made by the Single Market Operator Business to generators for electricity sold from generation sets scheduled to operate in accordance with the Licensee's instructions pursuant to the processes and procedures for central dispatch and merit order, and (ii) the payments received by the Single Market Operator Business from electricity suppliers in respect of the electricity purchased by such electricity suppliers.</p>
Ex-Ante DBC Target	<p>means, in respect of any Relevant Year, the Dispatch Balancing Costs approved by the Authority and the Commission for Energy Regulation for the purpose of their inclusion as a component in the Imperfection Charge proposed to be levied on suppliers by the Single Market Operator Business for that Relevant Year.</p>
Ex-Post DBC Target	<p>means, in respect of any Relevant Year, either the Ex-Ante DBC Target adjusted in accordance with an Ex-Post Adjustment provided that where no adjustment is to be made it shall be the Ex-Ante DBC Target for that Relevant Year.</p>
Ex-Post Adjustment	<p>means the adjustment (if any) to be made to the Ex-Ante DBC Target applicable in respect of any Relevant Year, as determined by the Authority and the Commission for Energy Regulation in accordance with, and taking account of the factors set out in, the SEM Decision Paper.</p>
Imperfection Charge	<p>has the meaning given to it in the Single Electricity Market Trading and Settlement Code.</p>
<u>Legal Requirement</u>	<p><u>means, in relation to the Licensee, any of the following:</u></p> <p><u>(a) any enactment to the extent that it applies to</u></p>

	<p><u>the Licensee;</u></p> <p><u>(b) any regulation made by the Council or the Commission of the European Communities to the extent that it applies to the Licensee and impacts on the Transmission System Operator Business or a decision taken by that Council or Commission which is binding on the Licensee and impacts on the Transmission System Operator Business to the extent that it is so binding;</u></p> <p><u>(c) any interpretation of law, or finding, contained in any judgment given by a court or tribunal of competent jurisdiction in respect of which the period for making an appeal has expired;</u></p> <p><u>(d) any direction of a competent authority other than, insofar as it applies to the Licensee, the Authority (except in the exercise of its powers under paragraph 4 of Condition 16) or the Department.</u></p>
Maximum Regulated SSS/TUoS Revenue	means the revenue calculated in accordance with the formula in paragraph 2 of this Annex.
Moyle Interconnector Collection Agency Agreement	has the meaning given to that expression in Condition 37.
Other System Charges	has the meaning given to it in the Single Electricity Market Trading and Settlement Code.
Permitted One-Year Percentage	means 4 per cent of the Maximum Regulated SSS/TUoS Revenue.
Permitted Three-Year Percentage	means 5 per cent of the Maximum Regulated SSS/TUoS Revenue in the second of the Relevant Years.
Price Control Decision Paper	means each of (i) the decision paper issued by the Authority on 19/02/2016 and entitled "Final Determination to the Price Control 2015-2020 for the Electricity System Operator for Northern Ireland (SONI)" (ii) the decision paper issued by the Authority on 10/03/2017 and entitled "Decision on the Licence Modifications for the Price Control 2015-2020 of the Electricity System Operator for Northern Ireland (SONI)" and (iii) as supplemented or amended by any

	further decision paper on the same subject.
Quantity Entering the Total System	means the aggregate quantity of units metered on entry to the total system in Relevant Year t (minus any units consumed by generation sets and imported from the total system).
Regulated SSS/TUoS Revenue	means the revenue (measured on an accruals basis) derived from SSS/TUoS Charges (including any revenue received from any Separate Business) after deduction of value added tax (if any) and any other taxes based directly on the amounts so derived.
<u>Relevant Change of Law</u>	<u>means the application to the Licensee of any Legal Requirement which did not previously so apply or the change of any Legal Requirement relating to the Licensee (including any such Legal Requirement ceasing to apply, being withdrawn or not being renewed).</u>
Relevant Year	means a financial year commencing on 1 October and concluding 30 September.
Relevant Year t	means that Relevant Year for the purposes of which any calculation falls to be made; " Relevant Year t - 1 " means the Relevant Year preceding Relevant Year t and similar expressions shall be construed accordingly.
SEM Decision Paper	means the decision paper issued jointly by the Authority and the Commission for Energy Regulation dated 5 June 2012 and entitled "Incentivisation of All-Island Dispatch Balancing Costs".
SO Interconnector Trade	has the meaning given to it in the Single Electricity Market Trading and Settlement Code.
SSS/TUoS Charge(s)	means the charges for System Support Services and for use of the All-Island Transmission Networks as provided for under Condition 30.
SSS/TUoS Charge Restriction Condition	means this Annex as from time to time modified or replaced in accordance with its own terms or pursuant to any enactment.
Testing Charges	has the meaning given to it in the Single Electricity

	Market Trading and Settlement Code.
Transmission Network Pre-construction Project	<p>means a transmission network project</p> <p>(a) identified, by the Licensee or the Transmission Owner, as a project which is necessary for the purposes of developing the transmission system;</p> <p>(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</p> <p>(c) approved by the Authority, following a submission by the Licensee for such approval, as a project in respect of which the Licensee may proceed to carry out the activities referred to in paragraph (b) above.</p>
Uncollected SSS/TUoS Revenue	means any amount owed to the Licensee in respect of Regulated SSS/TUoS Revenue, which amount remains unpaid six months after the date it first fell due for payment or which amount the Licensee deems (in accordance with the payment security policy) to be unrecoverable before the expiry of that six month period; plus the reasonable recovery costs incurred by the Licensee in respect of such amount and the reasonable interest attributable to such amount (calculated, in both cases, in accordance with the payment security policy).
Uninstructed Imbalance	has the meaning given to it in the Single Electricity Market Trading and Settlement Code.
Unit	means a kilowatt hour.

1.2 Where any table refers to a numbered Relevant Year t the applicable Relevant Year t is as follows:

Relevant Year t	Relevant Year
1	October 2015 - September 2016
2	October 2016 - September 2017
3	October 2017- September 2018
4	October 2018 - September 2019

2 **Restriction of SSS/TUoS Charges**

2.1 The Licensee shall, in setting the SSS/TUoS Charges, use its best endeavours to ensure that in each Relevant Year the Regulated SSS/TUoS Revenue shall not exceed the Maximum Regulated SSS/TUoS Revenue which shall be the aggregate of:

- (a) the maximum core SSS/TUoS revenue in Relevant Year t (M_{TSO_t}), calculated in accordance with paragraph 2.2 of this Annex;

Plus

- (b) the $CAIR_t$ amount,

where:

$CAIR_t$ has, in respect of each Relevant Year t , the same meaning as is given to that expression in the Moyle Interconnector Collection Agency Agreement.

2.2 The maximum core SSS/TUoS revenue shall be calculated as follows:

$$M_{TSO_t} = A_{TSO_t} + B_{TSO_t} - BI_t + D_{TSO_t} + Q_t + K_{TSO_t} + INCENT_t$$

where:

- (a) A_{TSO_t} means:

- (i) the costs of System Support Services in Relevant Year t (including amounts payable by the Licensee to any person for the provision or use of any System Support Services provided over any interconnector) in Relevant Year t ;

plus

- (ii) amounts payable to the Transmission Owner Business for the provision of transmission services in Relevant Year t ;

plus

- (iii) amounts levied in Relevant Year t on the Transmission System Operator Business by the Market Operation Activity in accordance with Annex 1 of the Northern Ireland Market Operator Licence to the extent not recovered under any other provision of this Licence or under the Northern Ireland Market Operator Licence;

- (b) B_{TSO_t} means the allowed SSS/TUoS revenue in Relevant Year t , which for each Relevant Year t in the period 1 October 2015 to 30 September 2020 is the aggregate of:

- (i) the amount allowed for each cost category listed in Table A in paragraph 2.2(b)(vi); and

- (ii) the rate of return allowance set out in Table B in paragraph 2.2(b)(vii),

which in each case:

(iii) is indexed by RPI_t in respect of each Relevant Year t with respect to RPI at April 2014 (255.7),

where:

(iv) the rate of return allowance is calculated in accordance with paragraph 2.3 of this Annex;

(v) RPI_t means the Retail Price Index (1987 = 100) published or determined with respect to April in Relevant Year t (i.e. RPI in the Relevant Year $t = 2$ means the value of RPI in April falling within the Relevant Year $t=2$);

(vi) Table A is as follows:

Relevant Year t	1	2	3	4	5
	£m	£m	£m	£m	£m
Payroll	7.217	7.217	7.217	7.217	7.217
IT & Communications	1.783	1.850	1.924	1.948	1.997
Other OPEX	1.411	1.411	1.411783	1.411629	1.411664
Pension Deficit	0.189	0.189	0.1890.57	0.1890.57	0.1890.57
Depreciation on Non-Building Assets	4.083	1.750	1.344	1.285	1.236
Depreciation on Building Assets	0.116	0.116	0.116	0.116	0.116
Depreciation on CAPEX Overspend for 2010-2015	n/a	n/a	n/a	0.850	0.850
Real Price Effects & Productivity	0.146	0.222	0.299	0.375	0.454

(vii) Table B is as follows:

Relevant Year t	1	2	3	4	5
	£m	£m	£m	£m	£m
rate of return allowance	0.440	0.339	0.305	0.364	0.321

(c) BI_t means the sum which is designed to share equally, between the Licensee and customers, the value of any outperformance or underperformance of the Licensee against the allowed SSS/TUoS revenue and which shall be calculated as follows:

$$BI_t = (B_{TSO_t}) - (C_{TSO_t}) * 50\%$$

where:

C_{TSO_t} means:

(i) the aggregate of the actual costs incurred by the Licensee in Relevant Year t in respect of each costs category listed in Table A in paragraph 2.2(b)(vi) of

this Annex, minus that part (if any) of such actual costs that the Authority determines to be Demonstrably Inefficient or Wasteful Expenditure;

plus

- (ii) the rate of return allowance for Relevant Year t as set out in Table B in paragraph 2.2(b)(vii) of this Annex;

(d) D_{TSO_t} means:

- (i) the aggregate of the total amount, allowed by the Authority in accordance with the approval given pursuant to paragraph 8.3(e) of this Annex, in Relevant Year t for excluded SSS/TUoS costs;

plus

- (ii) the total amount, allowed by the Authority in accordance with paragraph 6.1 of this Annex, in Relevant Year t for change of law;

(e) Q_t means an adjustment to be applied to the maximum core SSS/TUoS revenue, which:

- (i) in Relevant Year t ending 30 September 2017 shall be the amount which is determined by the Authority and notified to the Licensee in accordance with principles set out in a document provided to the Licensee; and;
- (ii) in each other Relevant Year shall be equal to zero.

(f) K_{TSO_t} means the correction factor (whether a positive or negative number) to be applied to the maximum core SSS/TUoS revenue in Relevant Year t derived using the following formula:

$$K_{TSO_t} = (F_{TSO_{t-2}} - R_{TSO_{t-2}}) (1 + I_t)$$

where:

(i) $F_{TSO_{t-2}}$ means:

(A) the M_{TSO_t} for Relevant Year t-2;

minus

(B) $(D_{TSO_{t-2}} - AD_{TSO_{t-2}})$;

minus

(C) that part (if any) of $AD_{TSO_{t-2}}$ that the Authority determines to be Demonstrably Inefficient or Wasteful Expenditure,

where:

$AD_{TSO_{t-2}}$ means:

- 1) where actual costs incurred by the licensee in relation to excluded SSS/TUoS costs and change of law in Relevant Year t-2 are less than the costs allowed for D_{TSO_t} in Relevant Year t-2, the total of such actual costs;
- 2) where actual costs incurred by the licensee in relation to excluded SSS/TUoS costs and change of law in Relevant Year t-2 are greater than the costs allowed for D_{TSO_t} in Relevant Year t-2, the total of the costs allowed for D_{TSO_t} in Relevant Year t-2,

- (ii) $R_{TSO_{t-2}}$ means:
- (A) the Regulated SSS/TUoS Revenue in Relevant Year t-2;
- minus
- (B) the CAIR_t amount in Relevant Year t-2;
- (iii) I_t means:
- (A) where the amount derived from the calculations undertaken pursuant to paragraphs 2.2(e)(i) and (ii) is a positive figure, the Average Specified Rate for Relevant Year t-2 plus 2% of that rate (as expressed in decimal figures); and
- (B) where the amount derived from the calculations undertaken pursuant to paragraphs 2.2(e)(i) and (ii) is a minus figure, the Average Specified Rate for Relevant Year t-2 plus 1% of that rate (as expressed in decimal figures).
- (g) INCENT_t means:
- (i) where the Achieved DBC for Relevant Year t-2 is below the Ex-Post DBC Target for that year, the amount (converted into pounds sterling at the Applicable Exchange Rate for Relevant Year t-2) that is equal to 25% of the DBC Success Amount (represented as a positive figure) for that Relevant Year;
- (ii) where the Achieved DBC for Relevant Year t-2 is above the Ex-Post DBC Target for that year, the amount (converted into pounds sterling at the Applicable Exchange Rate for Relevant Year t-2) that is equal to 25% of the DBC Failure Amount (represented as a negative figure) for that Relevant Year,
- where:
- (iii) DBC Success Amount means the amount that is equal to 10% of every whole 2.5% by which the Achieved DBC is below the Ex-Post DBC Target provided that:
- (A) where the Achieved DBC is less than 10% below the Ex-Post DBC Target, the amount shall be calculated as zero;
- (B) where the Achieved DBC is more than 20% below the Ex-Post DBC Target, the amount shall be calculated on the basis that Achieved DBC is 20% below the Ex-Post DBC Target.
- (iv) DBC Failure Amount means the amount that is equal to 5% of every whole 2.5% by which the Achieved DBC is above the Ex-Post DBC Target, provided that:
- (A) where the Achieved DBC is less than 10% above the Ex-Post DBC Target, the amount shall be calculated as zero;
- (B) where the Achieved DBC is more than 20% above the Ex-Post DBC Target, the amount shall be calculated on the basis that the Achieved DBC is 20% above the Ex-Post DBC Target.

Rate of Return

2.3 The rate of return allowance set out in Table B, in paragraph 2.2(b)(vii) of this Annex, for each Relevant Year t is calculated as follows:

$RAB_t \times WACC_t$

where:

(a) RAB_t means the average Regulated Asset Base amount for each Relevant Year t set out in the table below:

Relevant Year t	1	2	3	4	5
	£m	£m	£m	£m	£m
Average Non-Building RAB	5.072	3.470	3.056	2.907	3.142
Average Building RAB	2.385	2.268	2.152	2.036	1.919
Average CAPEX Overspend 2010-2015 RAB	n/a	n/a	n/a	1.275	0.425
Average RAB Total	7.457	5.738	5.208	6.218	5.486

(b) $WACC_t$ means:

(i) the Weighted Average Cost of Capital for Relevant Year t set out in the table below:

Relevant Year t	1	2	3	4	5
WACC	5.9%	5.9%	5.85%	5.85%	5.85%

and:

(ii) is calculated in accordance with the following formula –

$$WACC = ((r_e/(1-t_x)) \times (1 - g)) + (r_d \times g)$$

where:

(iii) r_e = cost of equity

(iv) r_d = cost of debt

(v) t_x = taxation

(vi) g = gearing

where:

(A) the value of (v) shall be the main rate of corporation tax, applicable to Northern Ireland, in existence at the commencement of the Relevant Year t.

3 Restriction of SSS/TUoS Charges: Adjustments

- 3.1 If, in respect of any Relevant Year, the Regulated SSS/TUoS Revenue exceeds the Maximum Regulated SSS/TUoS Revenue by more than the Permitted One-Year Percentage, the Licensee shall furnish an explanation to the Authority and in the next following Relevant Year the Licensee shall not effect any increase in the SSS/TUoS Charges unless it has demonstrated to the reasonable satisfaction of the Authority that the Regulated SSS/TUoS Revenue would not be likely to exceed the Maximum Regulated SSS/TUoS Revenue in that next following Relevant Year.
- 3.2 If, in respect of any three successive Relevant Years, the sum of the amounts by which the Regulated SSS/TUoS Revenue has exceeded the Maximum Regulated SSS/TUoS Revenue is more than the Permitted Three-Year Percentage, then in the next following Relevant Year the Licensee shall, if required by the Authority, adjust the SSS/TUoS Charges such that the Regulated SSS/TUoS Revenue would not be likely, in the judgment of the Authority, to exceed the Maximum Regulated SSS/TUoS Revenue in that next following Relevant Year.

4 **Information to be provided to the Authority**

- 4.1 Where any change is intended to be made in the SSS/TUoS Charges regulated under paragraph 2 of this Annex, the Licensee shall not later than the time referred to in paragraph 4.2 provide the Authority with:
- (a) a written forecast of the Maximum Regulated SSS/TUoS Revenue, together with its components, in respect of the Relevant Year t in which such change is to take effect;
 - (b) a written estimate of the Maximum Regulated SSS/TUoS Revenue, together with its components, in respect of the Relevant Year $t-1$ immediately preceding the Relevant Year in which the change is to take effect, unless a statement complying with paragraphs 4.5 and 4.6 in respect of Relevant Year $t-1$ has been furnished by the Licensee to the Authority before the time referred to in paragraph 4.2.
- 4.2 The relevant time referred to in paragraph 4.1 shall be 1 month prior to the publication by the Licensee of such charges.
- 4.3 The Authority may issue directions providing that any forecast or estimate provided in accordance with paragraph 4.1 shall be accompanied by such information as regards the assumptions underlying the forecast or estimate as may be necessary to enable the Authority to be satisfied that the forecast or estimate has been properly prepared on a consistent basis and the Licensee shall comply with any such directions.
- 4.4 Not later than 6 weeks after the commencement of each Relevant Year t , the Licensee shall send to the Authority a statement as to:
- (a) whether or not the provisions of paragraph 3 of this Annex are likely to be applicable in consequence of the Regulated SSS/TUoS Revenue in the preceding Relevant Year $t-1$ or the 3 preceding Relevant Years $t-1$, $t-2$ and $t-3$; and
 - (b) its best estimate (calculated to the extent possible on the basis of the formula set out in paragraph 2.2(e) of this Annex) as to the relevant correction factor K_{TSOt} in respect of Relevant Year $t-1$.
- 4.5 Not later than 3 months after the end of each Relevant Year the Licensee shall send to the Authority a statement, in respect of that Relevant Year, which includes:
- (a) the Maximum Regulated SSS/TUoS Revenue for that Relevant Year t ; and

(b) the specified items referred to in paragraph 4.7.

4.6 The statement referred to in paragraph 4.5 shall be:

(a) accompanied by a report from the Auditors that in their opinion:

- (i) such statement fairly presents each of the specified items referred to in paragraph 4.7 in accordance with the requirements of the SSS/TUoS Charge Restriction Condition; and
- (ii) the amounts shown in respect of each of those specified items are in accordance with the Licensee's accounting records which have been maintained in respect of each of the relevant Separate Businesses in accordance with Condition 2; and

(b) certified by a director of the Licensee on behalf of the Licensee that to the best of his knowledge, information and belief having made all reasonable enquiries:

- (i) there is no amount included in its calculations under paragraph 2 which represents other than an amount permitted under the SSS/TUoS Charge Restriction Condition to be so included;
- (ii) all amounts which should properly be taken into account for the purposes of the SSS/TUoS Charge Restriction Condition have been taken into account.

4.7 The specified items to be contained in the statement referred to in paragraph 4.5 shall be the actual amounts in respect to:

- (a) the Regulated SSS/TUoS Revenue;
- (b) the actual costs of A_{TSO_t} , (which are to be calculated to the extent possible in accordance with paragraph 2.2(a) of this Annex) and showing separately each component thereof;
- (c) the actual SSS/TUoS revenue (being C_{TSO_t} , and calculated to the extent possible in accordance with paragraph 2.2(c) of this Annex);
- (d) the actual costs incurred in respect of each category of expenditure for which the Authority determined an allowance with regard to excluded SSS/TUoS and change of law costs; and
- (e) such other items as shall be specified in directions issued by the Authority from time to time for the purposes of this Annex.

4.8 The Licensee shall, for each Relevant Year t commencing 1 October, submit to the Authority, its best endeavours to by no later than 31 March preceding the start of that Relevant Year t ,

(a) the amount of D_{TSO_t} costs:

- (i) that the Licensee considers to have previously been allowed by the Authority for that Relevant Year t ;
- (ii) that the Licensee is, or will be, requesting a determination in accordance with paragraph 6 or is, or will be, making a claim in accordance with paragraph 8

(but excluding any costs relating to Transmission Network Pre-Construction Project D_{TSO_t} and PCI D_{TSO_t}) for that Relevant Year t , and

- (b) its calculations in respect of the applicable K_{TSO_t} , together with its individual components, for the Relevant Year $t-2$,

and requesting approval from the Authority for such costs to be factored into the Licensee's SSS/TUoS Charges for that Relevant Year t (which approval may be given with such adjustments to the Licensee's proposed D_{TSO_t} and K_{TSO_t} as reasonably determined by the Authority to be appropriate in the circumstances).

5 **Duration of SSS/TUoS Charge Restriction Condition**

5.1 The restrictions on SSS/TUoS Charges outlined in paragraph 2 of this Annex do not apply to tariff years from 1 October 2020 onwards. However, if no modifications to apply any different restrictions with effect from that date 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:

- (a) the increase is approved by the Authority and the approval is given in advance of the tariff year in which the increase is to apply;
- (b) the increase is required to ensure that the Licensee is able to collect the Collection Agency Income Requirement required by it to discharge its duties under the Moyle Interconnector Collection Agency Agreement in accordance with Condition 37 of this licence;
- (c) the increase is required to enable the Licensee to collect the TUoS revenue that the Authority has determined is payable to the Transmission Owner Business for the provision of transmission services; or
- (d) the increase is required to enable the Licensee to collect System Support Services, Ancillary Services, Other System Charges and TUoS revenue in respect of generation, as determined by the SEM Committee.

Disapplication

5.2 This Annex shall apply so long as the Licence continues in force but shall cease to have effect (in whole or in part, as the case may be) if the Licensee delivers to the Authority a request (a "Disapplication Request") made in accordance with paragraph 5.4 and:

- (a) the Authority agrees in writing to the request; or
- (b) the application of this Annex (or any part of it) is terminated by a notice (a "Disapplication Notice") given by the Licensee in accordance with paragraph 5.5 and not withdrawn.

5.3 Save where the Authority otherwise agrees, no disapplication following delivery of a Disapplication Request pursuant to paragraph 5.4 shall have effect earlier than the date (the "Disapplication Date") which is the later of:

- (a) the date occurring 18 months after delivery of the Disapplication Request; and
- (b) 30 September 2020.

5.4 A Disapplication Request pursuant to this paragraph 5.4 shall:

- (a) be in writing addressed to the Authority;
- (b) specify this Annex or any part of it to which the request relates (excluding in either case this paragraph 5); and
- (c) state the date from which the Licensee wishes the Authority to agree that this Annex or the specified part of it shall cease to have effect.

5.5 A Disapplication Notice pursuant to this paragraph 5.5:

- (a) may be given in the circumstances described in either paragraph 5.6 or paragraph 5.7;
- (b) may be withdrawn by the Licensee at any time prior to the Disapplication Date; and
- (c) where it is given, shall:
 - (i) be in writing addressed to the Authority;
 - (ii) specify this Annex, or any part of it (which shall comprise only such part as was specified in the Disapplication Request) to which the notice relates; and
 - (iii) state the date from which the Licensee wishes the notice to take effect, which shall not be earlier than the Disapplication Date.

5.6 The circumstances described in this paragraph are that, by the beginning of the period of six months which will end with the Disapplication Date, the Authority has not in response to the Disapplication Request published a decision under Article 14(8) of the Order to modify:

- (a) this Annex, or any part of it to which the request relates; or
- (b) this paragraph 5, so as to remove the right of the Licensee to give to the Authority a Disapplication Notice in respect of the relevant Disapplication Request.

5.7 The circumstances described in this paragraph are that:

- (a) by no later than the beginning of the period of six months which will end with the Disapplication Date, the Authority has in response to the Disapplication Request published a decision of a type referred to in paragraph 5.6;
- (b) the Licensee has exercised its right to appeal to the CMA against that decision in accordance with Article 14B of the Order;
- (c) the CMA has, in respect of the provisions to which the Disapplication Request relates:
 - (i) quashed the decision of the Authority under Article 14E(2)(a) of the Order; and
 - (ii) neither remitted the matter back to the Authority under Article 14E(2)(b) of the Order nor substituted its own decision for that of the Authority under Article 14E(2)(c) of the Order; and
 - (iii) no more than 30 days has elapsed since the date on which the CMA quashed the decision of the Authority.

Change of Law

~~6.1 — Where it appears to the Licensee that there has been, or is likely to be, a relevant change of law which has had or is likely to have a material effect on the financial position and performance of the Transmission System Operation Business the Licensee may require the Authority to determine whether the relevant change of law has had or is likely to have such an effect, and if so what amounts, if any, should be treated as allowed change of law revenues in calculating D_{TSO_t} for relevant year t and each succeeding relevant year in accordance with paragraph 2 to ensure that the financial position and performance of the Licensee is likely, so far as reasonably practicable, to be the same as if the relevant change of law had not taken place. In determining the matters provided for in the paragraph above, the Authority shall have regard, where relevant, to:~~

~~(a) — its intentions in relation to the development and implementation of the “requisite arrangements”, as provided for in condition 60 of the NIE Energy Supply Licence;~~

~~(b) — the period over which the Licensee shall incur costs by reason of the relevant change of law;~~

~~(c) — the incremental costs (including financing costs) which the Licensee has been or will be required to incur as a consequence of the relevant change of law; and~~

~~(d) — the other circumstances of the case.~~

~~6.2 — A notice given to the Authority by the Licensee pursuant to paragraph 6.1 shall contain or be accompanied by all relevant details of the relevant change of law and such other information as the Authority shall require and, unless the Authority shall otherwise consent, shall be given not later than the first day of April immediately preceding the first of the relevant years in respect of which the Licensee wishes any change in such elements to take effect.~~

~~6.3 — This Annex shall be modified to give effect to any determination made by the Authority under this paragraph 6. Such modification shall have effect from the later of the date of the determination and the date upon which the relevant change of law comes into force.~~

~~6.4 — In this paragraph:~~

~~“legal requirement”~~

~~means, in relation to the Licensee, any of the following:~~

~~(a) — any enactment to the extent that it applies to the Licensee;~~

~~(b) — any regulation made by the Council or the Commission of the European Communities to the extent that it applies to the Licensee or a decision taken by the said Commission which is binding on the Licensee to the extent that it is so binding;~~

~~(c) — any interpretation of law, or finding, contained in any judgment given by a court or tribunal of competent jurisdiction in respect of which the period for making an appeal has expired which requires any legal requirement falling within (a) or (b) above to have effect in a way different to that in which it previously had effect;~~

~~(d) — any direction of a competent authority other than, insofar as it applies to the Licensee, the Authority (except in the exercise of its powers under paragraph 4 of Condition 16) or the Department;~~

"relevant change of law" means any of the following:

~~(a) — the application to the Licensee of any legal requirement which did not previously so apply or the change of any legal requirement relating to the Licensee (including any such legal requirement ceasing to apply, being withdrawn or not being renewed);~~

~~(b) — a change of the United Kingdom Plan, as it applies to Northern Ireland, for the reduction of emissions, made by the Secretary of State on 20 December 1990 pursuant to section 3(5) of the Environmental Protection Act 1990 (as it shall have been amended, supplemented or replaced from time to time).~~

~~6.1 The Authority may, including following a request made to it by the Licensee asking it to do so, determine that there has been, or is likely to be, a Relevant Change of Law which has had, or is likely to have, a material effect on the financial position and performance of the Transmission System Operation Business.~~

~~6.2 Where the Authority makes a determination pursuant to paragraph 6.1, it may, for the purposes of ensuring that the financial position and performance of the Licensee is likely, so far as reasonably practicable, to be the same as if the Relevant Change of Law had not taken place, give effect to that determination by also determining, and notifying the Licensee of, an amount (whether a positive or negative figure) that is an allowed amount for change of law, for the purposes of calculating $D_{TSO,t}$ in accordance with paragraph 2.2(d) of this Annex, for each Relevant Year t specified in the Authority's notification.~~

~~6.3 In determining the matters provided for in paragraphs 6.1 and 6.2, the Authority shall have regard, where relevant, to:~~

~~(a) its intentions in relation to the development and implementation of the "requisite arrangements", as provided for in condition 60 of the NIE Energy Supply Licence;~~

~~(b) the period over which the Licensee shall incur costs by reason of the Relevant Change of Law;~~

~~(c) the incremental costs (including financing costs) which the Licensee has been or will be required to incur as a consequence of the Relevant Change of Law; and~~

~~(d) any other circumstances relevant to the case.~~

6.4 Where the Licensee requests the Authority to make a determination pursuant to paragraph 6.1, the request shall:

(a) unless the Authority otherwise consents, be made no later than the first day in the April immediately preceding the first Relevant Year in respect of which the Licensee would (if the Authority were to make a determination pursuant to paragraph 6.1) want the Authority to determine an allowed amount for change of law under paragraph 6.2; and

(b) be accompanied by all relevant details (including a breakdown of internal and external incremental costs incurred) of the Relevant Change of Law and such other information as the Authority may request and require to be provided by the Licensee for the purposes of its consideration of the request.

7 Unit Coverage

- 7.1 The component of Maximum Regulated SSS/TUoS Revenue relating to System Support Services (or certain parts of that component) can potentially be recovered from the Quantity Entering the Total System in the authorised transmission area.
- 7.2 The final decision regarding which Units in particular the component of Maximum Regulated SSS/TUoS Revenue relating to System Support Services (or certain parts of that component) will be recovered from in Relevant Year t (“unit coverage”) rests with the Authority.
- 7.3 In each Relevant Year t on the decision of the Authority regarding unit coverage of the System Support Services charge, the Licensee will then draw up for the Relevant Year t the schedule of System Support Services charges in accordance with Condition 30 in a manner which is consistent with the decision of the Authority regarding unit coverage. If the Licensee draws up for Relevant Year t the schedule of System Support Services charges in accordance with Condition 30 in a manner which is not consistent with the decision of the Authority regarding unit coverage then the Authority’s approval under Condition 30 paragraph 6 for the form of this schedule will not be granted.

8 Excluded SSS/TUoS Costs

- 8.1 The Licensee may, subject to paragraphs 8.2 and 8.3, make a claim (to the Authority) that the following costs and revenues of the Licensee (whether a positive or negative amount) shall be treated as excluded TUoS/SSS costs in Relevant Year t:
- (a) any reasonable and efficient costs incurred (or likely to be incurred) by the Transmission System Operator Business (in Relevant Year t) in complying with the requirements imposed on the Licensee under legislation and other legal requirements through which Directive 2009/72/EC is implemented, whether before or after the coming into effect of this Annex, and to the extent not recovered under any other provision of this Licence or under the Northern Ireland Market Operator Licence or under the Transmission Owner Licence;
- (b) any reasonable and efficient costs incurred (or likely to be incurred) by the Transmission System Operator Business (in Relevant Year t) in complying with the requirements imposed on the Licensee:

- (i) under the arrangements for the Single Electricity Market (being the project described in the Memorandum of Understanding dated 23 August 2004 and made between the Authority and the Commission for Energy Regulation); and
- (ii) under the arrangements implementing the Integrated Single Electricity Market (I-SEM) (a joint project developed jointly between the Authority and the Commission for Energy Regulation for the all island electricity market to be compliant with the EU Target Model of the European Commission to facilitate a pan-European electricity market),

in each case whether before or after the coming into effect of this Annex and to the extent not recovered under any other provision of this Licence or under the Northern Ireland Market Operator Licence or under the Transmission Owner Licence;

- (c) any reasonable and efficient costs incurred (or likely to be incurred) in Relevant Year t associated with any future divestment of the Transmission System Operator Business;
- (d) the pension costs (in Relevant Year t) of the Transmission System Operator Business to the extent not recovered under any other provision of this Licence;
- (e) amounts that become Uncollected SSS/TUoS Revenue in Relevant Year t less any amount or part of an amount treated as Uncollected SSS/TUoS Revenue in respect of a preceding Relevant Year that has been paid to the Licensee in Relevant Year t ;
- (f) any reasonable and efficient costs incurred (or likely to be incurred) in Relevant Year t to finance the working capital requirements of SEMO and to the extent not recovered under any provision of this Licence or under the Northern Ireland Market Operator Licence. The financing costs are to be charged at Average Specified Rate plus 2%.
- (g) any reasonable and efficient costs incurred (or likely to be incurred) in Relevant Year t in relation to:
 - (i) the Licensee's membership of the European Network of Transmission System Operators for Electricity (ENTSO-E);
 - (ii) payments made, or required to be made, by the Licensee under and in accordance with the ENTSO-E Inter TSO Compensation Agreement;
 - (iii) the Licensee participating on a mandatory basis in Regional Security Coordination Initiatives (RSCIs) as a member of ENTSO-E.
- (h) any reasonable and efficient costs incurred in Relevant Year t in undertaking electricity transmission network planning activities associated with a Transmission Network Pre-Construction Project; and
- (i) any other reasonable and efficient costs incurred (or likely to be incurred) by the Transmission System Operator Business which:
 - (i) are not taken into account in the setting of A_{TSO_t} or B_{TSO_t} ;
 - (ii) cannot reasonably be controlled by the Licensee; and
 - (iii) the Authority determines, upon an application to it by the Licensee, shall be included for the purposes of this paragraph.

- 8.2 In making any claim pursuant to paragraph 8.1, the Licensee shall ensure that:
- (a) it takes account of, and gives regard to, the Price Control Decision Paper; and
 - (b) the costs or revenues in respect of which the claim is made are not included:
 - (i) in more than one category listed in sub-paragraphs (a) to (i) of paragraph 8.1; and
 - (ii) in more than one claim made pursuant to paragraph 8.1.
- 8.3 Any claim made by the Licensee pursuant to paragraph 8.1 shall:
- (a) be submitted by the Licensee, using its best endeavours, by no later than the first day in April immediately preceding the Relevant Year in respect of which the Licensee wishes the claim to take effect;
 - (b) differentiate between internal and external costs and revenues;
 - (c) relate only to those costs not recovered (or recoverable) under any other provision of this Licence or under the Northern Ireland Market Operator Licence or under the Transmission Owner Licence;
 - (d) contain or be accompanied by all relevant details of the costs claimed and such other information as the Authority shall require in order to determine whether such costs can be recovered by the Licensee; and
 - (e) require to be approved by the Authority as allowed costs for Relevant Year t and shall not become effective as such allowed costs until approved by the Authority.
- 8.4 Any claim for costs made by the Licensee pursuant to paragraph 8.1 received by the Authority after this paragraph 8.4 takes effect, shall be subject to the application of a de minimis threshold, by the Authority, of £40,000 (in nominal terms) in each Relevant Year for each category of costs referred to in paragraphs 8.1(a) to (i) or such other categories of costs as determined by the Authority.

9 Reporting

- 9.1 The Licensee shall, provide to the Authority all information requested in association with this Annex in such format and by such time as may be reasonably directed by the Authority.