



Requirements and Guidance on Uncertainty Mechanisms (excluding TNPPs) Costs

19 November 2021



About the Utility Regulator

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

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

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

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



Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.



Our vision

To ensure value and sustainability in energy and water.



Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.



Abstract

This paper sets out the Utility Regulator's (UR's) updated guidance for cost recovery of uncertain revenue applications by the electricity Transmission System Operator for Northern Ireland (SONI) following implementation of the new price control mechanisms.

The guidance covers existing uncertainty mechanisms (D_t , and Z_t) as well as the new proposed licence terms (E_t , and V_t) which will facilitate additions to ex-ante opex and capex allowances. The guidance also references the approach to uplifting allowances for network planning scoping and feasibility studies as well as adjustments to the pension deficit allowances.

Audience

This document is likely to be of interest to SONI, NIE Networks, other regulated companies in the energy industry.

Consumer impact

The guidance is for the benefit of SONI in the completion of these applications. There is not anticipated to be any impact on the consumer.



Contents page

1. Introduction	3
Overview of cost recovery process for [Dt, Et, Vt, Zt, SFUt and PTRAt] submissions.....	3
2. Outline of the ex-ante approval process for general uncertainty mechanisms	5
3. Ex-ante approval process for general uncertainty mechanisms	7
Timing of application.....	7
Format of application	7
The UR's assessment and response	8
Choice between types of uncertainty mechanism.....	9
Price control deliverables	10
Interactions with other potential cost remuneration channels	11
4. Approval process for Network planning and Pension deficit repair uncertainty mechanisms	12
Network planning.....	12
Pension deficit repair	12
5. Reporting on approved costs for all uncertainty mechanisms	14
Annual reporting	14
6. Project variations for all uncertainty mechanisms.....	15
Project variation for general uncertainty mechanism Dt and Zt costs	15
Project variation for general uncertainty mechanism Et and Vt scope changes.....	15
Project variation for SFUt and PTRAt uncertainty mechanism costs	16
7. Ex-post process for review of approved Dt, Zt (general uncertainty mechanisms) and SFUt costs	17
8. Review of and amendments to this Guidance	18

1. Introduction

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

- 1.1 The following requirements and guidance apply to applications by SONI for the approval of submissions from SONI for additional price control funding via the uncertainty mechanisms which are implemented in the licence via the following licence provisions: D_t , E_t , V_t , Z_t , SFU_t and $PTRA_t$.
- 1.2 The purpose of this document is to codify the processes by which SONI can recover its costs in respect of these submissions.
- 1.3 This document also provides guidance on how we will apply these processes and on what information SONI should provide to us. We recognise that SONI's submissions may concern costs which are by their nature uncertain.
- 1.4 We further accept that applications and approvals may be made on costs that have already been incurred. We would however expect SONI to seek prior approval before expenditure in most instances. Should SONI choose to incur costs prior to submission or approval, it will do so at its own risk.
- 1.5 The 2020-25 price control framework for SONI allows for two main types of uncertainty mechanisms to be used to increase price control allowances for SONI's costs (leaving aside TNPP applications which are outside the scope of these mechanisms and covered in separate guidance¹). These are briefly summarised as follows:
 - We can provide additional ex-ante allowances to cover central estimates² of the costs of additional price control deliverables or other requirements on SONI. For expenditure which is to be remunerated via operating expenditure allowances this works through the E_t licence provision and for expenditure which is to be remunerated via SONI's RAB this works 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

¹ https://www.uregni.gov.uk/files/uregni/media-files/2018-03-09%20Exhibit%201%20-%20TNPP%20Finalised%20Guidance_1.pdf

² For the purposes of transparency, the central estimate refers to SONI's best available forecast of the project costs. This should be justified by reference to relevant assumptions, basis of calculation and exclude any provision for contingency.

amount of efficiently incurred costs on a project or activity up to a pre-specified cap.³ For expenditure which is to be remunerated via operating expenditure allowances this works through the D_t licence provision and for expenditure which is to be remunerated via SONI's RAB this works through the Z_t provision.

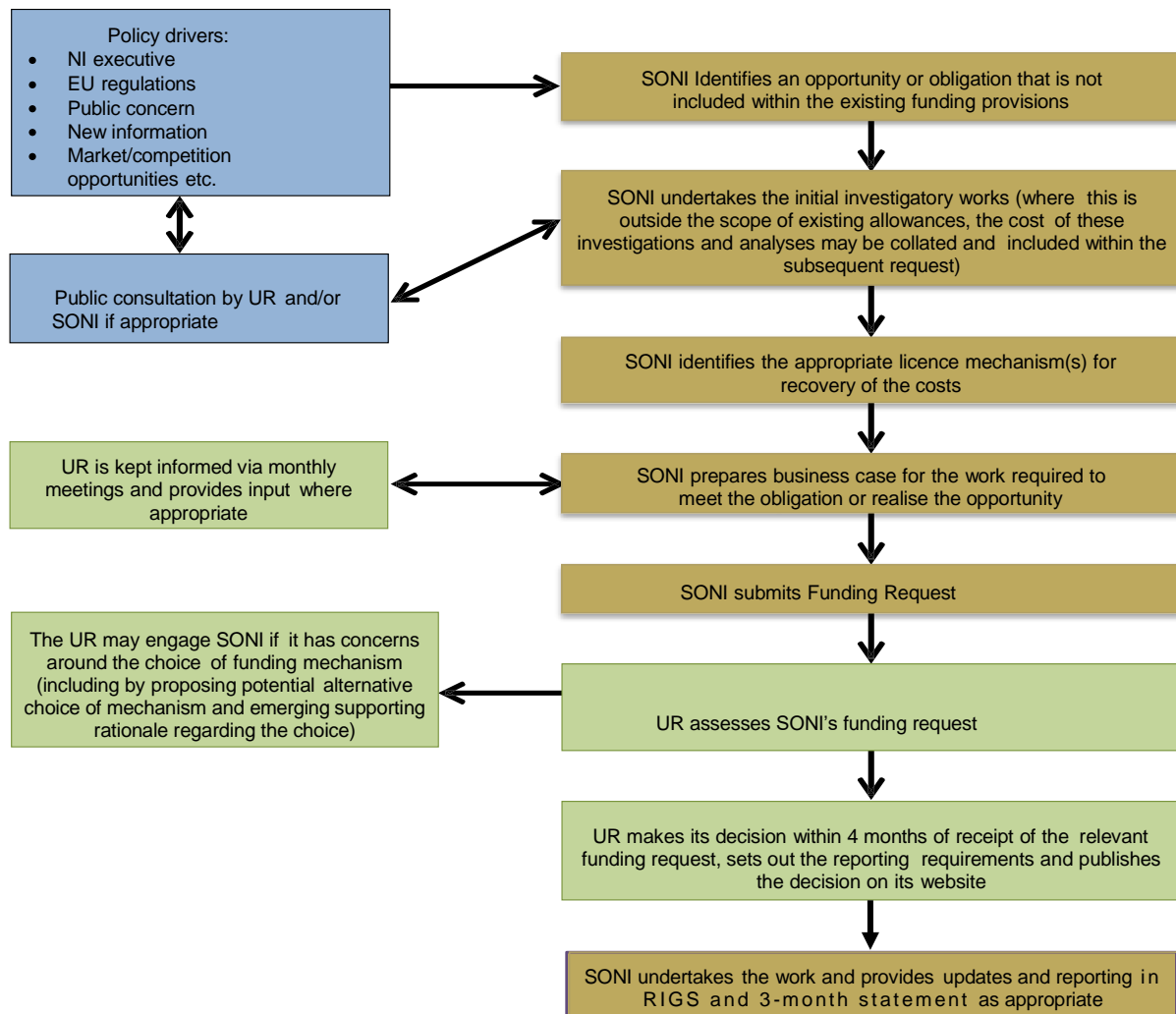
- 1.6 In the first instance it is for SONI to propose which of these mechanisms are appropriate for the additional cost allowances that it is seeking. We will specify the mechanism in any approval decisions. We provide further guidance on our approach to consideration of this below. SONI must make applications under paragraph 8.1 of Annex 1 of its transmission licence.
- 1.7 In this guidance, we refer to the D_t , E_t , V_t , Z_t , uncertainty mechanisms as “general uncertainty mechanisms” as they might be applied to a wide range of expenditure and activities within SONI's functions.
- 1.8 In addition to these general uncertainty mechanisms above, there are two other uncertainty mechanisms specific to particular types of costs. The first is the SFU_t term which can be used to request uplifts to the network planning scoping and feasibility allowances. The second is the $PTRA_t$ term which is specific to pension deficit repair costs. It can be utilised should there be a significant change in the pension deficit position following a triennial review.

³ It may be appropriate for SONI to include a contingency provision in the D_t/Z_t submissions. Contingency provision may be appropriate, where, for example, there is a lack of good information to set a robust baseline, for example, in light of uncertainty. SONI should separately identify the amount / percentage uplift for contingency and explain why such a request is reasonable.

2. Outline of the ex-ante approval process for general uncertainty mechanisms

2.1 The basic process is set out as follows:

Figure 1: Overview of cost recovery process



2.2 In summary this can be defined as follows:

- Step 1 – Issue or opportunity identified by SONI. Consult with stakeholders as necessary.
- Step 2 – SONI submit formal 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).
- 2.3 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.
- 2.4 All applications are subject to a materiality threshold of £40k in nominal terms in each relevant year. For the avoidance of doubt, where an application includes both capex and opex, the materiality threshold will be assessed at an aggregate level.
- 2.5 If capital spend results in ongoing opex costs which occurs over a number of years, in-year allowances below the threshold may be considered for approval in the relevant year in question despite being below the limit.

3. Ex-ante approval process for general uncertainty mechanisms

- 3.1 As identified in Section 2, SONI must apply to the UR for approval by submitting required information (e.g. on need, estimated costs, timelines and risks) as defined in the template.
- 3.2 Within four months of the UR receiving the submission, we will aim to either approve the application (and set an initial budget cap or allowance for the project) or reject it (setting out the reasons).
- 3.3 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.
- 3.4 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

- 3.5 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.
- 3.6 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

- 3.7 Formal submission should be made using the uncertainty mechanism template. However, it is recognised that large projects (over £1m) may require more in-depth justification and supporting documentation. 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.

3.8 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.

3.9 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, and that only efficient additional costs are being allowed.

The UR's assessment and response

3.10 The UR will assess SONI's application in line with its duties. At an early stage, we will review the completeness of the information provided by SONI.⁴

3.11 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

⁴ UR would aim to undertake such a review and notify SONI within one month of application, if a full resubmission is required.

ten working days in order to aid timely approval of submissions.

- 3.12 Where appropriate, the UR and/or SONI will publicly consult on the application, though this is unlikely to be required in most circumstances.
- 3.13 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.
- 3.14 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.
- 3.15 Confirmation will be provided in writing to SONI as to the outcome of the assessment. This will include confirmation of which licence provision(s) any amounts are being approved under (i.e. D_t , E_t , Z_t and/or V_t), and the amounts approved. UR will generally issue a provisional determination to SONI prior to a final decision. This gives SONI the opportunity to respond on matters of error in the UR interpretation of the data and evidence that it submitted in earlier steps of the process. It is not intended to provide SONI with an opportunity to introduce new evidence to the assessment. This step may not however always be necessary e.g. where full allowance is provided or where UR disagrees with the request. The approval letter will also be published on the UR's website.
- 3.16 Approved expenditure is recoverable in the first instance through tariffs, either in the relevant year or over time, through the relevant licence algebra. Subsequent adjustments are then made using the K-factor in the light of information on actual levels of expenditure.
- 3.17 In the event that the UR is minded to not approve 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.
- 3.18 We provide some further information on our approach to assessment below.

Choice between types of uncertainty mechanism

- 3.19 As indicated at the start of this document there are two different types of general uncertainty mechanism that can be used.

- 3.20 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.
- 3.21 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).
- 3.22 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 is particularly difficult or not worthwhile overall setting an ex-ante baseline for a specific new initiative. However, we expect this to be the exception.
- 3.23 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 generally most appropriate for remuneration of operating expenditure. The Z_t and V_t licence provisions are generally 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.
- 3.24 For the avoidance of doubt, where an application includes both capex and opex, the materiality threshold will be assessed at an aggregate level of the capex and opex. If capital spend results in ongoing opex costs which occurs over a number of years, in-year allowances below the threshold may be considered for approval in the relevant year in question despite being below the limit.⁵

Price control deliverables

- 3.25 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.
- 3.26 One exception to the specification of additional price control deliverables is where the allowance is for the costs of additional obligations and SONI

⁵ Consider the example where the TSO requests funding of £140k for an IT project split by £100k capital spend in Year 1 and £10k per annum opex licence costs in Years 2-5. Should the UR support such a project, the guidance provides flexibility to make provision for the ongoing opex licence costs, even though they fall below the de-minimis threshold.

would not have discretion to avoid spending the additional costs claimed.

Interactions with other potential cost remuneration channels

- 3.27 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.
- 3.28 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.
- 3.29 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.
- 3.30 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.

4. Approval process for Network planning and Pension deficit repair uncertainty mechanisms

Network planning

- 4.1 The SFU_t licence term will be used for any uplift (this amount cannot be negative) to opex allowances for network planning scoping and feasibility studies. The uncertainty mechanism template is not required to be used for these requests as it is probable that the information contained therein may be somewhat different.
- 4.2 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 complete the following application process:
- a) Write to UR detailing any request for uplift of network planning allowances and the year(s) impacted.
 - b) Provide justification for activity and cost forecasts and detail why existing allowances are insufficient.
 - c) Set out the outputs/benefits of the additional monies requested.
- 4.3 Whilst the application process (points a-c) for SFU_t requests is slightly different, the methodology and timings for queries, assessment, approval and publication will be the same as general uncertainty submissions.⁶

Pension deficit repair

- 4.4 The PTRAt term will be used for any adjustment (either positive or negative) to the ex-ante pension deficit repair allowance. Again, the uncertainty mechanism template is not required for such requests. SONI will need to complete the following application process:
- a) Provide the updated actuarial valuation and supporting calculations to the UR as soon as it is available to SONI.
 - b) SONI will need to make a proposal to UR as to whether there should be an adjustment, and if so, what it should be under the PTRAt term.
 - c) SONI must give reasons and evidence to support its proposal

⁶ For example, the same requirements of the general uncertainty mechanism for a) Timings of applications (paras 3.5 to 3.6); b) Approval timelines (para 3.2); c) Query process (paras 3.10 to 3.14); and d) Decision consultation and publication (para 3.17) also applies equally for this mechanism.

(including if it does not propose an adjustment).

- d) If proposing an uplift, SONI will need to detail how any changed level of employer contributions remain consistent with the principles as established in the FD and pension principles paper⁷ i.e. 10-year recovery plan etc.

- 4.5 The application process for PTRAt requests (points a-d) is slightly different, however the methodology and timings for queries, assessment, approval and publication will be the same as other submissions.⁸
- 4.6 The pension deficit adjustments can be both in a positive or negative direction. The adjustment can also be triggered by the UR should we consider that the improvement in the deficit position merits a reduction in the price control allowance.
- 4.7 If such an action is required, UR would engage with SONI prior to undertaking a pension deficit adjustment. PTRAt costs are only subject to determination after a triennial actuarial valuation. As a consequence, it is only possible to undertake one such downward amendment of revenues during the five year price control period.

⁷ <https://www.uregni.gov.uk/files/uregni/media-files/Pensions%20Conclusions%20and%20CIL%20Decision.pdf>

⁸ For example, the same requirements of the general uncertainty mechanism for a) Timings of applications (paras 3.5 to 3.6); b) Approval timelines (para 3.2); c) Query process (paras 3.10 to 3.14); and d) Decision consultation and publication (para 3.17) also applies equally for this mechanism.

5. Reporting on approved costs for all uncertainty mechanisms

- 5.1 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.
- 5.2 It is our intention to advise and agree reporting requirements with SONI on approval of any costs.

Annual reporting

- 5.3 Ongoing reporting will include:
- 1) The RIGs Submission (by 31 January each year) consisting of:
 - Information relating to current projects and those expected in the next 18 months.
 - Completed formal uplift requests for the upcoming year.
 - A summary of outturn for the previous year.
 - Latest best estimate of current project spends.
 - 2) The Three Month Statement (before 31 December each year) consisting of:
 - Actual cost data for any uncertainty mechanism items in the completed year.
 - K-factor adjustments for the previous tariff year.
 - Auditor's Report.
- 5.4 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.

6. Project variations for all uncertainty mechanisms

Project variation for general uncertainty mechanism D_t and Z_t costs

- 6.1 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.
- 6.2 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.
- 6.3 To apply for a variation, SONI should resubmit the pro-forma 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).
- 6.4 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.
- 6.5 The TSO is also free to submit further requests above the £40k threshold at any time during the year using the template.
- 6.6 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.
- 6.7 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.⁹

Project variation for general uncertainty mechanism E_t and V_t scope changes

- 6.8 For E_t and V_t costs, there is an ex-ante allowance and cost-sharing arrangements apply which mean that 75% of the value of any over-spend or under-spend (relative to the ex-ante allowance) is passed through to customers via the licence provisions (either within the relevant year or

⁹ See CMA final determination, p276, para 12.77.

through provisions for return and depreciation as set out in the algebra in SONI's licence).

- 6.9 SONI may submit applications for changes to the ex-ante allowances if there is a clear need to make changes to the scope of a project's deliverables. SONI can make such variation requests at any time, but should endeavour to do so in advance of an over-spend.
- 6.10 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.
- 6.11 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.

Project variation for SFU_t and PTRAt uncertainty mechanism costs

- 6.12 For SFU_t costs, SONI can at any time request further uplifts of the network planning cap above the £40k threshold providing the requisite information and justification.
- 6.13 PTRAt costs are only subject to determination after a triennial actuarial valuation. As a consequence, it is only subject to one such possible request during the five year price control period.

7. Ex-post process for review of approved Dt, Zt (general uncertainty mechanisms) and SFUt costs

- 7.1 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 SFU_t, D_t and Z_t provisions). 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.¹⁰
- 7.2 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.
- 7.3 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.
- 7.4 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.

¹⁰ [DIWE guidance](#).

8. Review of and amendments to this Guidance

- 8.1 These requirements and guidance apply to the process for SONI's applications for D_t , E_t , Z_t , V_t , SFU_t and $PTRA_t$ items in the current price control period, which ends on 30 September 2025.
- 8.2 The UR may update this document to make any material changes in consultation with SONI and affected parties, in the light of experience. Any changes made to the guidance within the year (01 October to 30 September) which are material would not apply until the next year (unless there is agreement that a change is necessary, for example, to correct an error or to improve a process).
- 8.3 The UR will also decide, subject to consultation whether the same overall process should be applied in the next price control, which is due to take effect from 1 October 2025.