Uncertainty Mechanisms Guidance

SONI Response to UR Consultation

15 February 2021

Table of Contents

Key Messages

- **Licence Modifications:** This response contains SONI's initial views only. We will need to review the licence modifications to be able to assess the full effects of this guidance. We currently expect to append an updated version of this document to our response to the consultation on the licence modifications.
- **Proposed Edits to the Guidance:** SONI would like to work with the UR to ensure that the uncertainty mechanisms are defined in a way that means that they can be applied in a consistent and predictable manner and that the processes within them are transparent and proportionate. To that end, we have suggested edits to the guidance document and append this to our response.
- **Resourcing**: The UR's Final Determination indicates that a significant number of submissions will be processed through these mechanisms. This will put significant pressure on resources within both SONI and the UR. We note that the four month turn around for funding approvals specified in the CMA order has be challenging to meet and ask that the UR provides sufficient priority to processing these funding requests.
- **Central Estimate**: The Et/Vt mechanism appears to be structured around the concept of the UR correctly identifying the "central estimate" in each case, and an assumption of a symmetrical distribution of probable costs around that. The UR does not explain in the guidance (or any cover paper) how the central estimate will be calculated nor does it address the probability that an estimate calculated close to the time of implementation is more likely to increase significantly than decrease by the same amount.
- **Negative Bias:** The reasons for excluding the Et/Vt mechanism from the conditional cost sharing are not fully explained. This omission creates a situation whereby SONI could incur efficient costs that deliver clear benefits for customers and still lose money consistently across the Et/Vt mechanism. This is exacerbated by the asymmetric nature of cost estimates made close to the time of implementation and the absence of any methodology that would ensure consistency in the calculation of the "central estimate".
- **Choice of Mechanism**: The two mechanisms have different risk profiles. The guidance does not include a suitable process to ensure that good regulatory practice is followed if the UR considers changing the mechanism from the basis upon which SONI made its application.
- **Reporting:** Although the (presumed) processes by which variances in the Et and Vt items are reconciled into SONI revenue entitlement are different from Dt/Zt, the reporting has been replicated across both. Only actual amounts in Dt and Zt items impact on the K-factor related to the year in which they were incurred. We propose that the RIGs are used as the main reporting route for the Et and Vt items.

- **Process:** We note that this guidance document updates and replaces the Dt guidance that was put in place in March 2018. The UR has not referenced this, nor has it set out the reasons for and effects of these changes. We would welcome sight of UR's perspective on this and have attempted to include SONI's perspective on this within our response.
- **Deleted Text:** We note that some of the features of the original Dt guidance have been removed. Given that some of these were included as a result of SONI's response to the December 2017 consultation and the UR has not indicated any intention to change the Dt mechanism we ask that these are reinstated, or equivalent safeguards inserted.

1 Introduction

1.1 About SONI

1. SONI Ltd. is the licensed Electricity Transmission System Operator (TSO) in Northern Ireland. SONI is responsible for planning and operating the electricity transmission system safely and securely to ensure a reliable supply of electricity for Northern Ireland consumers. SONI also operates the all-island wholesale electricity market with EirGrid plc through the Single Electricity Market Operator or SEMO (a joint venture with EirGrid) which has been in operation since November 2007.

2. SONI fulfils an essential and critical role which is central to the wider Northern Ireland economy and community. Between 2015 and 2020, Northern Ireland met the challenge of providing 40% of our electricity needs from renewable sources. This realised some 1,600MW of energy from renewable sources being accommodated on the system. The period of this Price Control 2020-2025 will result in even greater change as the energy transition begins in order to realise a trajectory to net zero carbon emissions by 2050.

3. SONI has a central role in delivering the transformation of the power system which will need to be operated in a more dynamic and responsive way. SONI is committed to realising the full benefits of this transformation for consumers through enabling the opportunities for the Northern Ireland economy in striving to have all of our energy needs met from renewable and low carbon energy sources. In this price control SONI is challenging itself (subject to funding) to be in a position to deliver up to 70% (or as otherwise advised upon finalisation of the NI Energy Strategy) of our energy from renewables by 2030 accompanied by 95% of non-synchronous penetration of wind on the system at any one time.

4. SONI notes that the UR states in its consultation on its Forward Work Plan 2021/22 that ***"In practice this [the energy transition] may mean that regulators are less prescriptive, more pragmatic, focussed more on principles and outcomes, adopt new approaches to accommodate innovation and a more diverse stakeholder environment.*** SONI recognises the importance this pragmatic approach, which is focused on principles.

5. The Uncertainty Mechanisms are a key feature of the SONI price control 2020-25 and smooth operation of them will be critical to the overall delivery of Northern Ireland's energy transition. Given the quantum of funding that the UR envisages being processed through these routes, they will need to be able to be applied in a consistent and predictable manner without adding an excessive burden on either SONI or the UR.

6. SONI has focused on these key objectives when reviewing the UR's proposed guidance document and proposed changes to it that will ensure that it provides a robust foundation for funding SONI's role in the energy future.

1.2 Consultation Process

7. In November 2017 the CMA directed the UR to put in place formal guidance on the application of the Dt mechanism. This direction specified certain parameters that the guidance would need to be consistent with.

8. Although not highlighted in any of the relevant papers or website text, the Uncertainty Mechanism Guidance that the UR is consulting upon appears to update and replace the current Dt guidance.

9. The reasons for these updates are not set out within the UR documentation (although it may be captured in the licence modification consultation which has yet to be published). In order to respond to the consultation effectively, SONI has had to infer the background to these changes and identify the effects of these. In order to complete this exercise and seek clarity on the UR intentions we have prepared a comparison between the two documents, which we append to this response.

10. We note that the process followed to consult on this updated uncertainty mechanism guidance and the associated documentation provided fall short of the standards set by the UR for itself, as defined in its publication of January 2010[1].

11. In the absence of information about how the new terms will be included within SONI's licence we have had to make certain assumptions, which we set out in the relevant sections below.

1.3 Structure of this Response

12. This response focuses on three aspects of the draft guidance:

- Text that has been deleted from the original (March 2018) guidance, which does not appear to have been replicated elsewhere in the updated document;
- Comments and requests relating to the text included within the draft guidance, including:
- elements of the new framework that SONI had assumed would be included within the new guidance, but is not included;
- Interactions between this guidance and the two other draft guidance documents that the UR is consulting on in parallel
- The process followed by the UR to consult upon the updates to this guidance document.

13. SONI's response sets out our concerns and requests in the order that the relevant text appears within the guidance document, starting with text that has been deleted from the document.

14. We have appended a mark-up of the draft guidance and template, highlighting the changes to the document that was put in place in fulfilment of the CMA Order. In this we also provide a cross reference to the points raised within this response.

15. This response is based on assumptions around the contents of the updated Annex to our licence which will sit above the guidance in the document hierarchy, which we have not yet had sight of. SONI will provide further commentary on any matters that arise from the drafting of the licence modifications within that response. SONI response to the draft

[1] https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/Consultation_Guidance.pdf

uncertainty mechanism guidance should be considered to be an interim view until after we have been able to consider the guidance within its legal and algebraic context.

2 Changes to the Current Dt Process

16. We note that the version of the guidance that is being consulted on contains some edits to the existing guidance are clearly made to increase the scope of the guidance to reflect the SONI price control 2020-25 final determination. However, other changes update or replace elements of the guidance that were included as a direct consequence of the 2017 Consultation[2].

17. The updates or removals that fall into this second category are of concern to SONI. We highlight the deletions or edits that fall into this category below, noting that there was neither a track change version of the guidance provided nor were reasons for these edits set out. It may be possible for our comments to be addressed through explanations provided by the UR and we look forward to engaging in this dialogue process.

18. **Original paragraph 1.3**: this explicitly provides for retrospective approval of Dt requests. This was feature of the outworking of the CMA process. *We have not been able to identify this assurance elsewhere in the guidance and would ask for it to be reinstated*.

19. **Original paragraph 1.4**: This paragraph was added into the guidance at SONI's request following the December 2017 consultation. While the UR has signalled that some of the costs that fell into the "managed pass thorough" category have been moved into the baseline allowances, some remain (for example the ENTSO-E ITC costs). *We therefore ask for this text to be reinstated.*

20. **Original Paragraph 1.38**: This paragraph set out the situations where a DIWE assessment would be undertaken and provided SONI with an opportunity to respond. This post-dates the publication of the DIWE guidance and was included to ensure clarity and proportionality. We are unclear why this has been deleted, particularly in the absence of any reasons being provided. *Unless equivalent assurances are being provided elsewhere, we so see no reason for this deletion and request a reversal of this change to the framework.*

[2] https://www.uregni.gov.uk/publications/tnpp-dt-consultation-documents

3 Comments on the Draft Guidance

22. In this section we provide our comments, requests and queries on the draft guidance presented for consultation. These are presented in the order they appear in the guidance. We note that the paragraph numbering differs between the word version provided to SONI by the UR and that in the published version. For ease of comparison with the mark-up document appended to this response, we have used the paragraph numbering in the word version. We use the headings from the guidance document as sub-heading in this comments section to also assist with references.

23. SONI notes that the UR states in its consultation on its Forward Work Plan 2021/22 that **"In practice this [the energy transition] may mean that regulators are less prescriptive, more pragmatic, focussed more on principles and outcomes, adopt new approaches to accommodate innovation and a more diverse stakeholder environment".** SONI recognises the importance of a pragmatic approach, which is focused on principles and has attempted to reflect this objective in our suggested edits to guidance document.

24. The UR's Final Determination indicates that a significant number of submissions will be processed through these mechanisms. This will put significant pressure on resources within both SONI and the UR. We note that the four months turn around specified in the CMA order has been challenging to meet and ask that the UR provides sufficient priority to processing these funding requests.

Introduction

25. **Paragraph 1.4**: The guidance states that the UR "*can provide additional ex-ante allowances to cover the **central estimates** of the costs of additional price control deliverables*" However "central estimates" is not defined further within the guidance. This is central to the risk that SONI will be exposed to under the Et/Vt mechanism and it is crucial that it is defined within the guidance to:

- Ensure consistency of decision making by UR; and
- Provide SONI with the information required to determine the acceptability or otherwise of the modifications to its licence that introduce these terms.

26. In SONI's opinion a "central estimate" will include for a measure of contingency above the "best available estimate", however in our experience, the UR rarely includes provision for contingency when providing allowances, instead only providing for the "best available estimate".

27. *We therefore ask that UR provides the clarity required to underpin consistent decision making and to facilitate informed decision making*.

28. We set out our concerns around this key aspect of the Et/Vt mechanism in section 4 of this response, along with suggestions that could be used to improve the consistency and predictability of this calculation. SONI looks forward to working with the UR to ensure that the definition included in the final guidance provides the certainty and clarity required.

29. In the same bullet point, the guidance refers to the UR's "***final determinations policy***". Again, this is not defined within the guidance, although it appears to have a status equivalent to the licence. SONI's understanding is that the licence takes precedence when our revenue entitlement is calculated, and that other documents such as this guidance are only relevant where the licence provides for that. While this may be addressed within the proposed licence modifications, they were not available to SONI when this response was prepared. We would therefore welcome clarity around what is intended by this term and clear legal definition of it.

30. At the end of the first bullet point under paragraph 1.4, the UR states that "***these costs fall outside of the conditional cost-sharing framework***". We note that an analysis of the effects of this decision does not appear to be presented in the Final Determination.

31. This would appear to indicate that statistically the UR expects half of these projects to outturn at a higher cost than the amount provided, even where the costs have been incurred efficiently and the UR has endorsed the benefits provided to customers. Combining this with the application of an undefined "central estimate", introduces a risk that the funding decisions are skewed against SONI and that we could be penalised for doing the right thing in an efficient manner.

32. This appears to be inconsistent with the UR's duties and sends a signal that contradicts the approach that the UR set out for SONI's price control in March 2019. Noting the quantum of costs that the UR has indicated will be included in the mechanism[3], we request clarification of the reasons for this policy approach, and highlight our concerns around the process used to introduce this material risk towards the end of this response.

33. The second bullet point under paragraph 1.4 states that operating expenditure allowances work through the Dt provision and RAB additions through the Zt provision. This is consistent with the current binary approach, that was set out in the UR's paper of August 2018[4], which stated that the codification of a new term (Zt) was being undertaken in order "to provide the TSO certainty of revenues based on depreciation and WACC return".

34. However, in paragraph 1.37, the wording is different, saying that the Dt mechanism is ***"likely*** to be most appropriate for the remuneration of operating expenditure."

35. SONI's recent experience with the disallowance of funding to cover the operating costs of a capital investment (the MIP solver), due to the application of a de minimis threshold across each of Dt and Zt, shows the importance of clear definition of the scope of each term.

36. While this may be included in the licence modifications that were not available to SONI when drafting this response, we request clarity and internal consistency within the guidance document.

37. **Paragraph 1.5**: The guidance states that it is for SONI to propose which of these mechanisms are appropriate, however the UR will specify which mechanism actually applies in its decision. The framework that the UR will use to make this decision and any rights that SONI has to seek review of that are absent from the guidance. We address this concern further in our comments relating to paragraphs 1.33 to 1.37 below.

---

[3] The UR has included potential future funding in the region of £16m in their cost/finance tables.

[4] https://www.uregni.gov.uk/sites/uregni/files/media-files/20180810%20Consultation%20paper%20on%20SONI%20Zt%20term%20for%20Special%20projects.pdf

38. **Paragraph 1.6**: We note that the references to Annex 1 of our licence are missing from the draft guidance. This means that we have not been able to review this document in the context in which it will be interpreted. We also do not have access to any updated or new definitions within our licence that apply to these new funding mechanisms, nor have we been able to assess the terms in their algebraic context. We therefore reserve the right to include an addendum to this consultation response within our response to the licence modifications, which (in line with UR's stated consultation policy) we expect to be considered before the UR finalises this guidance.

Outline of the Process

39. **Paragraph 1.7**: We note that the reference to a benchmark of "***over £1m***" to indicate which projects may require more in depth justification and supporting documentation has been deleted. This provided a useful indicator and we ask that it is reinstated, unless the UR intends to apply an alternative benchmark, in which case we would appreciate transparency around the identification and application of the alternative approach.

40. **Figure 1**: We note that this flow diagram was drawn to illustrate only the Dt process and has not yet been updated to reflect the new permutations and complexities associated with the increased number of mechanisms possible. It has however been updated to remove the word "or" from the box at the top right of the diagram. We are unsure why this one edit was considered important to make, while more significant additions and updates are excluded from the revised guidance. SONI has included a proposed update to this diagram within our mark-up of the guidance appended to this response and we look forward to working with the UR to ensure the process is clearly defined and understood upfront.

41. **Paragraph 1.8 – Step 7**: We currently detail the outturn costs of items approved under Dt and Zt within the 3 Month statement as individual line items because the requirement is defined in paragraph 4.7 of the Annex to our licence. However, we cannot comment on the appropriateness of this level of detail for the other items where an allowance is provided instead of a cap because we do not yet have sight of the proposed modifications to the Annex and reporting obligations specified therein.

42. In particular, we do not have visibility of whether the Et and Vt items are considered to fall within the scope of "excluded costs" or if they are being added to our revenue algebra under a different framework, given the application of a 75/25 risk share factor to them and how this will feed through into the calculation of revenue entitlements and the K factor.

43. We do, however, note the significant increase in reporting in general across the suite of guidance documents and query the value added by this level of detail within the three month statement when we assume that it will also be included under the RIGS, which will be provided to the UR later in the regulatory year.

44. We therefore request that the UR removes reference to the Et and Vt line items from the scope of the text in Step 7, unless the outturn costs for these items are required to calculate the K factor for the year that is being reported on.

45. As highlighted in the SONI response to the other guidance consultations, we consider that all three sets of guidance would benefit from a timeline for each calculation and how the

various elements feed into both the calculation of the cap/collar and the annual tariff process.

46. **Paragraph 1.11**: The UR states here that **"*all applications are subject to a materiality threshold of £40k*"**. This is currently specified differently within our licence, which states that the de minimis threshold is " £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"

47. When requesting funding for operating costs associated with capital investments, SONI intend to make one overall application which will include relevant operating costs for the remainder of the price control. Without sight of the modifications to our licence, we are unsure if the de minimis limit is being changed to apply to the total amount included in an application or if it will continue to apply per annum to each algebraic term.

48. Because the UR has not set out the reasons for the changes to the guidance document, or the intended effects of these changes, or provided SONI with its proposed modifications to the licence, we are unable to comment further on this paragraph 1.11 at this time, beyond highlighting that it is inconsistent with the drafting of Annex 1 as extant.

49. However, we would like to highlight our concerns around the treatment of operating costs that are only being incurred because of a capital investment that has been assessed to be of benefit to customers. We ask that this is resolved within the guidance and licence documentation to ensure that it does not result in a sub-optimal signal being sent to SONI around the categorisation of our costs or leave SONI disadvantaged (as was evidenced in the recent approval for the MIP Solver project).

Format of Application

50. **Paragraph 1.20**: We note that is paragraph is an addition to the existing Dt guidance and has been included without setting out an analysis of the potential effects of this insertion. This analysis would be particularly relevant the context of the substantial volume of investment that the UR is channelling through these mechanisms at a time when the Department for the Economy is setting ambitious targets for an energy transition in Northern Ireland, and which SONI will need to facilitate in a timely manner.

51. The UR highlights here that it expects to require a "***significant amount of detail on the scope and quality of what is planned***". SONI is concerned that the "significant" level of detail expected by the UR will not be available at the point in the project where SONI is required to commit to procurement exercises. This may therefore either result in SONI working ahead on projects at risk while awaiting funding approval or result in delays and additional costs if SONI waits for UR's funding approvals. Additional costs would be incurred because SONI may need to secure long tender validity periods, which would increase the risk placed on tenderers and therefore increase the tender prices. The purpose of the uncertainty mechanism is first and foremost a cost recovery mechanism for work undertaken. SONI urges a level of pragmatism in balancing the lead time and processes to award additional funding versus the lead time to deliver benefits for customers.

52. We also note that paragraph 1.18 of the guidance distinguishes between requests that are relatively straightforward and those requiring supporting detail. Although the word “may” is used in paragraph 1.20, it is unclear if which funding requests this “significant amount of detail” applies to.

53. Furthermore, paragraph 1.5 of the extant Dt guidance contains a benchmark of £1 million as an indication of the breakpoint where more detailed information would be required, however this has been deleted from the equivalent paragraph in the updated guidance.

54. Therefore we ask that paragraphs 1.18 and/or 1.20 are updated to either confirm proportionality within the information requirements or that the UR clarify that this is “one size fits all” obligation with “significant detail” being required for each and every request.

55. While we note and accept the obligation in point 3 under paragraph 1.20 to ensure that our investment reflect consumers interests, many of these requests will be designed to deliver government policy. Therefore, SONI will be relying on the democratic processes that underpin Government decisions, or result in mandatory obligations, and we expect to be presenting many of our initiatives in that context. We therefore ask that this point is expanded to reflect the public policy context in which both UR and SONI work and to reflect the validity of SONI undertaking an initiative to support the delivery of government objectives.

Network Planning

56. **Paragraphs 1.21 to 1.23**: we welcome the confirmation that network planning, scoping and feasibility costs can be funded through the Dt mechanism.

The UR’s Assessment and Response

57. **Paragraph 1.30**: we are unsure what is meant by expenditure being “recoverable in the first instance through tariffs ***and/or SONI’s RAB***”. While we do not yet have visibility around how these terms will be codified into SONI’s licence, we are not aware of any current mechanism whereby investments of this nature can be funded other than through our SSS tariff.

58. We would obviously be concerned if this draft guidance relates to a new mechanism that is not reflected in our tariffs; however, if this is unclear drafting, we ask that it is rectified.

59. **Paragraphs 1.33 to 1.37**: while we note that the UR sets out some indication of the processes that it intends to follow when selecting the mechanism it will apply to each request, this falls short of good regulatory practice. In particular a number of steps are missing:

- The process does not include an opportunity for SONI to respond to UR’s proposed mechanism if this differs from our original submission;
- The draft guidance does not provide SONI with an opportunity to update its funding request to reflect any change in risk. This would be particularly significant where SONI has provided a “best estimate” for a Dt/Zt request (knowing that it can seek an uplift if circumstances change or efficient costs increase) but the UR approves the

same value under the Et/Vt mechanism without uplifting the costs to a “central estimate”.

- The draft guidance does not include an explanation of how any change that would move costs into a de minimis request would be handled. This is particularly pertinent in the context of the ambiguity around the application of the de minimis threshold (set out above in our comments on paragraph 1.11) and the confusion around the potential to include both opex and capex within one Zt/Vt request, For example, if SONI asks for both the capital costs and associated opex under one Zt request, but the UR’s splits the approval into two items, one or both of which are de minimis, SONI could be left with new obligations without any proportionate route to query or respond to this decision.

60. Given that it is unusual for a regulator to provide itself with powers to unilaterally change the treatment of a company’s submission without any form of consultation or opportunity for the company to update the submission to reflect a change in risk profile, we ask that this section of the draft guidance is redrafted to reflect good regulatory practice and to introduce as a minimum:

- Consultation with SONI before the UR proposes a change in mechanism from the one SONI based it’s submission on;
- An opportunity to update the submission to reflect the mechanism chosen by the UR, explicitly reflecting the fact that Dt/Zt submissions are based on the best estimate while Et/Vt approvals will target a central estimate; and
- Confirmation that a change in mechanism would not be used to disadvantage SONI by moving some of the costs into a de minimis category.

61. SONI has proposed an appropriate consultation and resubmission process within the updated flow diagrams in the mark-up guidance document and looks forward to working with the UR to ensure that guidance document reflects good regulatory practice. This is the one area where we have not provided draft edits alongside this response because we believe there would be merit in using the diagram as a basis for discussion ahead of preparing the necessary text.

Price Control Deliverables

62. **Paragraph 1.38**: Because (at the time of drafting) we have not been able to review the licence modifications that will establish the accountability for the delivery of specific investments, we are not able to comment on its suitability to be copied across to these mechanisms. Should we have concerns, we will include that in an addendum to this response that we would submit alongside our response to the licence modifications.

63. **Paragraph 1.39**: We are unsure why obligations that are required to secure compliance would be treated differently from other projects, and if they do end up being treated differently, SONI would welcome confirmation if delivery of government targets count as obligatory or discretionary spend.

Interactions with other Potential Cost Remuneration Channels

64. **Paragraphs 1.40 to 1.43**: We would be very concerned that the UR would consider refusing funding because it thinks SONI should deliver outputs that are in customers' interests under other mechanisms, where cost recovery is not guaranteed. This appears to be at odds with the UR's overall approach of de-risking SONI and request that this possibility is unambiguously removed. We expect all submissions to be assessed on their own merits and we are concerned that the UR has introduced further uncertainty and asymmetric risk to SONI's business through the inclusion of this text in the draft guidance.

Annual Reporting

65. **Paragraph 1.46**: We note that the extant guidance is based upon on the 'April report'. This was put into the extant guidance document before SONI's RIGs were published[5]. Based on learning since 2018, we ask that we undertake a joint review of the reporting required to identify the appropriate information and timing of its submission. To facilitate this review, we propose that a reference to the RIGS is included here instead and that the relevant information is included within that process.

66. Our comments in relation to Paragraph 1.8 – Step 7 also apply to the reporting requirements set out in Paragraph 1.46 of the draft guidance.

Project Variation for Et and Vt Scope Changes

67. **Paragraphs1.55 to 1.58:** this section could be interpreted as exposing SONI to any increase of costs associated with an investment, even if they are efficiently incurred and provide value for customers/are essential to deliver government policy. Given the ambiguity within the guidance and the concerns that we have with earlier sections of the document, this section could construed as place an inappropriate level of the risk on SONI.

68. We would welcome an opportunity to review this section of the document again once the other aspects are addressed. We welcome further discussion with the UR on this aspect.

Review of and Amendments to this Guidance

69. **Paragraph 1.63**: we note that this refers to consultation on any updates, but does not provide any comfort for SONI around the approach to the consultation exercise. We ask that this paragraph is updated to include a reference to UR's own consultation policy, or any other applicable standard to ensure that future changes are transparent and fully consulted on in line with good regulatory practice.

[5] The extant guidance was published in March 2018, the RIGs in November 2018.

4 Central Estimate and Risk of Negative Bias in Et & Vt approvals

70. SONI notes that the UR states that it will approve a "central estimate" for items that are being processed through the Et and Vt mechanism. This implies that the outturn of the project is as likely to be above the estimate as below it. Therefore, SONI would only be expected to recover the efficient costs of delivering these benefits if both:

- The central estimate is calculated accurately each time; and
- Across the portfolio of projects, the overspent projects are of a similar scale to those that are underspent (for example the underspends are not predominantly small projects and the overspends are not predominantly large projects).

71. The guidance does not explain how the central estimate will be calculated on a consistent and predictable basis. Without this the Et and Vt options turn into a one-way bet against SONI, where we would lose money even when costs are incurred efficiently and provide value for consumers.

72. SONI expect to be making an Et or Vt submission much closer to the time of implementation than a traditional 5 year price control submission. This means that there is very little potential for costs to come in significantly lower than estimated, however the risks that would result in an increase in costs remain. Not all of these events will result in an increase in scope that would create an opportunity for SONI to request an uplift under the Et and Vt mechanism guidance as drafted.

73. In SONI's experience, the UR does not routinely include contingency within cost approvals; however if only the best estimate at the time of submission is provided for within a Et or Vt approval, SONI would be highly likely to lose money across this mechanism.

74. For SONI to have a fair opportunity of breaking even on efficiently delivered Et and Vt work the method to be used to calculate the "central estimate" would need to be:

- Clear, robust and repeatable;
- Appropriate for projects of a range of sizes;
- Transparently capable of reflecting the full range of risks (both known and unknown) associated with each project; and
- Simple enough to be implementable without a disproportionate use of resources from both SONI and UR.

75. During the time provided by the consultation on this guidance, SONI has not been able to develop a calculation methodology that would result in a central estimate that would ensure a fair bet. We look forward to working with the UR to explore these issues further before the licence modifications are finalised.

5 Changes to the Template

77. SONI has reviewed the proposed update to the submission template and includes a mark-up version as an attachment to this response.

78. We note that there very few changes were made; however, two of these appear to be reversing changes made at SONI's request following the previous consultation exercise. Given that no reasons have been provided to support these edits, we ask that the text of the current template is reinstated**.**

79. We note that the UR requests detailed timescales for each proposal. Given the dependency on funding approvals and other aspects outside our control, this can only be provided on a best endeavours basis and we have added some text that would improve transparency around these estimates.

80. We have also reflected one edit that we made to the guidance document within the scope of the information associated with the "outputs".

6 Consultation Process

81. In November 2017 the CMA directed the UR to put in place formal guidance on the application of the Dt mechanism. This direction specified certain parameters that the guidance would need to be consistent with. Paragraph 1.40 of the current Dt guidance states that the UR will decide if the guidance continues to apply to the price control that takes effect from 1 October 2020 "**subject to consultation**".

82. Although not highlighted in any of the relevant papers or website text, the draft Uncertainty Mechanism Guidance that the UR is consulting upon appears to update and replace the current Dt guidance.

83. The reasons for these updates are not set out within the UR documentation (although it may be captured in the licence modification consultation which has yet to be published). In order to respond to the consultation effectively, SONI has had to infer the background to these changes and identify the effects of these. In order to complete this exercise and seek clarity on the UR intentions we have prepared a comparison between the two documents, which we append to this response.

84. We note that the process followed to consult on this updated uncertainty mechanism guidance and the associated documentation provided does not align with the process set by the UR (as defined in its publication of January 2010[6]).

85. We assume that the modifications to SONI's licence will give legal effect to the uncertainty mechanism guidance document. The mechanism for incorporating the terms into the revenue algebra will presumably also be set out there.

86. The absence of information about how the new terms will be included within SONI's licence including the associated definitions has limited our ability to respond fully to this consultation and we would be concerned about the potential for responses from other parties to be unintentionally ill-considered because they do not have the contextual information that is available to SONI.

[6] https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/Consultation_Guidance.pdf

Attachments: Mark-Up Version of Guidance and Template

Redline version of the Dt Guidance (based on March 2018 decision)

Key
Additions – blue underline
Deletions – ~~red strikethrough~~
SONI's proposed edits – green text with grey highlight

1. Introduction

Overview of cost recovery process for ~~Dt~~[Dt, Et, Vt, and Zt] submissions

1.1 The following requirements and guidance apply to applications by SONI for the approval of ~~D_t~~ submissions~~.~~ from SONI for additional price control funding via two uncertainty mechanism which are implemented in the licence via the following licence provisions: D_t, E_t, V_t and Z_t.

1.2 The purpose of this document is to codify the processes by which SONI can recover its costs in respect of ~~D_t~~ these submissions.~~[1]~~

1.3 ~~1.2~~ This document also provides guidance on how we will apply these processes and on what information SONI should provide to us. We recognise that ~~D_t~~ SONI's submissions ~~will~~ may concern costs which are by their nature uncertain.

~~1.3 SONI must make a D_t application under paragraph 8.1 of Annex 1 to its licence. We expect SONI to be able to recover its efficiently incurred costs up to the approved cap. The guidance sets out that SONI may recover efficiently incurred costs in the following circumstances:~~

- ~~Up to the approved cap;~~
- ~~Where the cap has been amended subject to approved D_t variations; and;~~
- ~~Where the cap has been amended subject to retrospective UR approval.~~

~~1.4 We note that some D_t applications largely fall outside of SONI's control, for example, because they relate to statutory obligations or are needed to satisfy public policy perspectives. Where appropriate, these costs may be treated more akin to a managed pass through.~~

Comment [A1]: SONI would welcome explanation of this change.

Comment [A2]: Retrospective approval was a key outcome of the CMA. This reference seems to have been deleted without explanation.

We ask that this text is reinstated.

Comment [A3]: This wording was proposed by SONI and was an important addition to the UR 2018 guidance.

No reasons have provided for its deletion and we ask for it to be reinstated.

1.4 ~~1.5~~ The 2020-25 price control framework for SONI allow for two types of uncertainty mechanisms to be used to increased price control allowances for SONI's costs (leaving aside network planning costs which are outside the scope of these mechanisms and covered in separate guidance[1]). These are briefly summarised as follows:

- We can provide additional ex ante allowances to cover central estimates of the costs of additional price control deliverables or other requirements on SONI. For operating expenditure allowances this works through the E_t licence provision and for capital expenditure allowances (RAB additions) through the V_t provision. Under the licence and our final determinations policy, the costs that SONI incurs in respect of these allowances will be subject to a mechanistic cost-sharing approach with 25% incentive rate (these costs fall outside of the conditional cost-sharing approach).

- We can make additional allowances to enable SONI to recover the amount of efficiently incurred costs on a project or activity up to a pre-specified cap. For operating expenditure allowances this works through the D_t licence provision and for capital expenditure allowances (RAB additions) through the Z_t provision.

1.5 In the first instance it is for SONI to propose which of these mechanisms are appropriate for the additional cost allowances that it is seeking. We will specify the mechanism in any approval decisions. We provide further guidance on our approach to consideration of this below.

1.6 SONI must make applications under paragraphs [xxx] of Annex 1 of its transmission licence.

Outline of the process

1.7 ~~1.5~~ The template should be completed by SONI for every ~~D_t project~~ submission. 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.

.

[1] [Add ref] [previous footnote 1 linked to paragraph 1.2 has been deleted: ~~In accordance with the Final Determination and Order of the Competition and Markets Authority dated 10 November 2017~~

Comment [A4]: The definition of "central estimate" is the key to the Et/Vt mechanism. Without clarity around how this is defined and calculated, that mechanism could function as a one-way bet against SONI.

We ask that this is clearly defined in the final guidance, including the method that will be used to determine it.

Comment [A5]: We are not sure which document is being referred to here. We would expect this to be defined in the licence and that any policy document to be lower in the legal hierarchy than the licence.

We cannot comment further without sight of the licence modifications.

Comment [A6]: When considered in combination with the ambiguity around the concept of a "central estimate", SONI has no guarantee of recovering efficiently incurred costs in aggregate across the suite of Et/Vt works.

We would welcome explanation of the reasons behind this choice, and an opportunity to respond further once these are available.

Comment [A7]: The binary nature of paragraph is not replicated in paragraph 1.37.

We request clarity and internal consistency within the guidance document.

Comment [A8]: We provide comments on this under Section 1.37 below.

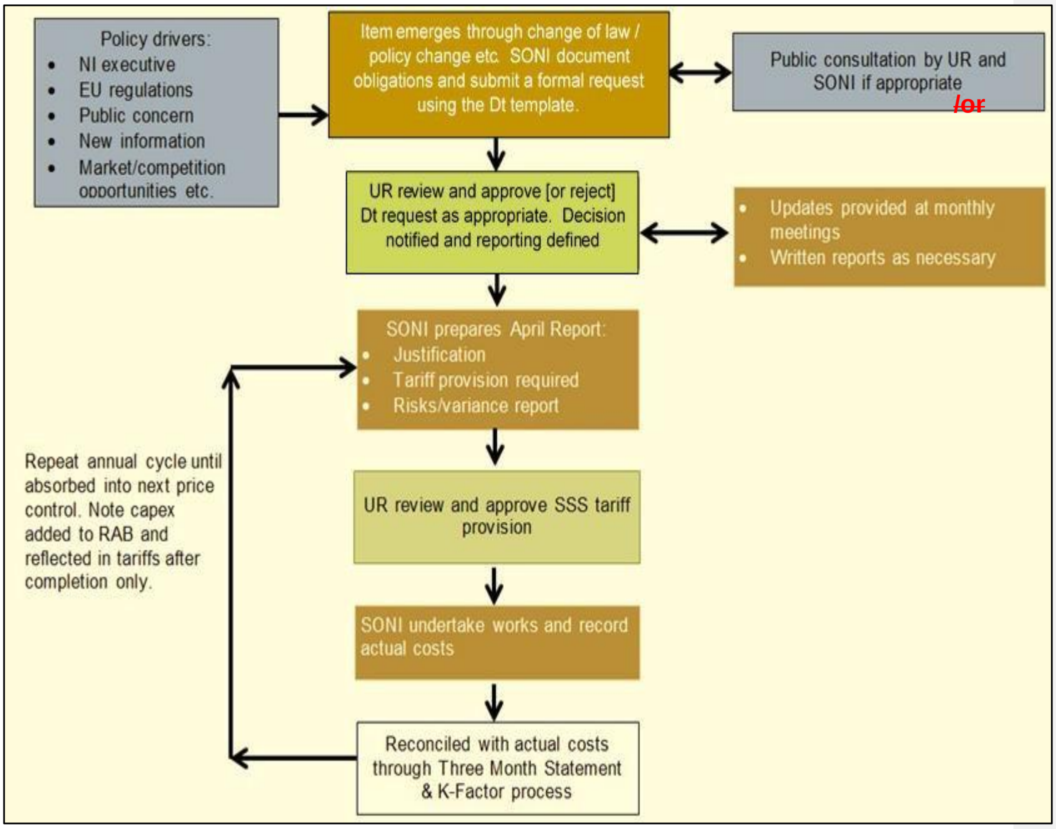
Comment [A9]: The text of the relevant licence sections was not available to SONI at the time of drafting. We cannot comment fully on this guidance document without the legal text that it sits below and the algebraic context.

Comment [A10]: The benchmark of £1m is useful.

No reasons have been provided for its deletion and we ask that it is reinstated.

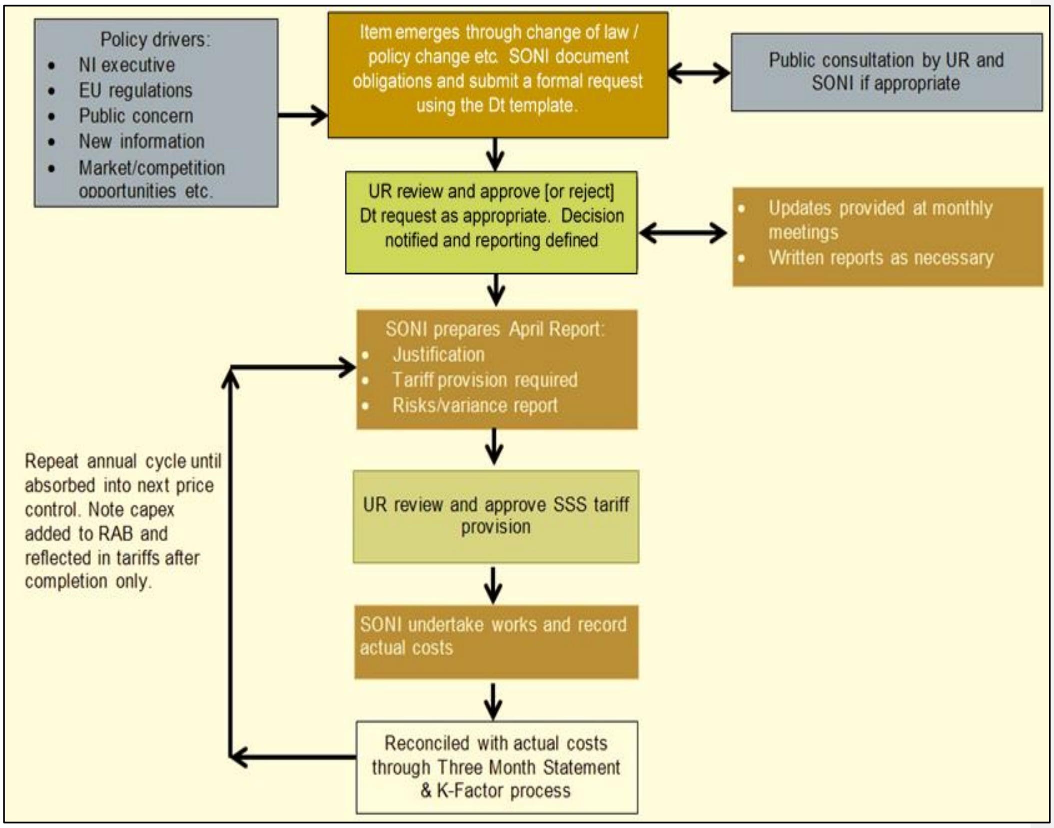
1.8 ~~1.6~~ The basic process is set out as follows:

Figure 1: Overview of ~~Dt~~ cost recovery process

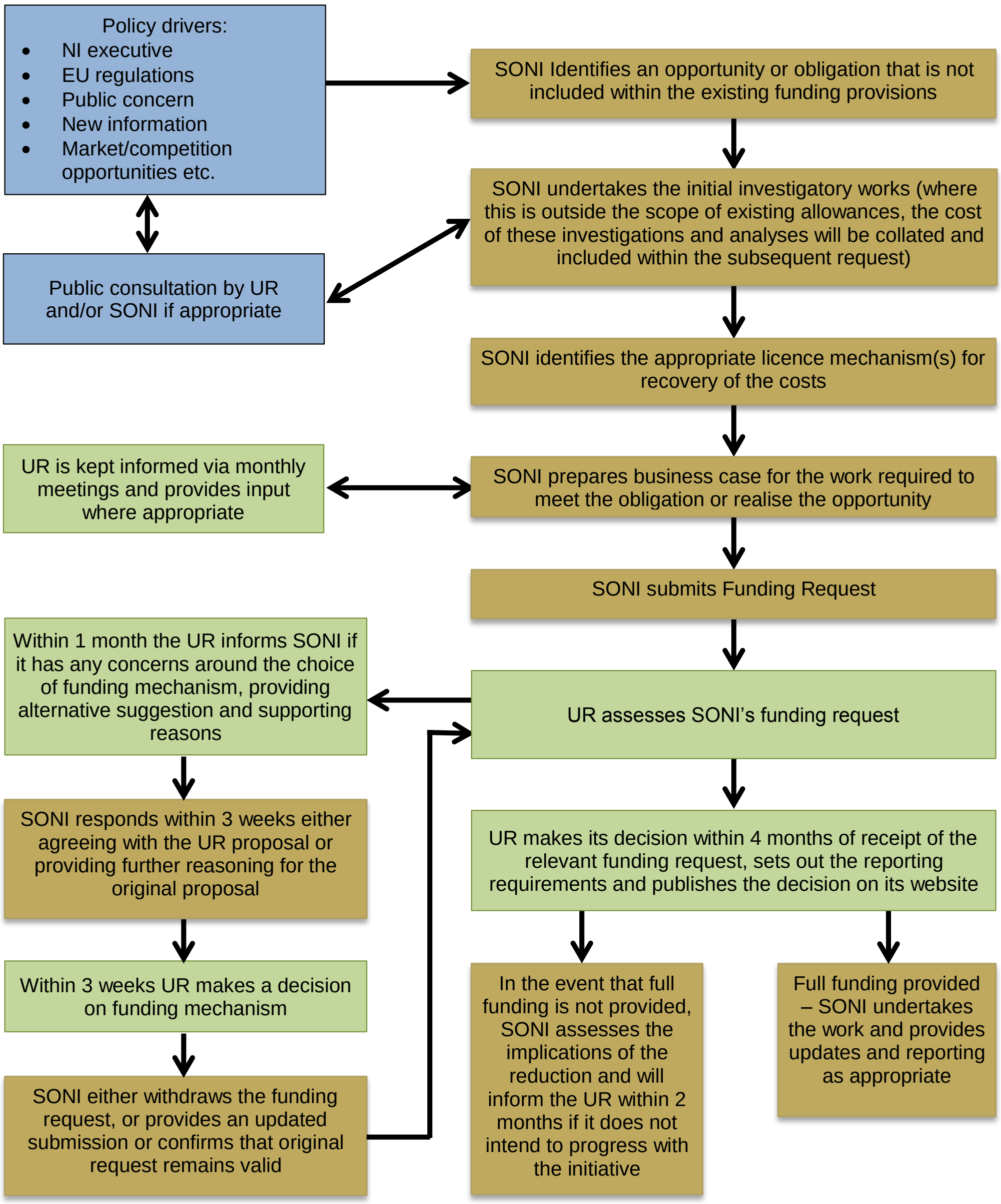


Comment [A11]: Only the title of the diagram and one box have been updated.

This diagram is misleading because it does not represent the new complexities and we ask that it is either updated or removed. SONI has included its suggested updated diagram below.

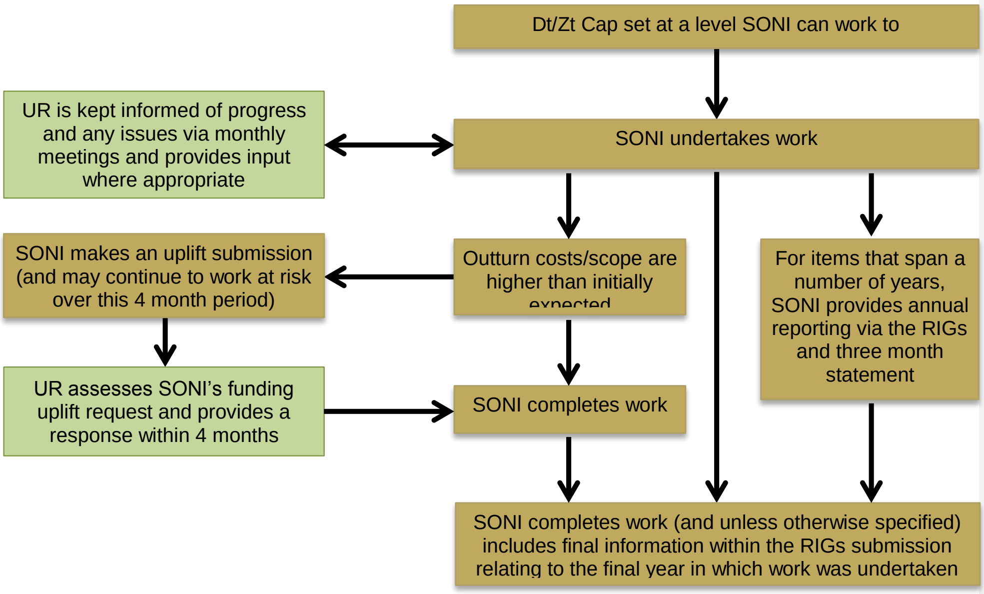

Policy drivers:
NI executive
EU regulations
Public concern
New information
Market/competition opportunities etc.
Item emerges through change of law / policy change etc. SONI document obligations and submit a formal request using the Dt template.
Public consultation by UR and SONI if appropriate
UR review and approve [or reject] Dt request as appropriate. Decision notified and reporting defined
Updates provided at monthly meetings
Written reports as necessary
SONI prepares April Report:
Justification
Tariff provision required
Risks/variance report
Repeat annual cycle until absorbed into next price control. Note capex added to RAB and reflected in tariffs after completion only.
UR review and approve SSS tariff provision
SONI undertake works and record actual costs
Reconciled with actual costs through Three Month Statement & K-Factor process

Part 1: Uncertainty Mechanism Application Process

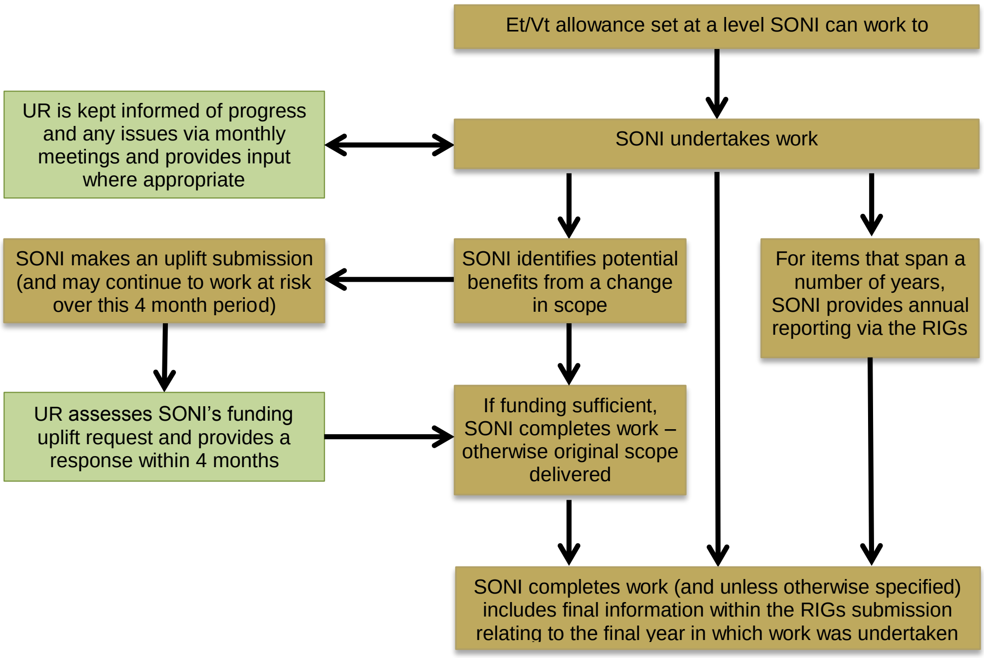


Comment [A12]: SONI has included proposed updated flow diagrams below. These reflect the new complexities around the updated processes.

Part 2a: Dt & Zt – Implementation, Reporting & Tariffing



Part 2b: Et & Vt – Implementation, Reporting and Tariffing



1.9 In summary this can be ~~defined~~ simplified as follows:

- Step 1 – Issue or opportunity identified by SONI. Consult with stakeholders as necessary.
- Step 2 – SONI submit formal ~~D_t~~ request using template.
- Step 3 – The UR review and approve (or otherwise) an additional ex ante allowance or 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 (for D_t and Z_t costs) ~~or in event of overspend or underspend (for E_t and V_t costs)~~.

1.10 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.

1.11 All applications are subject to a materiality threshold of £40k. [SONI edit: For the avoidance of doubt and to avoid sending signals that would result in a sub-optimal outcome for consumers, where an application includes both capex and opex, the materiality threshold will be assessed at an aggregate level.]

Comment [A13]: These steps do not reflect the new complexities (e.g. choice of mechanism or increase in scope/cost). We see little value in adding this complexity at this point in the document, but propose this minor edit for clarity.

Comment [A14]: No reasons have been provided for the inclusion of Et & Vt amounts separately within the 3 month statement. We assume that they will also be included in the RIGs submission and are unsure why this added layer of reporting has been added.

We suggest that this addition is removed unless there is a clear reason for including this in the three month statement.

Comment [A15]: As drafted and interpreted literally, this sentence contradicts the wording in SONI's licence as extant.

Without visibility of the proposed licence modifications, we are unable to comment on the insertion of this paragraph.

However, if the threshold is applied separately to opex and capex required to deliver one initiative, this could incentivise outcomes that are sub-optimal, which is not in consumers interests. SONI suggests additional wording that would address this issue.

2. Ex-ante approval ~~of Dt spends~~ process

1.12 ~~1.9~~ As identified above, SONI must apply to the UR for approval ~~for each Dt~~ by submitting required information (e.g. on need, estimated costs, timelines and risks) as defined in the template.

1.13 ~~1.10~~ Within four months of the UR receiving the submission, we will either approve the application (and set an initial budget cap or allowance for the project) or reject it (setting out the reasons).

1.14 ~~1.11~~ 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 four months of resubmission.

1.15 ~~1.12~~ 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

1.16 ~~1.13~~ 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.

1.17 ~~1.14~~ 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

1.18 ~~1.15~~ 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. Except in certain circumstances as indicated by the UR, this clarifying material does not constitute a re-submission for the purposes of calculating timelines for approval.

1.19 ~~1.16~~ Additional detail might include where relevant:

- NPV analysis (if costs being incurred over a number of years);
- Cost Benefit Analysis (CBA);
- Supporting justification / calculations;
- Outputs and timelines for delivery;
- Impact on consumers or key performance metrics;
- Cost profile (if being incurred over a number of years); or
- Option / Risk analysis.

1.20 SONI's submissions for additional funding under uncertainty mechanisms should include proposed deliverables that meet the following requirements to ensure the TSO's accountability for delivery:

1) **Well-specified:** the plan should set out clearly what is to be delivered in practice, and/or how successful delivery would be measured, in order for delivery to be verified. This may require a significant amount of detail on the scope and quality of what is planned.

2) **Time-bound:** the plan should contain clear dates for delivery, using milestones within the financial year for initiatives which are to be delivered over several years.

3) **Consumer Interest:** SONI should demonstrate that any changes to allowances are in consumers' interests and reflect consumers' requirements, [SONI edit: or are required to deliver government policy, or to achieve compliance with mandatory requirements,] and that only efficient additional costs are being allowed.

Network Planning

1.21 It is anticipated that the D_t licence term will also be used for any uplift to allowances for network planning scoping and feasibility studies. Whilst the

Comment [A16]: Paragraph 1.18 implies that there is a proportionate approach to the information required, but the previous benchmark of £1m has been deleted.

We ask that the revenant paragraphs are reviewed to ensure that SONI can anticipate the level of detail required and that this is both realistic and achievable at an early stage in each project.

Comment [A17]: SONI expects to be making requests that are required to deliver government policy and commitments or to achieve compliance with mandatory standards. These will have been consulted on by the bodies that have put them into place. SONI would expect to be able to rely on those processes and would expect to be able to refer to them as part of this request rather than re-justify them from first principles. We have suggested text that could be included here to remove ambiguity.

We ask that this point is expanded to include that context and the validity of SONI undertaking work to deliver public policy.

Comment [A18]: SONI welcomes the clarity that this section provides.

same template should be used, it is possible that the information contained therein may be somewhat different.

1.22 For instance, it could be that these requests are not specifically project related but are due to volume of work increases. In this scenario SONI will need to provide some justification for activity and cost forecasts. However, we appreciate that the level of certainty we would normally expect may not be present when these costs are somewhat volatile.

1.23 This may also be true of option analysis and outputs/benefits which may be less focused than we would otherwise expect for specific project cost requests.

The UR's assessment and response

1.24 ~~1.17~~ 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.[2]

1.25 ~~1.18~~ 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.

1.26 ~~1.19~~ Where appropriate, the UR and/or SONI will publicly consult on the ~~Dt~~ application, though this is unlikely to be required in most circumstances.

1.27 ~~1.20~~ 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.

1.28 ~~1.21~~ 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. The UR will comply with its legal obligations in terms of Freedom of Information and may withhold commercially sensitive information from publication where lawful and appropriate.

1.29 ~~1.22~~ Confirmation will be provided in writing to SONI as to the outcome of the assessment~~. For each~~ This will include confirmation of which licence

[2] UR would aim to undertake such a review and notify SONI within one month of application, if a full resubmission is required

provision(s) any amounts are being approved ~~application, we will set a maximum amount of expenditure that can be recovered through tariffs~~ under (i.e. D_t, E_t, Z_t and/or V_t), and the amounts approved. The approval letter will also be published on the UR's website.

1.30 ~~1.23~~ Approved expenditure is recoverable in the first instance through tariffs ~~and/or SONI's RAB~~ [SONI proposed edit: either in the relevant year over a period of time through the RAB algebra]. Subsequent adjustments are then made using the K-factor ~~for~~ in the light of information on actual ~~.~~levels of 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.~~

1.31 ~~1.24~~ In the event that the UR is minded to not approve ~~the project~~ funding requests in a submission, 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. Ahead of publication, these will be shared with SONI, providing them the opportunity to identify any publication concerns.

1.32 We provide some further information on our approach to assessment below.

Choice between types of uncertainty mechanism

1.33 As indicated at the start of this document there are two different types of uncertainty mechanism that can be used. [SONI edit] – this section should be updated to reflect good regulatory practice – SONI has suggested processes a potential process within the updated flow diagram]

1.34 To limit risks of distortions to SONI's incentives and cost reporting, our starting position would be that the uncertainty mechanism applied should involve an approach to cost remuneration and cost incentives that is most aligned with that used within the SONI price control for other similar costs.

1.35 Most of SONI's internal costs are subject to a conditional cost-sharing approach with a 25% incentive rate, and the uncertainty mechanism provided for under licence provisions E_t and V_t is most aligned with this (it involves mechanistic cost-sharing with a 25% incentive rate).

1.36 However, we recognise merit in allowing flexibility to depart from this starting point. For instance the approach of recovery of costs incurred up to a cap (under the D_t and Z_t licence provisions) may make sense if it does not seem appropriate to set an ex ante allowance subject to cost sharing incentives, due to the degree of uncertainty on the efficient levels of costs and/or the scope of a project.

Comment [A19]: We comment on the issues associated with this unilateral choice under paragraphs 1.33 to 1.37 below.

Comment [A20]: SONI is not aware of any mechanism within its current licence whereby cost of this nature are recovered through any source of revenue other than our tariffs.

While we have not seen the proposed modifications when drafting this response, we would be concerned if this was being introduced at such a late stage.

We suggest alternative wording on the assumption that this is not a new funding mechanism.

Comment [A21]: This section does not provide an obligation on UR to consult with SONI prior to changing the funding mechanism.

It does not provide an opportunity for SONI to update its costs to reflect the change in mechanism

It does not provide security for SONI for changes that could move some cost elements into a de minimis category, disadvantaging SONI.

We ask that it is updated to implement good regulatory practice. See process suggested in updated flow diagram.

1.37 Which specific licence provision(s) to use will also depend on the mix of operating expenditure and capital expenditure in the relevant costs. The E_t and D_t licence provisions are likely to be most appropriate for remuneration of operating expenditure. The Z_t and V_t licence provisions are likely to be most appropriate for remuneration of capital expenditure, and work through RAB additions. However, we will also consider in any case if there are specific factors that affect the appropriate remuneration channel.

Price control deliverables

1.38 We generally expect to specify price control deliverables where uncertainty mechanisms are used to increase price control funding for SONI (whether by additional ex ante allowances or approvals for remuneration of costs incurred up to a cap). These deliverables will be subject to the same accountability and performance arrangements as for deliverables set as part of our final determinations.

1.39 One exception to this approach to accountability is where the allowance is for the costs of additional obligations and SONI would not have discretion to avoid spending the additional costs claimed.

Comment [A22]: This is not consistent with the current approach and without sight of the licence algebra we cannot understand the mechanism for recovering opex costs in the year in which they are incurred under the Vt/Zt provisions. We are also not aware of any relevant UR precedent for adding opex costs to a RAB for recovery through depreciation and return.

We ask that that section is updated to align with the licence algebra.

Comment [A23]: This does not provide the level of predictability required.

Comment [A24]: We do not yet have visibility of the status of "price control deliverables" under our licence, nor how they would be used to determine our revenues.

We will include any concerns in an addendum to our response to the licence modifications consultation.

Comment [A25]: Given that a large volume of the funding that will pass through these mechanisms will be driven by delivery of government policy**, we would ask for confirmation that the investments required to meet these targets is included within the "non-discretionary" category.**

Interactions with other potential cost remuneration channels

1.40 Under the SONI price control framework, there is the potential for SONI to receive additional price control funding for higher costs associated with improvements in its performance and service quality through two other elements of the price control framework:

1) The conditional cost-sharing arrangements.

2) The evaluative performance framework.

1.41 In making assessments of applications from SONI for additional funding under the D_t, E_t, Z_t and V_t licence provisions, we will take account of the existence of the opportunities under these other elements of the framework, where relevant.

1.42 However, we will not treat the existence of the conditional cost-sharing arrangements or the evaluative performance framework as a reason to reject otherwise strong submissions from SONI for additional funding under the D_t, E_t, Z_t and V_t licence provisions.

1.43 We recognise that the ex post outcomes from the conditional cost-sharing arrangements and evaluative performance framework are not perfect substitutes for ex ante approval under uncertainty mechanisms. Furthermore, the conditional cost-sharing arrangements have a higher materiality threshold.

Comment [A26]: The possibility of the UR unilaterally refusing a request and instead forcing SONI to deliver outputs that are in customers' interests under other mechanisms where recovery of our costs remains at risk would be inconsistent with the UR's stated approach to this price control and this level of risk is not reflected in the associated financeability assessment.

No reasons have been provided for the inclusion of this possibility

We therefore ask that this option is unambiguously removed.

3. Reporting on approved costs

1.44 ~~1.25~~ 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. Any detail requested will be proportional and necessary for the purposes of regulatory scrutiny and oversight.

1.45 ~~1.26~~ It is our intention to advise and agree reporting requirements with SONI on approval of any costs.

Annual reporting

1.46 ~~1.27~~ Ongoing reporting will include:

1) The RIGs ~~April~~ Submission (before 1 April each year) consisting of:

- Information relating to current ~~Dt~~ projects and those expected in the next 18 months.
- Completed formal ~~Dt~~ uplift requests for the upcoming year.
- A summary of outturn for the previous year.
- Latest best estimate of current ~~Dt~~ project spends.

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

- Actual cost data for any ~~Dt~~ uncertainty mechanism items in the completed year.
- K-factor adjustments for the previous tariff year.
- Auditor’s Report.

~~1.28 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).~~

1.47 ~~1.29~~ Annual reporting format and submissions may develop over time. This reporting will also be considered in line with ongoing work on TSO cost and output reporting development.

Project ~~variation~~ variations for Dt and Zt costs

Comment [A27]: The concept of an April submission was superseded by the RIGs. Given the overlap between these pieces of work we suggest that this section is updated to align with and refer to the RIGs processes.

Comment [A28]: Please see our comments under Paragraph 1.8

1.48 ~~1.30~~ The UR recognises that some D_t, and Z_t, costs can be uncertain or outside SONI's control, or that efficient levels of costs may change as the appropriate scope of a project changes.

1.49 In the event that the approved cost cap will be breached, SONI may submit an application to increase the cap. SONI can make such variation requests at any time, but should endeavour to do so in advance of the cap being exceeded.

1.50 ~~1.31~~ To apply for a variation, SONI should resubmit the pro-forma ~~in Annex (c) to this document~~ template 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 (or mandatory).

1.51 ~~1.32~~ 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.

1.52 ~~1.33~~ The TSO is also free to submit further requests above the £40k threshold at any time during the year using the template.

1.53 ~~1.34~~ If required, UR approvals will signal if a D_t or Z_t submission is considered uncontrollable expenditure. If this designation is given, variation applications must still be made for spend above the initial cap. However, such applications will be allowed in all instances as specified in the approval.

1.54 ~~1.35~~ Where costs are within SONI's control, 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.[3]

Project variation for Et and Vt scope changes

1.55 For E_t and V_t costs, there is an allowance but cost-sharing arrangements apply which mean that 75% of the value of any over-spend or under-spend is passed through to customers via the licence provisions (either within the relevant year or through provisions for return and depreciation as set out in the algebra in SONI's licence ~~and RAB~~).

1.56 SONI may submit applications for changes to the cost allowances if there is a clear need to make changes to the scope of a project's deliverables. SONI

[3] See CMA final determination, p276, para 12.77.

Comment [A29]: The interpretation of this section will be greatly aided by the removal of ambiguity elsewhere in the guidance document, particularly the definition of "central estimate" which will ensure that this mechanism is a fair bet for SONI.

We would therefore welcome an opportunity to review this section once our earlier comments are addressed.

Comment [A30]: This suggests a new RAB funding mechanism that is not defined within our licence.

Are not aware of any such mechanism and suggest that this is deleted to remove ambiguity.

can make such variation requests at any time, but should endeavour to do so in advance of an over-spend.

1.57 To apply for a variation, SONI should resubmit the pro-forma to this document identifying that it is a variation on an existing ex ante allowance. This should be provided alongside an explanation, supported by evidence, as to why a change in scope and additional spend is both efficient and necessary (or mandatory). This should include associated changes to price control deliverables where applicable.

1.58 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.

Comment [A31]: Can the UR explain how does this feed through into the revenue entitlement and when?

Ex-post process for review of approved Dt and Zt costs

1.59 ~~1.36~~ 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 not greater than or below the cap (in respect of amounts funded by the D_t and Z_t provisions). ~~and that none of the~~ The UR may also choose to consider whether any 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.[4]

1.60 ~~1.37~~ 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.

~~1.38 Should we have concerns around the potential for costs to be assessed to be 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.~~

Comment [A32]: This original text post-dates the publication of the DIWE guidance and provides context for its application in this context.

No reasons have been provided for its deletion and we ask that it is reinstated.

1.61 ~~1.39~~ In the event that reductions are sought we will write to SONI and advise of the rationale and quantum 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

1.62 ~~1.40~~ These requirements and guidance apply to the process for SONI's applications for D_t, E_t Z_t, and V_t items in the current price control period,

[4] DIWE guidance.

which ends on 30 September ~~2020.~~2025.

1.63 ~~1.41~~ The UR may update this document, in consultation with SONI, in the light of experience. The UR will also decide, subject to [full] consultation [as set out in the relevant UR policy[5]], whether the same overall process should be applied in the next price control, which is due to take effect from 1 October ~~2020~~ 2025.

Comment [A33]: We ask that a reference to the UR's own consultation process is added here to ensure that any further updates are made in a transparent manner with the reasons and effects clearly set out.

[5] At the time of drafting the relevant policy can be found here: https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/Consultation_Guidance.pdf

Redline version of the Dt Template (based on March 2018 decision)

Key
Additions – blue underline
Deletions – ~~red strikethrough~~
SONI's proposed edits – green text with yellow highlight

Request Name

Uncertainty Mechanism Submission

XX Month 201X

General Guidance

This pro forma is designed to facilitate documentation of formal submissions for all Dt, Et, Vt and Zt, applications (unless bespoke arrangements exist). The pro-forma is a general template covering the minimum requirements. All sections should be completed, but it can be adapted and tailored to suit particular spending areas as desired. The spaces and tables should be enlarged or modified as required to accommodate all the necessary information.

There are no precise rules about the length of the document for these applications. However, the information provided needs to be sufficient to both justify the project and the associated forecast expenditure. Larger and/or more complex projects will likely require more justification and detail. Separate submissions should be provided alongside this form where appropriate.

All costs should be submitted in constant prices. The company should confirm what price base the submission is in as part of the cost template. It should also be detailed whether the request is for capex, opex or a combination of both.

Comment [A1]: The guidance does not specify when this will apply.

Summary

Name	
Submission Date	
~~Reference~~ Request Type	Opex / Capex / Both
~~Type~~ Licence Mechanism	~~Opex / Capex / Both~~
Request Amount	
Price Base	

Comment [A2]: It is useful to have a reference for tracking purposes. This will become even more significant with the increased volume of reporting.

SONI suggests that this is added back in.

Comment [A3]: Row that this is in has been moved due to deletion of reference.

Brief Description

- Explain the background to the proposal including its relevance to the electricity industry in Northern Ireland (and RoI if applicable).
- Identify the key stakeholders and explain their commitment and any outstanding issues, if applicable.

Identification of Need

- Identify the obligation placed on SONI to incur these costs, or the problem to be solved and or the basis for investment in improvements.
- Explain the nature of the needs, or demands or obligations that are to be addressed.
- Detail any ~~potential future~~ deficiencies in ~~existing~~ service provision, if applicable.

Comment [A4]: SONI will be asking for funding before we enter into a situation with "deficiencies in service provision". These words were added as a direct result of the previous consultation on the guidance and it is surprising that they have been deleted without explanation.

The deletion of this text is prejudicial and we ask that they are reinstated.

Outputs

- Explain and list the objectives in specific measurable terms, if appropriate or applicable.
- Include measurable targets where possible.
- Detail timescales for deliverables, including the assumptions underpinning these estimates.
- Demonstrate how the proposal is in the interests of consumers, delivers government policy or addresses a compliance requirement
- Identify any likely constraints to the project e.g. timing issues, legal requirements, professional standards and so on.

Comment [A5]: This will have to be done on a "best endeavours basis".

SONI has added suggest text to include the assumptions upon which these timescales are based.

Comment [A6]: SONI asks that this text is added to reflect that fact that many of these requests will be focused on delivering government policy or compliance with external requirements.

Option Analysis

- If appropriate, consider alternative ways to meet the objectives e.g. variations in scale, quality, technique, location, timing etc.
- If appropriate, the shortlist of options should include a baseline Status Quo or 'Do Minimum' option and a suitable number of alternative 'Do Something' options (usually at least two).
- Where no alternative options are available the box should state 'Not Applicable'.

Expected Costs (and benefits)

- Estimates should be provided for capital costs, operational costs and monetary benefits.
- Assumptions of financial costs and benefits should be detailed~~, if applicable~~.
- Non-monetary benefits should be listed e.g. resilience, security of supply, legal compliance etc.
- Profile of the resource requirement should be detailed (if spanning a number of years).
- Price base should be explicitly detailed.
- NPV analysis will not be required unless different capital options have been considered.

Comment [A7]: This is also text that was added following the Dec 2017 consultation exercise. These submission will continue to contain items where SONI will not be able to quantify costs and benefits (e.g. the ITC scheme).

No reasons have been given for its deletion, we therefore ask that it is reinstated.

Risks & Mitigation

- Identify and describe the risks that the activities may face or that are associated with the obligations.
- Explain the likely impact of the various risks without mitigation, noting that in some cases SONI may have no ability to mitigate these costs.
- Identify measures to ensure that each risk is appropriately managed and mitigated, if possible.
- Explain and justify any contingency allowances included for risks in the costings.

Any other relevant information