RP7 - NIE Networks Price Control 2025-2031

Draft Determination Annex S Price Control Design (Uncertainty Mechanisms)

November 2023

About the Utility Regulator

The Utility Regulator is the economic regulator for electricity, gas and water in Northern Ireland. We are the only multi-sectoral economic regulator in the UK covering both energy and water.

We are an independent non-ministerial government department and our main duty is to promote and protect the short- and long-term interests of consumers.

Our role is to 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.

We are based at Queens House in Belfast. The Chief Executive and two Executive Directors lead teams in each of the main functional areas in the organisation: CEO Office; Price Controls, Networks and Energy Futures; and Markets and Consumer Protection.

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 Annex sets out the design of the RP7 Price Control. It describes how and in what circumstances the determination can be varied to reflect changing requirements. It builds on the design of the RP5 and RP6 price controls and our experience of the application of uncertainty mechanisms. Our proposals consider uncertainty over the uptake of low carbon technologies (LCTs) over the RP7 period and any changes to energy policy in Northern Ireland.

Audience

This will be of interest to regulated companies, consumers, other regulatory bodies, government and other statutory bodies.

Consumer impact

The design of the price control defines an allocation of risk between NIE Networks and consumers as it delivers the price control. The design of the price control ensures that we can determine reasonable ex-ante amounts which will allow NIE Networks to discharge its general functions. A cost risk sharing mechanism provides a strong incentive for the company to reduce costs and share these savings with consumers. The use of volume drivers and re-opener mechanisms ensures that we do not have to estimate key activities rates or project costs before sufficient information is available. We believe that the design of the price control acts in the interest of consumers.

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Executive Summary

Introduction

This Annex to the RP7 Draft Determination sets out our proposals for the design of the RP7 price control. It shows how the price control design builds on the design of the RP5 and RP6 price controls. It responds to proposals which NIE Networks made in its Business Plan submission to amend existing uncertainty mechanisms or introduce new mechanisms which allow funding to be amended or determined during the course of the price control. It provides a summary of other modifications we propose to make to the transmission and distribution licences to give effect to our decisions on the RP7 price control or address other matters.

The underlying principle of the price control design is that a reasonable estimate of most future costs can be determined in advance. It is then for NIE Networks to meet its obligations within these ex-ante allowances. The existing price control mechanisms allows these ex-ante allowances to be determined in one of three ways:

- Allowances for capex and opex set out in the final determination of the price control. These are intended to cover the company's normal activities and are based on historical costs, subject to efficiency challenge and reasoned adjustments for future changes in activities.
- Volume drivers which apply pre-determined unit cost rates to the actual number of units delivered (for example meter installation).
- Re-opener mechanisms, whereby additional ex-ante allowances are determined within a price control for a project or activity once there is more certainty on the needs case, project scope or quantities (for example large transmission projects).

The price control allows for some uncertain categories of costs which NIE Networks cannot control to be passed through to consumers, although these are limited.

Building on RP5 and RP6 price control designs

The design of the RP7 price control builds on the design of the RP5 and RP6 price controls.

First, it continues key design features from the RP5 price control including:

- The determination of ex-ante allowances for most of the costs incurred by NIE Networks to discharge its functions, through a combination of allowances fixed in the price control, volume drivers and re-opener mechanisms described above.

- The retention of 50:50 cost sharing of the difference between actual costs and ex-ante cost allowances. This provides a strong incentive for NIE Networks to deliver for less than the determined costs while providing consumers and the company with some protection against cost forecasting risk.

- A mechanism to protect consumers against costs which are demonstrably inefficient and wasteful.

- The ability and incentive for NIE Networks to defer certain categories of planned investment in a way which reduces short term costs for consumers, but also ensuring that any deferred investment is not funded a second time in a subsequent price control.

- The ability to delay the determination of ex-ante allowances (initially limited to major transmission projects), mitigates a major source of scope and cost forecasting risk.

- The use of volume drivers which apply ex-ante cost rates to activities (such as the number of meters installed) to calculate an allowance.

The high-level design for RP5 formed the basis of the design of the RP6 price control with some amendments and additions including:

- The introduction of a reliability incentive mechanism designed to incentivise the company to reduce customer minutes lost due to planned and unplanned interruptions to supply.

- The introduction of additional categories of costs determined through a re-opener mechanism. For example, innovation, low carbon technology investment and investment to address generation congestion on the 33kV network.

- An additional volume driver for undereaves wiring allowed capex.

- A mechanism to provide flexibility on investment decisions by allowing NIE Networks to substitute between different investment categories while maintaining the overall value of outputs delivered to consumers.

- A Rate of Return Adjustment Mechanism which allows the determined cost of capital to be updated for the benchmark nominal cost of debt when NIE Networks raises new debt.

Much of the high-level price control design for RP5 and RP6 has been carried forward into RP7 with appropriate modifications to address additional challenges and uncertainties of developing electricity networks to support the delivery of net zero.

NIE Networks proposals for RP7

In its Business Plan, NIE Networks set out its proposals on various price control mechanisms which it thought should be retained, amended or added for RP7. We have summarised these proposals and our response in Table 1 below with a more detailed assessment provided in Section 4.

Key changes to the price control design in response to the proposals made by NIE networks are:

- The introduction of re-opener mechanisms and volume drivers for distribution primary network and secondary network load related expenditure in place of the lump sum allowances in RP5 and RP6.
- The determination of ex-ante allowances for IT investment up to Year 2 of RP7 with a re-opener mechanism for the determination of investment in the subsequent years.
- The determination of business rates as pass through cost (subject to checks on efficiently incurred costs) as opposed to ex-ante allowances in RP5 and RP6.

In addition, we have identified two key uncertainties which we have not addressed in the design of the price control because the likely outcome is too great to capture in pre-defined uncertainty mechanism as follows:

- The introduction of smart metering.
- The development of a new connection charging policy.

We intend to address these changes through future licence modifications when there is sufficient clarity to scope them. This will include the determination of additional allowed capex and opex as appropriate.

Other key design changes for RP7

In addition to considering the changes proposed by NIE Networks, we have concluded that other changes should be made to the design of the price control in RP7 including:

- The introduction of an Evaluative Performance Framework incentive mechanism which provides an incentive for NIE Networks to develop its Forward Work Programme in RP7 taking account of stakeholder engagement (see Annex V).
- Amendments to the Rate of Return Adjustment Mechanism to adjust for actual inflation and risk-free rate throughout RP7. This will remove the inflation forecasting risk from the determination of cost of capital and align the calculation of revenue with the inflation of the Regulatory Asset Base.

Giving effect to the price control design

The outworking of the principles and processes which underpin the design of the price control are codified in NIE Networks' transmission and distribution licences, in particular those sections of the licence which detail how the maximum regulated revenue the company can recover from its customers is calculated. In this Annex, we have provided detailed information on how we intend to amend Annex 2 of the NIE Networks licences (the Charge restriction condition) in line with these proposals.

We will consult on licence modifications to give effect to the price control when we publish our final determination. In this Annex we have set out our initial thinking on the licence modifications which will be necessary. In doing so, our intention is to provide clarity which will inform our on-going engagement with NIE Networks on these issues.

Uncertainty/Risk		RP6 Framework	Proposal for RP7	UR determination
Primary Network – Forward Power Flow		Ex-ante allowance with 50/50 mechanism	Ex-ante plus reopener	Accepted in principle subject to review of the allowance on underspend.
Primary Network – Reverse Power Flow		Reopener	Ex-ante plus reopener	Accepted in principle subject to review of the allowance on underspend.
Secondary Network Investment		Ex-ante allowance with 50/50 mechanism	Ex-ante plus volume driver with mid-point review	Volume driver for all expenditure.
Low rated cut outs		Ex-ante allowance with 50/50 mechanism	Volume driver	Accepted in principle
Looped Services		Ex-ante allowance with 50/50 mechanism	Volume driver with mid-point review	Accepted in principle
Net zero		n/a	Reopener	
Environmental		n/a	Reopener	Existing change of law mechanism to apply
Sub-sea cables		n/a	Ex-ante allowance for inspection and testing and reopener as business case materialises	Accepted in principle
Telecoms	SONI asset transfer	n/a	Reopened	Accepted in principle
	DSO Operation Telecoms		Reopener (2-stage)	Accepted in principle
	OTN Comms conditional investment		Reopener	Accepted in principle
Creosote Poles		n/a	Reopener	Existing change of law mechanism to apply
Non-recoverable alterations		Ex-ante allowance with 50/50 mechanism	Pass through	Not accepted. Ex-ante allowances to be determined.
Innovation		UIOLI allowance approved through reopener mechanism	Ex-ante for defined projects plus reopener (light touch) for network innovation (NIF)	Not accepted. Existing re-opener mechanisms to be updated in line with proposals in Annex N.

Uncertainty/Risk	RP6 Framework	Proposal for RP7	UR determination
Capex asset replacement (Asset requirements may change as needs arise)	Limited substitution offered in RP6 50/50 Mechanism	Broader use of substitution mechanism	Not accepted
Transmission capacity and capability projects (For projects brought forward by SONI)	Reopener: the 'D5 mechanism'	Refinement to the D5 mechanism	Accepted
Large scale capex asset replacement (For large scale projects whose costs are uncertain at the time of setting the price control)	Reopener: the additional capex reopener. Specific projects cited for both transmission and distribution.	Retain RP6 arrangement	Accepted for projects defined in the RP7 determination
Transmission protection philosophy (Philosophy set by SONI. Changes can have cost implications)	Reopener	Retain RP6 arrangement	Accepted
Severe weather	Ex-ante allowance with 50/50 mechanism	Pass-through	Not accepted, ex-ante allowance determined.
Distribution undereaves	Volume driver	Retain RP6 arrangement	Accepted
Cluster developments	Connecting customers bear the costs through the SoCC Unrecovered costs added to the RAB	Retain RP6 arrangement	Accepted
Distribution connection charging policy (Cost implications of change of policy)	n/a	Reopener	Not accepted. New licence modifications would be considered, if and when required.
Meter installations/replacements (Costs driven by volumes)	Volume Driver	Retain RP6 arrangement	Accepted
Smart meters (Cost implications if smart meters are mandated)	No explicit method to address costs	Reopener (2-stage)	Not accepted. New licence modifications would be considered, if and when required.
I-SEM (Cost implications if there are changes to the wholesale market)	Some opportunity for additional allowances through the ESt term (For the Enduring Solution)	Retain RP6 arrangement	Accepted

Uncertainty/Risk	RP6 Framework	Proposal for RP7	UR determination
IT Systems (New requirements)	Some opportunity for additional allowances through the NESt term (for new energy strategy IT solution or market services IT systems)	Refinement of the RP6 arrangement to incorporate the delivery of the S/4 HANA project in RP7	Ex-ante allowance determined for the first 2 years with a reopener mechanism for the determination of investment in the subsequent years.
Injurious affection (cost implications of IA claims)	Reopener: the IAt term	Retain RP6 arrangement	Accepted
Business rates (cost implications following revaluations)	Ex-ante allowance with 50/50 mechanism	True-up mechanism	Accepted as pass through, subject to checks
Corporation tax (tax rates are outside our control)	Applicable rate varies according to the prevailing rate set by HMRC	Retain RP6 arrangement	Accepted
Pension historic deficit repair (cost implications if deficit worsens)	Customers bear 100% of deficit repair costs for pre-April 2012 deficit. The balance is borne by the company	Retain RP6 arrangement	Accepted
UR licence fees	Pass through	Retain RP6 arrangement	Accepted
Change of law	Reopener: the Change of Law provision	Retain RP6 arrangement	Accepted
Price indexation	RPI used to adjust allowances	CPIH used to adjust allowances	Accepted
Real price effects	Ex-ante allowance with 50/50 mechanism	True-up adjustment based on indexation	Not accepted in principle, determined values to apply.

Table 1: Amendments proposed by NIE Networks and UR draft determination.

1. Introduction

Overview

1.1 This Annex to the RP7 draft determination sets out our proposals for the design of the RP7 price control. It shows how the price control design builds on the design of the RP5 and RP6 price controls. It responds to proposals which NIE Networks made in its Business Plan submission to amend existing uncertainty mechanisms or introduce new mechanisms which allow funding to be amended or determined during the course of the price control. It provides a summary of other modifications we propose to make to the transmission and distribution licences to give effect to our decisions on the RP7 price control or address other matters.

1.2 The underlying principle of the price control design is that a reasonable estimate of most future costs can be determined in advance. It is then for NIE Networks to meet its obligations within these ex-ante allowances. The existing price control mechanisms allows these ex-ante allowances to be determined in one of three ways:

a) Allowances for capex and opex set out in the final determination of the price control. These are intended to cover the company's normal activities and are based on historical costs, subject to efficiency challenge and reasoned adjustments for future changes in activities.

b) Volume drivers which apply pre-determined unit cost rates to the actual number of units delivered (for example meter installation).

c) Re-opener mechanisms, whereby additional ex-ante allowances are determined within a price control for a project or activity once there is more certainty on the needs case, project scope or quantities (for example large transmission projects).

1.3 The price control allows for some uncertain categories of costs which NIE Networks cannot control to be passed through to consumers, although these are limited.

1.4 The outworking of the principles and processes which underpin the design of the price control are codified in NIE Networks' transmission and distribution licences, in particular those sections of the licence which detail how the maximum regulated revenue the company can recover from its customers is calculated.

1.5 We will consult on licence modifications to give effect to the price control when we publish our final determination. In this Annex we have set out our

initial thinking on the licence modifications which will be necessary. In doing so, our intention is to provide clarity which will inform our on-going engagement with NIE Networks on these issues. As we develop licence modifications for RP7, we will consider opportunities to rationalise and simplify the structure of the licence. For example, there may be merit in bringing together all re-opener mechanisms under a single licence term to avoid the proliferation of different terms for individual reopeners.

Structure of this annex

1.6 The initial sections of this Annex provide an overview of the development of the Licence and considers and responds to NIE Networks proposals for changes to the various mechanisms of the Licence which embed the price control determination, manage change and set out how revenues are determined, as follows:

Section 2 RP5 Price Control design

Section 3 RP6 Price Control design

Section 4 NIE Networks proposals for uncertainty mechanisms in RP7.

Section 5 Other changes to the price control design

1.7 We then consider in more detail the individual sections of Annex 2 of the transmission and distribution licences (Charge Restriction Condition) which set out how the various determined values and mechanisms of the price control are applied to calculate the maximum regulated revenue which NIE Networks can recover in any Regulatory Year, as follows:

Section 6 Introduction to Annex 2 and general changes

Section 7 The maximum regulated revenue

Section 8 The regulatory asset base

Section 9 The return amount

Section 10 The opex amount

Section 11 The pension deficit amount

Section 12 The tax amount

Section 13 Revenue protection amount

Section 14 The correction factor amount

Section 15 Duration of the charge restriction condition

1.8 In each of these sections we provide an overview of how the relevant part of the charge restriction condition operates and identifies general and specific changes we intend to make in line with Section 4 and 5. We have included values for the various determined amounts, unit costs and other values which will be written into the Licence consistent with this draft determination. These values may change as appropriate to reflect our final determination for RP7.

1.9 We conclude with Section 16 Next steps.

2. RP5 Price Control Design

Introduction

2.1 The RP5 price control covered a period of 5½ years, running from the 1 April 2012 and ending on 30 September 2017.

2.2 The Utility Regulator (UR) published a final determination for RP5 on 23 October 2012 together with proposed draft modifications to the transmission and distribution licences. NIE Networks responded, rejecting the proposed licence modifications and suggested that a reference should be made to the Competition Commission (CC) (now the Competition and Markets Authority (CMA)). The CC published its final determination[1] on the RP5 price control on 15 April 2014, amended on 22 April 2014. The CC's decision specified licence modifications to be implemented by UR. Underpinning the specified licence modifications was a price control design. The principles of this design were carried forward into the RP6 price control.

2.3 In this Section we provide an overview of the design of the RP5 price control. This serves as an introduction to the principles which underpin the detailed mechanisms of the RP6 price control design as described in Section 3 below.

RP5 price control design

2.4 An underlying principle of the CC's price control design for RP5 was that ex-ante allowances could be determined for most of NIE Networks operational and capital expenditure as either:

a) lump sums set in the price control determination;

b) unit cost applied set in the price control determination applied to specified volume drivers; or

c) further determinations made in the course of the price control for specified projects, in particular, projects to improve the capacity and capability of the transmission network.

2.5 A cost sharing mechanism was introduced against these ex-ante allowances which maintained a strong incentive for NIE Networks to out-perform the

[1] https://assets.publishing.service.gov.uk/media/535a5768ed915d0fdb000003/NIE_Final_determination.pdf

determination and, in doing so, share savings with customers and reveal more efficient baseline costs.

2.6 The CC established a number of price control design features used to either define or moderate the determination. These design features were annotated as D1 to D10. They are summarised below with a reference to the relevant sections of the CC determination where a full consideration of the mechanisms can be found.

a) ***D1: Cost risk-sharing mechanism*** (CC determination Paragraphs 5.49 to 5.96). This mechanism was set up to adjust NIE Networks' maximum revenue and Regulated Asset Base (RAB) according to differences between the expenditure forecasts in the determination and NIE Networks' out-turn expenditure. CC determined that 50 per cent of such differences should be passed through to consumers via adjustments to NIE's maximum regulated revenue and Regulated Asset base (RAB). The purpose of the mechanism is to provide some financial protection to both consumers and NIE Networks against potential inaccuracies in estimates of NIE Networks efficient expenditure requirements and against unforeseen future developments that affect NIE Networks' costs—while also maintaining clear and strong financial incentives for NIE Networks to operate and invest efficiently.

b) ***D2: Inefficient spend clause*** (CC determination Paragraphs 5.97 to 5.111). CC determined that NIE Networks' Licence should include a provision that UR can adjust NIE Networks' maximum regulated revenue or RAB to protect consumers from exposure to costs incurred by NIE Networks which UR finds to be demonstrably inefficient or wasteful.

c) ***D3: Measures to tackle risks from deferral of planned network investment*** (CC determination Paragraphs 5.112 to 5.214). This ensures that there should be no double-funding of any deferred network investment at future price control reviews. It involves an assessment of the extent to which NIE Networks' investment forecasts for the subsequent price control include expenditure that is needed because of deferral of projects and investment volumes identified in the forecasts used for the previous determination. As well as avoiding double funding of deferred network investment, it also provides an incentive to defer investment, sharing the financial benefit with consumers and potentially revealing lower activity rates for future price controls.

d) ***D4: Investment projects for distribution network load-related expenditure*** (CC determination Paragraphs 5.215 to 5.245). The CC decided to set an upfront allowance for load related investment which would not be varied, and therefore not subject to the D3 deferral mechanism described above.

e) ***D5: Investment projects to increase transmission system capacity*** (CC determination Paragraphs 5.246 to 5.279). This made provision for the determination of ex-ante allowances for large transmission projects at a later stage on the basis that the cost of these projects are uncertain and large and the need and scope of works (determined by the System Operator for Northern Ireland (SONI)) is not within the control of NIE Networks. The scope of this mechanism included some nominated large transmission replacement projects.

f) ***D6: Smart grid initiatives*** (CC determination paragraphs 5.280 to 5.286). The CC made provision for some smart grid initiatives within the determined allowances. NIE Networks could have invested in Smart grid initiatives sharing 50% of the cost with consumers under the D1 cost sharing mechanism (unless UR deemed the investment to be demonstrably inefficient or wasteful under the D2 clause). This did not include allowances for the general introduction of smart metering.

g) ***D7: Electricity meter investment and smart meter programme*** (CC determination paragraphs 5.287 to 5.303). Metering was determined as a volume driver with unit costs per meter type. No provision was made for smart metering. The CC stated that it would expect UR and NIE Networks to make use of either the change of law provision in the existing Licence conditions or a Licence modification in the event of smart metering being introduced.

h) ***D8: Pass-through of part of connections charges to NIE's RAB*** (CC determination paragraphs 5.304 to 5.315). This allows for the pass though of some connection costs up to the 1 October 2015. The current licence extended this principle.

i) ***D9: Pass-through of specified operating costs*** (CC determination paragraphs 5.316 to 5.384). Pass through was permitted for regulatory licence fees and injurious affection. The CC was explicit that it had not allowed pass through of rates and wayleave costs but had included these activities in the ex-ante determined allowed opex.

j) ***D10: Other terms to remove from current Licence conditions*** (CC determination paragraphs 5.385 to 5.395). These related to adjustments to the Power team costs and prior re-opener mechanisms superseded by the CC's other decisions.

2.7 Much of the high-level price control design for RP5 was carried forward into RP6 with some modifications and additions. We intend to continue to apply this general approach for RP7 with appropriate modifications to address additional challenges and uncertainties of developing electricity networks to support the delivery of net zero.

3. RP6 Price Control Design

Introduction

3.1 The RP6 price control covers a period of 7½ years, running from the 1 October 2017 and ending on 31 March 2024. UR published a final determination for RP6 on 30 June 2017 together with proposed draft modifications to the transmission and distribution licences covering a 6-year period. Subsequently UR published further modifications to extend the RP6 price control by a year to give a total of 7½ years.

3.2 Our RP6 uncertainty mechanisms built on both the Competition Commission's determination of RP5 and our experience in developing the RP5 Licence Modifications. In this Section we have provided an overview of key changes made to the design of the price control in RP6.

Modifications made through the RP6 final determination

3.3 As part of the final determination for RP6, we introduced a number of key modifications to the design of the price control which are described below. These introduced new mechanisms which allowed for further modification to outputs, allowances and revenues to manage change and address potential forecasting errors, as follows:

- a reliability incentive related to customer minutes lost (CML);
- contestability;
- determination of additional allowed capex;
- innovation;
- low carbon technology funding;
- 33kV congestion due to LV generation connections;
- a volume driver for undereaves service connections;
- rate of return adjustment mechanism;
- direct network investment allowance substitution;

3.4 We have provided an outline of these changes below. Further information on the detailed working of these mechanisms and the reasons for introducing

them can be found in the RP6 final determination and the subsequent UR consultation and decisions on licence modifications.

Reliability incentive (customer minutes lost)

3.5 We introduced a reliability incentive in RP6 to incentivise reductions in customer minutes lost (CML) due to planned and unplanned interruptions. The incentive was symmetrical and subject to a cap and collar originally estimated at 1.5% of distribution revenue converted to fixed amounts in the RP6 final determination.

3.6 The detail of the incentive mechanism was captured in a Reliability Incentive Model published with our decision on licence modifications for RP6[2]. During RP6, the company has delivered a stepped change in performance on CML. We plan to continue the incentive in RP7, recalibrating the performance targets and cap and collar to reflect performance to date and the benefits of investment We accept NIE Networks argument within their Business Submission that there is greater uncertainty in relation to future planned CML Therefore we plan to adjust the revenue allocation on an 80:20 split and use a 3-year rolling average to set planned CML targets. Further detail is provided in Annex M.

Contestability

3.7 We made provision in the RP6 licence modifications to add £3.567m to the RP6 opening regulatory asset base for costs associated with the introduction of contestability. This was a single one-off adjustment in respect of costs already incurred by NIE Networks.

Determination of additional allowed capex

3.8 For RP6, we amended the licence to include two categories of investment which could be addressed through the D5 mechanism established by the CMA in its final determination for RP5.

a) Major transmission asset replacement projects which were defined in the RP6 final determination.

b) Nominated distribution projects which were defined in the RP6 final determination whose scope could be materially impacted by potential transmission capacity projects carried out under the reopener section of the transmission licence (D5 projects).

[2] RP6 Licence Mods Appendix 5 : Reliability Incentive Model

3.9 These were in addition to the provision made for transmission system capability and capacity projects included in the RP5 licence to give effect to the CC's 'D5' mechanism.

3.10 We also confirmed that changes to the transmission protection philosophy required by SONI would fall within the scope of this mechanism as projects which improve the capability and capacity of the transmission system.

3.11 We have made and published a number of decisions during the RP6 period under all categories of investment above. We expect to continue these mechanisms in RP7.

Innovation

3.12 The RP6 price control did not include any ex-ante allowance for innovation. Instead, a re-opener mechanism was introduced to allow capital allowances for this work to be determined once sufficient information was available. The mechanism was subject to a cap of £6.36m (2015/16 prices). We subsequently raised this limit to £9.536m (2015/16 prices) through licence modifications which extended the duration of RP6 by one year.

3.13 We intend to retain an innovation re-opener mechanism in RP7, excluding innovation activities for which an ex-ante allowance has been included in the price control. However, this mechanism is expected to change in line with proposals as detailed in Annex N.

Low carbon technology funding.

3.14 The RP6 final determination recognised the potential increasing use of low carbon technologies and the impact that this might have on load related investment. However, this was at the very early stages of development and the impact on future investment highly uncertain. As a result, we made provision for low carbon technology investment in RP6 in two parts:

a) First, an ex-ante allowance for low carbon technology load growth of £2.6m to cover investment in the first three years of RP6.

b) Second, a ring-fenced allowance of £10.5m in anticipation of low carbon technology load replacement investment in the second half of RP6. This place holder would be replaced by an ex-ante allowance to be determined on the basis of assessment of low carbon technology load growth at the midpoint of RP6.

3.15 We made decisions in respect of the ring-fenced allowance in October 2022 under a 'Green Recovery' initiative which saw the start of increased load

related investment expected to continue into RP7. We extended this funding in the RP6 extension year decision.

3.16 In RP7, our draft determination includes ex-ante allowance and volume drivers to determine load related expenditure. As a result, we do not intend to continue the low carbon technology mechanisms established for RP6. Instead, we intend to introduce primary and secondary network load related mechanisms which will allow funding to be amended if appropriate in responds to changes in the impact of low carbon technology.

33kV congestion due to Low Voltage generation connections

3.17 The RP6 final determination made no allowance for future 33kV congestion due to Low Voltage (LV) generation connections. Generation connections are expected to pay for necessary reinforcement costs at the voltage level they connect to and one level up. As a result, NIE Networks would not be able to recover the costs of the aggregated impact of LV connections on the 33kV network. We introduced a mechanism in RP6 to allow 33kV reinforcement due to LV generation connections to be recovered.

3.18 The company has not asked for any additional allowances under this mechanism. We propose to remove this mechanism for RP7 on the basis that a new primary load related reopener makes it redundant.

Volume Driver for undereaves service connections

3.19 In RP6, we decided to introduce a volume driver to cover undereaves wiring replacement work. This would ensure that the company could be funded for the volume of work it planned to carry out and also ensure that consumers are protected if further survey work did not reveal the volume of defective undereaves wiring assumed by the company in its plans.

3.20 The allowance is subject to a cap of 19,500 properties over the RP6 period which was the volume proposed by the company in its business plan submission. We noted that there may be circumstance where the company will want to exceed the 19,500 output cap by substituting an allowance in from other investment areas and if this was the case we would consider such a request and would be open to considering further licence modifications to allow such a change.

3.21 Work on the replacement of undereaves wiring is expected to continue into RP7 and we intend to maintain the undereaves volume driver to fund this work.

Rate of return adjustment mechanism

3.22 We introduced a rate of return adjustment mechanism in RP6 which provides for the allowed rate of return to adjust up or down in line with prevailing benchmark interest rates at the time NIE Networks raises new debt.

3.23 We introduced this mechanism to address the risk that NIE Networks can earn excess returns, or sub-normal returns, during RP6 because the forecast costs of debt in our determination were wrong. We also noted there have been criticisms of such 'windfall' gains and losses on financing costs in regulated industries, with the likes of the National Audit Office and the UK Government highlighting that it is unfair for regulation to be set up in such a way as to produce outcomes in which prices are likely to be significantly higher or significantly lower than they need to be in order to cover companies' actual costs of debt.

3.24 The detail of the mechanism was captured in a Rate of Return Adjustment Mechanism set out in Annex H[3] and Annex I[4] of the RP6 final determination. The model adjusted the rate of return to reflect the benchmark cost of debt at the time the company raises finance (subject to a 20:80 sharing of movement in benchmark from the final determination). The model also adjusted for changes in corporation tax over the price control.

3.25 We intend to maintain a Rate of Return Adjustment Mechanism during RP7. However, we intend to amend the mechanism to adjust for actual inflation and risk-fee rate. This will further reduce the forecasting risk for real rates of interest and better align the rate of return used to determine revenues with the application of actual inflation to the Regulatory Asset Base. Chapter 13 of our draft determination provides further detail on these adjustments and our reason for introducing them.

Direct network investment allowance substitution

3.26 In its RP6 business plan submission, NIE Networks highlighted the uncertainty inherent in estimating planned volumes of network investment in RP6. Over this period, NIE Networks noted that it was likely that changes in the rate of deterioration of different types of assets will change and the rate and/or extent which assets will require refurbishment or replacement will vary, either up or down.

3.27 To deal with this uncertainty, the company proposed that UR introduce a new mechanism in RP6 which will allow it to substitute higher priority outputs for lower priority outputs which are then deferred to a future price control

[3] RP6 FD Annex H – Rate of Return Adjustment Mechanism
[4] RP6 FD Annex I – Rate of Return Adjustment Mechanism Model

without a financial penalty to NIE Networks. In its business plan submission, the company proposed a cap on substitutions equal to 15% of the overall RP6 asset replacement programme (excluding rolling programmes).

3.28 For the RP6 final determination, we decided to set an overall limit on substitution of 10% of the value of the relevant allowances. For the sake of clarity, and given the level of judgement in the assessment we determined that the total limit on substitution should be £25m. We concluded that this provided more than ample headroom for the company to make substitutions in RP6. We noted that substitution should only be made on the basis of need where the company is able to demonstrate that the substitution has clear benefits. We also noted that we expected the company to be able to provide a brief explanation to consumers of the substitutions it carried out and demonstrate that each substitution has clear benefits and was made at value.

3.29 The substitution mechanism is an administrative process which would amend the direct network investment volumes capture in Annex P of the RP6 Final Determination. We would consider substitution as part of our review of deferral at the end of the relevant price control.

Licence changes after the RP6 price control

3.30 Subsequent to the RP6 Price Control determination and licence modifications, UR consulted on and implemented licence changes which introduced new mechanisms which impact on the design of the price control as follows:

- IT requirements
- Pass through capex expenditure – Shared Asset Charge
- RP6 extension licence modifications

3.31 We have provided further explanation of these changes below. We intend to maintain and extend the mechanisms for IT requirements and Shared Asset Charge in RP7.

IT requirements

3.32 On the 16 August 2021, modifications to both the transmission and distribution licences for new IT requirements for NIE Networks came into effect. These licence modifications were consulted on in March 2020[5].

[5] Consultation on NIE Networks licence modifications for new IT requirements | Utility Regulator (uregni.gov.uk)

3.33 These new licence conditions were required to enable UR to approve costs related to the need for further IT investment by NIE Networks to facilitate the delivery of the NI Executive's Energy Strategy.

3.34 The licence modifications allowed NIE Networks to recover efficiently incurred opex and capex costs in relation to:

a) a New Energy Strategy IT Solution;

b) any significant changes required to the specification of the information technology systems utilised by the licensee for the purposes of providing the Market Data Service or the Market Registration Service.

Pass through capex expenditure – Shared asset charge

3.35 On the 18 January 2020, the transmission and distribution licences were modified to add an additional category of pass through capex in respect of Shared Asset Charges payable by the Distribution Business for the connection of the Distribution System to that part of the transmission system that has been funded by a third party pursuant to a connection agreement entered into between that third party and the Transmission System Operator (the **CCAS_Xt term**).

3.36 The decision paper for these licence modifications were published in November 2019[6]. These licence modifications were consulted on in November 2019[7]

RP6 extension licence modifications

3.37 On the 24 May 2023, the transmission and distribution licences were modified to extend the duration of RP6 by one year and defer the start of the RP7 price control.

3.38 The modifications were required in order to enable UR to:

a) extend the duration of NIE Networks' current price control (RP6) by one year, moving the end date of the RP6 Price Control from 31 March 2024 to 31 March 2025;

b) introduce allowed values, unit rates and amounts for the RP6 extension year including values, rates and amounts for operational expenditure, capital expenditure and pension deficit repair;

[6] https://www.uregni.gov.uk/publications/decision-modifications-nie-networks-transmission-and-distribution-licenses-capex
[7] https://www.uregni.gov.uk/news-centre/consultation-proposed-modifications-nie-networks-transmission-and-distribution-licences

c) extend the definition of various terms to include the year ending 31 March 2025; and

d) modify the Reliability Incentive Model as it applies in respect of the RP6 extension year.

3.39 The modifications allowed the maximum regulated revenue to be calculated for the additional year of the RP6 price control (1 April 2024 to 31 March 2025) for the purposes of setting tariffs for the distribution and transmission networks.

4. Price Control Design for RP7

Introduction

4.1 In Sections 2 and 3 above we outlined the high-level design of the RP5 price control and key amendments made to it during the RP6 price control. We intend to carry much of this existing price control design forward into RP7.

4.2 In this section we have responded to the proposals which NIE Networks made in respect of the uncertainty mechanisms for RP7. We have also highlighted other changes we think are necessary including noting circumstances which would require licence modifications if material changes occur.

4.3 As noted in our final approach to RP7, the RP7 price control period will be impacted by the increased demands and expectations placed on the electricity network. The rate of development and distribution of new renewable generation, uptake of electric vehicles (EVs), and other technologies will have an impact on demand. The use of new technologies will impact the way electricity is transmitted, distributed and consumed. The mechanisms outlined below are designed to address this uncertainty.

Overview of NIE Networks proposals

4.4 Table 4.1 below summaries NIE Networks proposals for uncertainty mechanism's which it considered should be maintained, amended, or added for the RP7 period.

Uncertainty/Risk		RP6 Framework	Proposal for RP7
Primary Network – Forward Power Flow		Ex-ante allowance with 50/50 mechanism	Ex-ante plus reopener
Primary Network – Reverse Power Flow		Reopener	Ex-ante plus reopener
Secondary Network Investment		Ex-ante allowance with 50/50 mechanism	Ex-ante plus volume driver with mid-point review
Low rated cut outs		Ex-ante allowance with 50/50 mechanism	Volume driver
Looped Services		Ex-ante allowance with 50/50 mechanism	Volume driver with mid-point review
Net zero		n/a	Reopener
Environmental		n/a	Reopener
Sub-sea cables		n/a	Ex-ante allowance for inspection and testing and reopener as business case materialises
Telecoms	SONI asset transfer	n/a	Reopened
	DSO Operation Telecoms		Reopener (2-stage)
	OTN Comms conditional investment		Reopener
Creosote Poles		n/a	Reopener
Non-recoverable alterations		Ex-ante allowance with 50/50 mechanism	Pass through
Innovation		UIOLI allowance approved through reopener mechanism	Ex-ante for defined projects plus reopener (light touch) for network innovation fund (NIF)
Capex asset replacement (Asset requirements may change as needs arise)		Limited substitution offered in RP6 50/50 Mechanism	Broader use of substitution mechanism
Transmission capacity and capability projects (For projects brought forward by SONI)		Reopener: the 'D5 mechanism'	Refinement to the D5 mechanism
Large scale capex asset replacement (For large scale projects whose costs are uncertain at the time of setting the price control)		Reopener: the additional capex reopener. Specific projects cited for both transmission and distribution.	Retain RP6 arrangement
Transmission protection philosophy (Philosophy set by SONI. Changes can have cost implications)		Reopener	Retain RP6 arrangement
Severe weather		Ex-ante allowance with 50/50 mechanism	Pass-through

Uncertainty/Risk	RP6 Framework	Proposal for RP7
Distribution undereaves	Volume driver	Retain RP6 arrangement
Cluster developments	Connecting customers bear the costs through the SoCC Unrecovered costs added to the RAB	Retain RP6 arrangement
Distribution connection charging policy (Cost implications of change of policy)	n/a	Reopener
Meter installations/replacements (Costs driven by volumes)	Volume Driver	Retain RP6 arrangement
Smart meters (Cost implications if smart meters are mandated)	No explicit method to address costs	Reopener (2-stage)
I-SEM (Cost implications if there are changes to the wholesale market)	Some opportunity for additional allowances through the ESt term (For the Enduring Solution)	Retain RP6 arrangement
IT Systems (New requirements)	Some opportunity for additional allowances through the NESt term (for new energy strategy IT solution or market services IT systems)	Refinement of the RP6 arrangement to incorporate the delivery of the S/4 HANA project in RP7
Injurious affection (cost implications of IA claims)	Reopener: the IAt term	Retain RP6 arrangement
Business rates (cost implications following revaluations)	Ex-ante allowance with 50/50 mechanism	True-up mechanism
Corporation tax (tax rates are outside our control)	Applicable rate varies according to the prevailing rate set by HM Revenue and Customs (HMRC)	Retain RP6 arrangement
Pension historic deficit repair (cost implications if deficit worsens)	Customers bear 100% of deficit repair costs for pre-April 2012 deficit. The balance is borne by the company	Retain RP6 arrangement
UR licence fees	Pass through	Retain RP6 arrangement
Change of law	Reopener: the Change of Law provision	Retain RP6 arrangement
Price indexation	RPI used to adjust allowances	CPIH used to adjust allowances
Real price effects	Ex-ante allowance with 50/50 mechanism	True-up adjustment based on indexation

Table 4.1: NIE Networks RP7 uncertainty mechanism proposals

Primary network

NIE Networks proposals – Forward power flow

4.5 NIE Networks proposal for primary network Load Related Expenditure (LRE) is categorised into forward and reverse power flow, driven by demand and generation growth respectively.

4.6 Its proposal for a forward flow ex-ante allowance was based on its 'best view' Low Carbon Technology (LCT) uptake scenario. NIE Networks stated that it has deliberately taken a prudent approach to its network modelling to make sure that there is low risk of the ex-ante expenditure not being fully required. However, in doing so NIE Networks consider there is risk that this ex-ante funding will not be sufficient enough during the RP7 period.

4.7 NIE Networks notes that it has adopted a 'flexibility first' approach which looks to purchase services (load shedding or generation) to avoid or defer capital investment. Some savings from this approach are built into its RP7 business plan from the outset. However, the company is concerned that if the flexibility market does not materialise as assumed in its business plan, then it will have to revert to more costly conventional solutions.

NIE Networks proposals – Reverse power flow

4.8 NIE Networks notes that its primary network has significant reverse power flow constraints due to the volume of distributed generation connected to achieve the 40% RES-E target by 2020 and that most of the latent network generation capacity on our primary network has been exhausted as is evident in its capacity map.

4.9 NIE Networks has highlighted that its customers have told it that investment is essential in this area to achieve 80% RES-E targets by 2030, especially given the changes to building regulations and rising cost of energy, both of which are likely to drive more dispersed Photovoltaic (PV) installations.

4.10 NIE Networks considers that there is significant uncertainty with regards to the number and location of small-scale generators that will seek to connect to the distribution network in RP7. It further notes that its stakeholders felt it should be investing more ahead of need. NIE Networks considers that with an appropriately agile uncertainty mechanism it can ensure that the network does not become a blocker to the development of LCTs.

4.11 NIE Networks notes that it has only asked for ex-ante allowances to address primary substations where there is currently no reverse power flow capacity remaining, with a re-opener mechanism to increase allowances as the

investment need arises at other substations which are not currently fully utilised.

4.12 NIE Networks noted that the primary network investment, both forward and reverse power flow, when compared to secondary network investment can be categorised as lower volumes with higher costs which vary significantly between projects. NIE consider that that a re-opener mechanism is the most appropriate uncertainty mechanism to manage this risk. NIE Networks proposed uncertainty mechanism for the forward and reverse power flow categories in shown in Table 4.2.

Parameter		Description
Allowance type		Lump sum
Output Measures	Forward	Retention of existing output measure (LI5s <2% at the end of the period.
	Reverse	No. of substations with no reverse capacity at the end of the period.
Reopener window		April 2027 (Year 2) and April 2029 (Year 4)
Trigger		Triggered by NIE Networks, if the full RP7 expenditure for either forward or reverse power flow investment is forecast to exceed its respective ex-ante allowance plus materiality threshold.
Materiality threshold		5% of ex-ante allowance for respective categories.
Scope	Forward	This re-opener will be used where NIE Networks expects to incur additional expenditure above the ex-ante allowance plus materiality threshold, due to: • Forecast demand growth exceeding our 'best view' scenario. • Flex market failure. • Whole system solution investment where there is a strong case to invest. This will require a formal submission by NIE Networks to UR, at the reopener window, setting out the needs case and justification for increased allowance.
	Reverse	This re-opener will be used where NIE Networks expects to incur additional expenditure above the ex-ante allowance plus materiality threshold due to: • Actual or forecast generation growth resulting in additional substations forecast to become fully utilised within the RP7 period. • Whole system solution investment where there is a strong case to invest. This will require a formal submission by NIE Networks to UR setting out the needs case and justification for increased allowances.
Application of cost sharing mechanism		50:50 cost sharing mechanism retained.

Table 4.2: NIE Networks proposed Primary Network Uncertainty mechanism

UR consideration – Primary Network Uncertainty Mechanism

4.13 We agree with NIE Networks that there is a risk that a higher than expected uptake could require additional of LCT and generation connections and a lower than anticipated availability of flexible services makes it difficult to determine a robust ex-ante allowance for primary network load related investment in RP7.

4.14 We agree that there is a risk that limitations on reverse power flow at the High Voltage (HV) to 33kV interface could prevent the use of renewable generation connected to the LV and HV grids and limit our ability to deliver renewable generation targets. We agree that there is a need to provide the

company with the ability to address this issue during the RP7 Price Control and the level of uncertainty makes it unreasonable to determine a robust ex-ante allowance for this activity.

4.15 We note that the NIE Networks proposed uncertainty mechanism for the primary network has some similar characteristics to the Ofgem RIIO-ED2 load related expenditure re-opener for the primary network for the GB Distribution Network Operators' (DNO), in that it envisages two re-opener windows.

4.16 However, we note that there are differences in the materiality threshold, scope of the proposed NIE Networks mechanism compared to the Ofgem RIIO-ED2 mechanism. For example, the Ofgem mechanism has a materiality threshold of 0.5%[8] of adjusted revenue, whereas NIE Networks envisages materiality threshold of 5% of ex-ante allowance for respective categories.

4.17 We also note that the allowed capex for primary network is proposed by the company as a lump sum which would not subject to any form of control if assets do not get built. We note that Ofgem decided that it will revisit GB DNO's LRE allowances during RIIO-ED2 close-out if DNO's have not spent more than 80% of their non-volume driver allowances.

4.18 Ofgem note that this assessment will include a consideration of how much of the underspend is due to cost efficiency (which it would not seek to claw back) and how much is due to works not being completed, which could lead to undeserved windfall gains. This review may result in an ex-post reduction to RIIO-ED2 allowances, to better reflect the work that has actually been undertaken.

UR decision for RP7 – Primary network uncertainty mechanism

4.19 We are in agreement with NIE Networks for the need for a reopener for primary network load related allowances, with the caveat that we are minded to adopt an approach similar to Ofgem where, an ex-post review of the allowance would be triggered at the end of the price control if expenditure was less than 80% of the ex-ante allowance. This review would consider whether underspend is due to cost efficiency (which we would not seek to claw back) and how much is due to works not being completed when we may decide to reduce the allowance.

4.20 We agree with NIE Networks' proposal for the reopener however consider that this submission should be provided in August 2027 and August 2029

[8] This materiality threshold relates to changes to allowances resulting from our assessment, multiplied by the cost risk sharing rate of 50% relative to a threshold of 0.5% of annual average base revenues.

rather than the windows of April 2027 and April 2029 proposed by NIE Networks. This would allow the submissions to take account of audited costs for the previous financial years included in the Regulatory Information Guidelines (RIGS) submissions. We further propose that this reopener threshold should be symmetrical, and we consider 20% is a more appropriate level.

4.21 If the re-opener is triggered, and additional allowances agreed for additional outputs in the latter part of the programme, the delivery of these outputs would be subject to the deferral mechanism at the start of RP8.

Implementation – Primary network uncertainty mechanism

4.22 Our decision can be implemented without a new licence change by adding a further category to the additional allowed capex which can be determined through the **ACDR_X_t** term of the existing licence.

4.23 The burden of proof lies with NIE Networks to demonstrate that additional allowances are warranted within any submission in the re-opener window.

Secondary Network Investment

NIE Networks proposals – Secondary network uncertainty mechanism

4.24 NIE Networks noted that its secondary network ex-ante allowance request is based on its 'best view' LCT uptake scenario. NIE Networks noted that it has deliberately taken a prudent approach to its network modelling to make sure that there is low risk of the ex-ante expenditure not being fully required. In doing so, it suggested that there is risk that this ex-ante funding will not sufficient during the RP7 period. It has therefore proposed, a volume driver uncertainty mechanism to manage this which is outlined in the Table 4.3 below:

Parameter	Description
Type of uncertainty	LCT uptake and whole system solutions
Proposed uncertainty mechanism	Volume driver and mid-point review
Volume measures	1) Substations: capacity of ground mounted and pole mounted transformers added to network 2) Circuits: km of underground cable and Overhead Line (OHL) installed 3) Flexibility: Deferred MVA/annum of substations and/or km of circuit
Unit Costs	1) £85.7/MVA pole mounted substation • £80.2/MVA ground mounted substation 2) £95.9/km HV cable • £57.0/km HV OHL • £101.7/km LV cable 3) [✂✂]/MVA/annum flexibility procured
Control measures	Yearly reporting measures to ensure efficient use of volume driver: 1) Transformer utilisation 2) Circuit utilisation 3) Positive Common Evaluation Methodology (CEM) output A mid-point review of the effectiveness of the volume driver.
Application of cost sharing mechanism	50:50 cost sharing mechanism applied to unit costs only as volumes will vary in line with volume driver.

Table 4.3: NIE Networks proposed Secondary Network Uncertainty mechanism

UR consideration – Secondary network uncertainty mechanism

4.25 We recognise the uncertainty that the rate and distribution of low carbon technology such as EVs and heat pumps might have on secondary network investment. We agree that it is prudent to introduce an uncertainty mechanism to amend allowances to reflect this uncertainty. However, we think that this mechanism should be symmetrical. Therefore, we intend to make the entire allowance volumetric based on the unit costs for the five intervention solutions proposed by NIE Networks.

4.26 The introduction of a volume driver would avoid the need to apply a deferral mechanism on an ex-post basis if output delivery is less than planned. It would allow NIE Networks to flex investment up or down, depending on actual LCT uptake with minimal involvement by UR. The volume driver allows NIE Networks to respond to need. It does not require NIE Networks to delay decisions while seeking further approval from UR.

4.27 Following engagement with NIE Networks on our preferred approach to a volume driver for secondary network investment, NIE Networks provided a submission outlining four main concerns to this approach i.e.

a) Risk in a 'slow start' scenario

b) Flexibility First opportunities missed

c) Volume driver novelty

d) Industry confidence

4.28 We considered the above concerns in turn and give our conclusions as follows

a) We do not think a volumetric driver would be a cause of a slow start to investment. NIE Networks should plan its investment according to need in any circumstances and, as with other volume drivers, UR approval is not required for investment. If LCT uptake materialises more slowly than forecast, the company's criteria for identifying works would suppress expenditure in any case whether funded through ex-ante allowances or volume driven mechanisms. If work is delayed for contract or other project management reasons, the volume driver will ensure that consumers only pay for the benefits delivered.

b) We agree that the volume driven allowance could impede the flexibility first approach as there would be no unit rate identified for these solutions. However, we consider this risk to be minimal given the flexibility services identified on the primary network (1% of total allowance).

c) NIE Networks state that a volume driven approach and the associated control measures have not yet been deployed in Northern Ireland. However, volume drivers are in place for other activities and are being added to in RP7. NIE Networks has proposed a volume driver for additional work under this category of investment.

d) Our approach should not impede NIE Networks' progress, and only requires regulatory input at the end of each year when reviewing NIE Networks' utilisation reports. Therefore, we see no reason why our proposed approach should affect industry confidence. Industry should be assured that NIE Networks can proceed with the delivery of necessary work irrespective of the type of uncertainty mechanism applied.

UR decision for RP7 – Secondary network uncertainty mechanism

4.29 After considering NIE Networks' concerns we have amended our approach as we agree that the volumetric solution carries some risk of missing Flexibility First opportunities. As mentioned above, the element of flexibility solutions for the primary network is 1% of total allowance. Therefore, we are minded to allow a lump sum ex-ante allowance of £1.1m for the purposes of procuring flexibility services on the secondary network.

4.30 We intend the remaining allowance will be volumetrically driven against the unit rates identified in Annex P. We consider that our preferred approach is proportionate and provides the correct balance of risk between the company and consumers as it ensures NIE Networks is remunerated for volumes delivered whilst ensuring consumers are not funding LCT uptake which does not materialise. Given our position on the remaining allowance being volume driven, the 50:50 cost sharing mechanism should only apply to unit costs.

Implementation – Secondary network uncertainty mechanism

4.31 A new licence term will be required to add the Secondary Network Load Related volume driver to the determination of allowed capex.

Low rated cut outs

NIE Networks proposals – Low rated cut outs

4.32 The majority of LV service cables to consumer premises are terminated in a service cut-out with a fuse which is located before the meter and the subsequent customer's consumer unit/fuse board. The cut-out fuse provides protection against overload of the service and provides back-up fault protection to the meter and customer's installation.

4.33 When a consumer is installing a low carbon technology such as an EV charge point and/or heat pump, their existing older type cut-out may need to be replaced of insufficiently rated. In these circumstances, the consumer's cut-out would be replaced with a modern equivalent within each customer's agreed connection capacity and in accordance with health and safety requirements.

4.34 Historically, the condition, age and fault rates of cut-outs in service were used to determine an appropriate volume for replacement during a price control period. For RP7 NIE Networks has proposed that additional replacement volumes be allowed that are driven by consumer uptake of LCTs.

4.35 NIE Networks has stated they will only carry out LCT driven cut-out replacements reactively but have forecast that 1,456 cut-outs would need to be replaced during RP7. This volume is based on its 'best view' LCT uptake scenario, however it has concerns that this forecast may be conservative and therefore is requesting an uncertainty mechanism to allow additional replacements should its forecast be exceeded.

4.36 NIE Networks has proposed replacing 15,000 condition-based cut-outs in RP7, but also indicated that this volume would need to be increased as part of smart meter roll-out considerations. They state that current manual meter reading allows for inspection of cut-outs on a quarterly basis, enabling the cut-out condition to be closely monitored and delivery of a prioritised replacement programme. The company has highlighted a risk that, if smart metering is introduced, cut-outs will not be subject to regular inspection as part of the meter reading process. This is an issue which will be considered through any licence modifications which are necessary once plans for smart metering have been further developed.

4.37 In its submission, NIE Networks stated that the uncertainty associated with the impact of smart metering could be addressed through the smart metering reopener mechanism. However, its preference, for consistency and efficiency purposes, is that one mechanism addresses both the uncertainties of LCT uptake and the impact of smart metering.

4.38 Through RP6 cut-out replacements have been carried out under a single programme with a single unit cost allowance. For RP7, NIE Networks has proposed categorising cut-out replacements into two job programmes: simple and complex (including three-phase), with different unit costs. Simple jobs were defined as a straightforward replacement of the cut-out, whereas complex jobs involved works in addition to facilitate replacement of the cut out such as excavations and meter cupboard modifications.

4.39 Regardless of whether the volume was driven by a cut-out condition, LCT uptake, or smart meters, the job could be classified as simple or complex, depending on whether additional complexities were encountered. According to NIE Networks forecast, 60% of replacements will be simple and 40% will be complex.

4.40 NIE Networks' plans for investment in cut-outs are summarised in Table 4.4 below.

Sub-programme	UoM	Replacement Driver	Volume	Unit Cost (£k)	Total Direct Proposal (£k)
D11a – Replace Service Cut-outs	Each	Condition based	9,000	[✂]	[✂]
		LCT uptake	874		
D11b – Replace Service Cut-outs (Three-phase or Complex)	Each	Condition based	6,000	[✂]	[✂]
		LCT uptake	582		

Table 4.4: NIE Networks proposed investment in cut-outs

UR consideration – Low rated cut outs

4.41 We agree that there is uncertainty regarding the number of LCT uptake driven cut-out replacements that will be required in RP7. Actual numbers will be dictated by consumer decisions on LCT uptake, the load demand of their chosen LCT(s) and whether their property has an inadequately rated cut-out.

4.42 Determining an ex-ante volume is inappropriate as it risks blocking deployment of LCTs, that could contribute to the achievement of the Northern Ireland's Executive's net zero targets, should forecasts be exceeded. This is an emerging issue and there is no experience on which to base an ex-ante volume estimate. A volume driven allowance will give NIE Networks flexibility to meet demand, and consumers will be protected as expenditure will only be incurred when necessary.

UR decision for RP7 – Low rated cut outs

4.43 We have accepted the proposed volume driver uncertainty mechanism to facilitate additional cut-out replacements driven by consumer uptake of low carbon technologies. The volumes will not be capped. Adjustments to allowed expenditure will be based on actual volumes of LCT uptake driven replacements and our determined unit rate.

4.44 We have not accepted NIE Networks proposal to split the existing cut-out replacement sub-programme to separate simple and complex/three-phase sub-programmes. We have provided our full rationale for this position in the Service Cut-Outs section of our published draft determination document Annex P: Assessment of RP7 Network Investment Direct Allowances.

4.45 We have therefore used the existing programme to inform our draft determination and have set our draft determination unit cost at the RP6 outturn unit cost to March 2023, £288.42. This allowed unit cost will apply to all cut-out replacements regardless of driver.

4.46 We will assess what is appropriate for cut-out replacements as a result of smart metering, as part of considerations for that project outside of the RP7

price control process. Further engagement and analysis outside of the RP7 process will be required to establish what changes to the condition-based volumes are required as result of decreased inspection frequencies.

Implementation – Low rated cut outs

4.47 We are establishing a separate cut-out replacement programme to capture LCT driven replacements, distinct from the condition-based replacements which will continue set by and ex-ante allowed capex, subject to the deferral mechanism. This will simplify analysis and adjustment during annual tariff determinations. The unit cost for both programmes will be the same, and we will account for total volumes and outturn costs across both programmes for the purposes of the cost risk sharing mechanism and informing any future unit rate determinations.

4.48 We will introduce an additional term (the **LRCt term)** in the Allowed capex for distribution Regulated Asset Base (RAB) (the existing **AC_DNt term**) of the distribution licence. It will be calculated on the volume of cut-out replacements driven by LCT uptake multiplied by our determined unit rate, adjusted by our determined frontier shift for that reporting year.

Looped services

NIE Networks proposals – Looped services

4.49 NIE Networks has noted that analysis by its consultants had concluded that looped services are inadequate for homes with any LCTs connected and that unfortunately, many of its customers don't inform NIE Networks when they have connected an LCT, despite being obligated to do so. This creates an immediate safety and network risk once the LCT connects. NIE Networks strongly considers that it must be proactive in removing this legacy asset from the network in the RP7 period and its ambition is to unloop the vast majority of looped services on its network by the end of RP7.

4.50 NIE Networks has acknowledged that there will be challenging situations with some looped services running under houses and customers refusing to facilitate what can be disruptive work. NIE Networks consider that an ex-ante allowance to unloop all looped services would carry risk of under delivery.

4.51 NIE Networks has requested an ex-ante allowance of £4.8m in RP7 to adopt a reactive approach to the removal of looped services from a demand growth perspective i.e. waiting until an LCT seeks to connect or has connected to the network.

4.52 However, NIE Networks outlined that a reactive approach would not be sufficient from a safety and network risk perspective. It is therefore proposing that a volume driver is introduced, to provide allowances above the ex-ante level to enable the proactive removal of looped services from the network.

4.53 NIE Networks noted, that considering this programme is more extensive than previous price control and targets a wider range of properties and scenarios, it considers that there is unit cost uncertainty. To mitigate this to both the customer and the company, NIE Networks has proposed a mid-point review; whereby, the unit cost is reviewed based on the outturn unit cost position during the first half of the RP7 period.

UR consideration – Looped services

4.54 We do not consider that unit rates should be subject to a midterm review as this lessens the incentive for NIE Networks to control and reveal lower costs which would benefit consumers in the future.

4.55 We consider that a volume driven uncertainty mechanism is appropriate given the uncertainty over LCT uptake and the possible impact this might on the rate at which looped services issues might emerge.

UR decision for RP7 – Looped services

4.56 We agree with the addition of a volume driven reopener coming into being at the point where NIE Networks has efficiently expended its ex-ante allowance. The company shall present to UR a written submission laying out the case for further funding to be allowed and shall proceed with additional works at its own risk until agreement from UR is given to invoke the volume driven mechanism.

4.57 The cost rate for the volume driven additional allowances shall be based on the latest average outturn unit rate (from 2018 to time of submission).

Implementation – Looped services

4.58 We will introduce an additional term (the **LSRt term)** in the allowed capex for distribution RAB (the existing **AC_DNt term**) of the distribution licence. It will be calculated on the additional volume of looped service replacement replacements from 2028/29 onwards in excess of that anticipated in our ex-ante allowance for RP7.

4.59 The additional volume driver for the replacement of looped services triggered by LCT connections will only come into effect if and when the determined volume for other looped services has been exceeded.

Net zero

NIE Networks proposals – Net zero

4.60 NIE Networks in its Business Plan submission stated that the journey to net zero will present unexpected requirements which the RP6 suite of uncertainty mechanisms do not account for. To this end it proposed including a general net zero reopener mechanism that can be triggered by either the company or UR at any time during the price control.

4.61 Whilst this mechanism is broad in nature NIE Networks proposed that it was clearly linked to the achievement of net zero targets and stated that it may be particularly pertinent where more strategic investment is required which cannot be accommodated within the other uncertainty mechanisms NIE Networks proposed for RP7.

4.62 NIE Network provided an example relating to EV charging. They claimed that following recommendations by the EV task force or a Government Department a need is established to reinforce strategic parts of the network to facilitate the connection of EV charging infrastructure, it is unlikely that these types of large and strategic reinforcement jobs could be accommodated within the 20% tolerance outlined within the proposed secondary network reinforcement uncertainty mechanism.

UR consideration – Net zero

4.63 We consider that a 'net zero' reopener is appropriate for the RP7 Price Control in order to ensure that the price control can adapt to major changes to the delivery of net zero. This provides a means to amend the price control in response to changes relating to meeting net zero carbon targets which affect the costs and outputs of NIE Networks. The benefit of this approach is that necessary changes can take place within the price control period without further licence modification or waiting until the RP8 Price Control.

4.64 This approach recognises that net zero policy will not develop in six-year cycles in line with our electricity network price controls and therefore there may be circumstances within a price control period where assumptions used to set the price control are no longer appropriate due to significant changes related to net zero.

4.65 Changes could include changes in government policy, the role of NIE Networks, or market developments. The impact of these changes could be to increase, or decrease, the allowed revenue for NIE Networks during the price control rather than waiting until the next price control. We consider that this approach complements our other uncertainty mechanisms related to net zero.

4.66 This re-opener mechanism would be used to take account of changes connected to the achievement of net zero carbon targets not otherwise captured by other RP7 mechanisms, especially where changes are driven by external factors such as material changes in government policy at a national level, or more locally in Northern Ireland, which impact the nature of the connection of new low carbon generation and the uptake of low carbon technologies.

4.67 However, we consider that UR should retain the sole ability to trigger the net zero reopener. This is to ensure that the re-opener is only used where UR is satisfied that there is a sufficient level of certainty over the change in question and its impact. We consider that a materiality threshold of 0.5% of revenue is reasonable.

UR decision for RP7 – Net Zero

4.68 We agree that a Net Zero re-opener is appropriate for the RP7 price control. A net zero re-opener mechanism would be used to take account of changes connected to the achievement of net zero carbon targets not otherwise captured by other RP7 mechanisms, especially where changes are driven by external factors such as material changes in government policy at a national level or more locally in Northern Ireland which impact the nature of the connection of new low carbon generation and the uptake of low carbon technologies. We do not expect this mechanism to be used as an alternative to adjustments to investment which can be addressed through other mechanisms including the primary network and secondary network load related expenditure mechanisms.

4.69 However, we consider that UR should retain the sole ability to trigger the net zero reopener. This is to ensure that the re-opener is only used where UR is satisfied that there is a sufficient level of certainty over the change in question and its impact. We consider that a materiality threshold of 0.5%[9] of revenue is reasonable for any one instance, calculated on the basis of combined transmission and distribution revenues.

Implementation – Net zero

We are minded to introduce a licence modification to enable net zero re-opener in the RP7 price control, which can only by triggered by UR and where the impact of a change relating to the meeting of net zero carbon targets is material. This follows the approach taken by Ofgem in the RIIO-ED2 final determinations[10].

[9] This materiality threshold relates to changes to allowances resulting from our assessment, multiplied by the cost risk sharing rate of 50% relative to a threshold of 0.5% of annual average base revenues.
[10] Page 34 of the Ofgem RIIO-ED2 final determination core methodology

Environmental

NIE Networks proposals – Environmental

4.70 NIE Networks has noted that its RP7 price control has been developed to enable the fulfilment of its Environmental Action Plan (EAP), NIE Networks notes that legislative requirements and stakeholder expectations are likely to change throughout the period, requiring adjustment to the level of ambition within its EAP. As such, it proposed an environmental reopener mechanism which can be triggered by either the company or UR at any time during the price control.

4.71 NIE Networks considers that this mechanism should be broad in nature and that it must be clearly linked to environment and/or sustainability considerations.

UR consideration – Environmental

4.72 Ofgem provided for an environmental re-opener in its RIIO-ED2 final determination, to include circumstances where the DNO has incurred or expects to incur costs caused by new, or amended, legislative requirements that relate to the DNO's impact on the environment that are contained within or could have been contained within its EAP[11].

4.73 There is an existing Change of Law provision in the NIE Networks transmission and distribution licences which can be utilised by NIE Networks to recover efficient costs associated with the impact of legislative changes.

4.74 The company has proposed a further re-opener in respect of environmental and/or sustainability considerations which can be triggered by either the company or UR at any time during the price control. This would be in addition to the Change of Law provisions in the current licence. Therefore, we understand that the company intends this to address optional environmental and/or sustainability issues over and above that required in legislation.

4.75 We are concerned that the mechanism proposed by the company is wide ranging and unlimited. This risks undermining the general principle of setting ex-ante allowances (largely based on historical costs), and allowing the company to manage all the work it considers necessary within those cost allowances, including work it might want to undertake under the broad heading of social and corporate responsibility.

[11] Page 57 of Ofgem RIIO-ED2 final determination core methodology document

4.76 We are also conscious of that additional, discretionary, expenditure will flow through to consumer bills. Consumers have seen significant increases in energy bills in recent years placing a strain on family and business finances. Additional investment is proposed in RP7 to reinforce the network to deliver the environmental and sustainability objective of net zero. Consumers will pay a cost for these network improvements. These costs may be off-set by reduced transport and heating costs as we adopt alternative technologies, with the distribution of additional costs dependent on uptake. However, at a time of significant change we do not consider it appropriate to make provision for further discretionary costs to pass through to consumers.

4.77 NIE Networks continues to have the ability to undertake discretionary activities in line with its corporate social and responsibility objectives. The licence would allow 50% of these costs to pass through to consumers, unless they are determined to be demonstrably inefficiency and wasteful.

UR decision for RP7 - Environmental

4.78 We consider the existing Change of Law provision provides NIE Networks with adequate means of recovering costs associated with the impact of environmental legislative changes that impact NIE Networks costs.

4.79 We do not intend to introduce an additional re-opener mechanism in RP7 to allow further costs of discretionary environmental and sustainability costs to pass through to consumers in the absence of a change in law.

Subsea Cables

NIE Networks proposals – Subsea cables

4.80 NIE Networks has highlighted that it has submarine cables to Rathlin Island, Inish Conra and Inish Doney. At the beginning of RP7 the cables will be 18 years old with an expected lifespan of between 20-40 years. The company's view is that they require inspection and testing to inform future asset replacement / refurbishment.

4.81 NIE Networks consider that this information is particularly important for submarine cables as the replacement cost is significant and such a decision must be well evidenced; equally, the cost, disruption and timeline to repair a faulted submarine cable is extensive.

4.82 NIE Networks has requested allowances for the inspection and testing of the three cables as well as a reopener mechanism to provide allowances for replacement/refurbishment works required within the RP7 period, as a result of the inspection and testing activity. NIE Networks has requested that the uncertainty mechanism can be triggered by the company at any time

throughout RP7 as the results of the inspection and testing may require urgent intervention.

UR consideration – Subsea cables

4.83 We note that an uncertainty mechanism in the form of a re-opener for subsea cables has precedent. Ofgem in the ED1 – RIIO provided an uncertainty mechanism to allow Scottish and Southern Networks (SSEN) to recover the efficient costs of burying subsea cables should they be required to do so by Marine Scotland.

UR decision for RP7 – Subsea cables

4.84 We have included an allowance to fund the inspection of sub-sea cables. However, we have made no ex-ante provision from the work which might arise from the inspection of these assets. We recognise that work on these assets is not covered in the general run rate of costs used to establish our ex-ante allowance for capital maintenance and we recognise that the additional costs could be material. Therefore, we consider it appropriate to include a re-opener mechanism to cover future expenditure which might be required following surveys.

Implementation – Sub-sea cables

4.85 The existing **ACDR_X_t** term can be amended to allow for additional costs for sub-sea cables should the need arise. Any submission in relation to this re-opener should be well evidenced for the refurbishment/replacement of subsea cables.

Telecoms

NIE Networks proposals – Telecoms

4.86 NIE Networks has noted that the Operational Telecommunications Network (OTN) currently serves around 750 control and monitoring points which will increase to 6,000 points in RP7. This is largely driven by the roll out of LV monitors is expected to reach a value of 25,000 by 2050. The existing communications network arrangements do not have the capacity, reach or scale needed to connect all the devices required in the journey to net zero and therefore require significant investment in the RP7 period.

4.87 NIE Networks Business Plan submission also sets out the justification for the investment necessary to support the successful transfer of SONI assets to NIE Networks, as determined by UR in the last SONI price control. Due to the uncertainties as to the timely completion of the investment programmes

by SONI, and the service, legal and people issues contained within this paper it is proposed that this will be progressed via a reopener mechanism.

4.88 NIE Networks have carried out analysis that recommends a private wireless network as the optimum solution to deliver an OTN that is scalable, reliable, and resilient enough to facilitate net zero requirements for Northern Ireland. However, uncertainty exists with regards to the securing of spectrum from Ofcom, and the potential cost efficiencies associated with a shared utilities model. As such a two-stage reopener mechanism is proposed which can be triggered by the company during RP7. Stage one will cover expenditure associated with planning and design of the LTE network. Stage two will cover expenditure associated with the delivery of the LTE network

UR consideration – Telecoms

4.89 To facilitate increasing volumes of LCTs on the distribution network, investment in the OTN during RP7 will be required, to manage a more dynamic network. We agree that the operational telecoms network infrastructure will be essential in connectivity from Transmission and Distribution Control Centres to, and between, generation units and substations.

4.90 With the ever-increasing LCT touch points on the system, the OTN interactions will increase from currently around 750 control and monitoring points, to 6,000 points within RP7, and 25,000 by 2050. It is accepted that further analysis is needed to consider the impact and the requirements that will be required to handle the system of the future.

UR decision for RP7 – Telecoms

4.91 In regards to NIE Networks Business Plan submission, we accept the uncertainties identified in relation to the timely completion of the investment programmes by all the parties involved, and agree with the proposal that this will be progressed via a reopener mechanism.

4.92 We also accept the need for costs associated with the transfer of assets from SONI will be subject to a reopener mechanism.

Implementation – Telecoms

4.93 New licence term will be required to add the re-opener Telecoms requirements to the determination of allowed capex.

Creosote poles

NIE Networks proposals – Creosote poles

4.94 NIE Networks has noted that it is highly likely that during the RP7 period, new legislation will dictate that new creosote impregnated poles can no longer be installed in Northern Ireland, due to environmental concerns.

4.95 The company has also noted that recently implemented legislation which addresses how poles already installed on the network are to be disposed of will be the subject of a Change of Law submission in RP6.

4.96 The company has proposed that the Change of Law mechanism in the current Licences is the appropriate mechanism for dealing with these legislative changes. The company also suggested that it would be prudent to include an additional reopener mechanism specific to the potential ban on creosote poles, to reflect international supply chains potentially moving faster than Northern Ireland legislation and the consequent price impact.

UR consideration – Creosote poles

4.97 We agree that the Change of Law mechanism in the current licence is the correct mechanism for addressing potential changes in legislative requirements, regarding disposal of existing creosote poles, and any limitations on the use of creosote poles in the future.

4.98 The ex-ante allowances proposed in this draft determination do not make any allowances for those changes. The company has indicated that it will make a Change of Law submission in RP6 in respect of recently implemented legislation. We will consider this on its merits, once it is received. If we can make decisions on this submission in advance of the RP7 final determination, we will incorporate any financial impact in the ex-ante allowances determined for RP7. If we have not made a final decision on the issue in advance of the final determination, we will clarify that the financial impact of any Change of Law decision will extend to the end of RP7.

4.99 We do not agree with the company's suggestion that an additional re-opener mechanisms should be included in RP7, in respect of creosote poles against the possibility of international supply chains moving faster than Northern Ireland legislation, resulting in price changes in advance of a change of law. The determination already makes provision for changes in future costs through the inflation adjustment and real price effects. These cover a wide range of risks and opportunities which might increase or reduce specific unit costs during the course of the price control. Identifying specific issues which might result in changes of market rates for individual materials, but which are

not related to clearly defined and limited circumstances (such as change of law), undermines the underlying principle of a price control based on ex-ante allowances. It would be asymmetric in that only focuses on costs which might increase. If it were implemented, it would be difficult to distinguish between changes in costs, which reflect how international supply chains potentially moving faster than Northern Ireland legislation, and other causes. In effect, it would make the costs of creosote poles a pass through, but only if they increase.

UR decision for RP7 – Creosote poles

4.100 We agree that the impact of Changes of Law in regarding the use and disposal of creosote poles should not addressed through the existing Change of Law mechanisms of the licence.

4.101 In view of the commentary above, we do not intend to introduce a specific re-opener mechanism in RP7 specific to the potential ban on creosote poles to reflect international supply chains potentially moving faster than Northern Ireland legislation.

Non – recoverable alterations

NIE Networks proposals – Non recoverable alterations

4.102 Non-recoverable alteration costs are incurred by NIE Networks where a customer cannot be charged for an alteration to electricity equipment on their land. This arises where the alteration complies with Conditions 12 and 13 of an established Wayleave Agreement or where a notice to remove equipment is enforced. For example, electricity infrastructure is impeding a bona fide development.

4.103 NIE Networks forecast non-recoverable alteration expenditure of £18.2m for the RP7 period based on its experience to date in RP6. However, it has recommended that expenditure in this area be subject to a pass-through style uncertainty mechanism. NIE Networks has recommended this approach as the volume of activity in this area will be driven by customer behaviour and subsequent scope of required works that it has little control over. It believes this approach will give it greater protection should activity significantly increase over RP6, or should activity decrease, costs to consumers will be minimised.

4.104 NIE Networks has also proposed that the scope of works be increased over the current approach to non-recoverable alterations. Specifically, it considers that raising lines to achieve clearances over a property is no longer a technically acceptable solution. Instead, the overhead line route

should be altered to ensure no properties are underneath. Currently this solution is offered to connecting customers, but with the customer bearing the additional costs over the line raise.

4.105 With this change in approach, it has forecast that non-recoverable alteration expenditure would require an increase of £5.4m over its RP7 ex-ante request. NIE Networks did not include this value in its ex-ante request, but anticipates that its proposed pass-through style uncertainty mechanism will provide the necessary funding.

UR consideration – Non recoverable alterations

4.106 We agree that the volume and scope of work for this activity are influenced by factors outside of NIE Networks' control; however, NIE Networks is responsible for managing and controlling the costs of the required work. Applying a pass-through mechanism to this expenditure would reduce NIE Networks' incentive to minimise the costs passed through to all consumers while continuing to comply with all legal requirements.

4.107 We established a determined lump sum allowance for RP6 based on the outturn costs in RP5, as we expected historical spending to be a good predictor of future expenditure in this area. The annual average allowance for RP6 was £2,750k, which compares reasonably to the RP6 outturn of £2,885k to March 2023, a 4.9% difference. Applying the 50:50 cost risk sharing mechanism to this variation means the company has under recovered by £67.5k annually.

UR decision for RP7 – Non recoverable alterations

4.108 We recognise that the out-turn cost of non-recoverable alterations will be dependent on the level of future activity. However, this is true for all allowances.

4.109 A key principle of the underlying design of the price control is that ex-ante allowances are set where possible and pass through costs kept to minimum. This provides an on-going incentive for NIE Networks to manage and minimise costs of individual activities and in total. It also minimises the risk of errors in cost allocation, affecting the outcome for consumers.

4.110 We do not see sufficient reasons in NIE Networks submissions to change this for non-recoverable alterations. The protection provided by the 50:50 cost risk sharing mechanism and low variance between allowance, and outturn in RP6 gives comfort to continue this approach in RP7.

Innovation

NIE Networks proposals – Innovation

4.111 NIE Networks RP7 innovation request consisted of two discrete elements,

a) £8.8 million in ex-ante funding to deliver projects defined in this paper, and its annexes

b) Up to £10.3 million in the form of a Network Innovation Fund (NIF).

4.112 NIE Networks noted that its proposed NIF is designed as a flagship innovation fund, visible to stakeholders which would support network innovation in Northern Ireland. NIE Networks noted that the NIF proposal had been endorsed by its stakeholders in the public consultation at the end of 2022, and was intended to enable NIE Networks to propose and fund new innovation projects, subject to a light touch regulatory approval process.

4.113 NIE Networks noted that this would enable it to respond to emerging needs and technologies in an agile and flexible manner. NIE Networks proposed an annual submission, at the end of the financial year of project proposals to UR for consideration.

4.114 NIE Networks set out criteria which would be incumbent on the company to demonstrate to UR that the proposed innovation projects fulfil, and therefore facilitate a light touch reopener mechanism.

4.115 NIE Networks also proposed that an 'Innovation Council' is established to independently monitor and steer NIE Networks' innovation programme in line with stakeholder requirements. NIE Networks noted that, the Council would offer a recommendation to UR regarding approval, or otherwise, of proposals NIE Networks brings forward under the NIF. However, NIE Networks also noted the recommendation of the Innovation Council does not bind UR to any decision in relation to any specific proposal, nor bind NIE Networks on whether to progress a proposal.

UR consideration – Innovation

4.116 RP6 represented the first significant allowance for NIE Networks dedicated to network innovation. NIE Networks has indicated that this has facilitated significant learning in delivering innovation projects and transitioning their outcomes into Business as Usual (BAU) activity. NIE Networks reports that most stakeholders it consulted were supportive of baseline innovation funding of at least £8.8m for RP7.

4.117 Annex N: Innovation sets out our approach to determining innovation allowances for the RP7 price control. We have assessed the specific projects proposed by NIE Networks and provided an ex-ante allowance for those which met our tests.

4.118 In relation to NIE Networks proposal for an 'Innovation Council' we consider that it is a matter for NIE Networks to develop where it considers external advice would help it better develop its innovation activities in RP7. However, it is not something that UR requires to support investment decisions. We will, however, take account of collaboration of other bodies on innovation proposals made by NIE Networks which includes the commitment of external financial support and resources to achieve common objectives.

UR decision for RP7 – Innovation

4.119 We are minded to have one re-opener window for innovation at the midpoint of the price control. This will need to consider delivery against funded baseline projects as well as the need to for new innovation activity.

4.120 We also note that NIE Networks is proposing a set of criteria that would inform what projects could be included in the re-opener. The proposed criteria are broadly in line with those utilised in other areas for innovation funding mechanisms.

4.121 The criteria reflect a general direction of travel that is broadly consistent with energy policy in Northern Ireland, and with the criteria used for similar innovation mechanisms in GB and Ireland. Consequently, we are broadly content with the suggestions made by NIE Networks.

4.122 We are not minded to place any cap on the scale of funding for additional innovation projects. We recognise the need for innovation on the path to net-zero. We expect to assess and approve proposals based on their individual economic merit.

Implementation – Innovation

4.123 We intend to amend the wording in Annex 2 Paragraph 4.38 (c) of the distribution licence, and in Annex 2 Paragraph 4.35 € of the transmission licence, to reflect that there is no formal cap on innovation trials expenditure under the re-opener.

Capex asset replacement

NIE Networks proposals – Capex asset replacement

4.124 NIE Networks noted that the expenditure forecasts in its RP7 Business Plan for asset replacement reflect its best view at the point it submitted its business plan. NIE Networks noted that RP7 will run until 2031, and inevitably the priority to replace particular types of assets may change during that time. For example, a new investment stream may be required as a result of asset type failures not included in the plan or a higher volume of replacement may be required.

4.125 To deal with this uncertainty, NIE Networks proposed that there should be greater flexibility within the price control structure, to reprioritise investment based on the changing needs of the network without financial penalty to NIE Networks. NIE Networks consider that investment in the network is part of a long-term planning process and in the majority of instances, equipment highlighted for replacement and refurbishment can only be deferred for a short period of time.

4.126 NIE Networks noted that as such, when an urgent network issue arises requiring the unforeseen replacement of assets, there are already inherent limitations on its ability to re-prioritise the plan. It suggested that these limitations are further exacerbated by the 20% restriction at a category level which results in there being no possibility of substitution in investment areas of high value, low volume nature. NIE Networks proposed the removal of this category cap in addition to an increased overall limit on substitution linked to the total value of the Network Investment Plan.

4.127 NIE Networks noted, that the ability to substitute only in areas of investment with already identified outputs greatly restricts its ability to react to circumstances which were not foreseeable as part of its long-term investment planning. NIE Networks cited the example of this during the RP6 period was the need to install noise enclosures at Kells Main. NIE Networks thought that the funding position for the investment was unclear under the current price control rules.

UR consideration – Capex asset replacement

4.128 NIE Networks raised similar concerns in its RP6 submission. We considered these concerns at that time and developed the current substitution methodology.

4.129 To date, NIE Networks has not brought to our attention any substantive changes under the existing substitution mechanism.

4.130 We note that the price control provides the funding necessary for NIE Networks to fulfil its statutory objectives in respect of the electricity network, with a substantial element of ex-ante allowances. We note that the CC in its decision for RP5 did not consider any substation mechanisms necessary within its overall framework of ex-ante allowances, cost risk sharing and deferral mechanisms. This approach comes with some degree of opportunity and risk. It is not the case that the price control seeks to eliminate that risk in its entirety, and there is merit in ensuring that NIE Networks remains in charge of the decisions it makes on how it funds individual obligations and needs as they arise.

4.131 We do not consider that the evidence presented to us was a strong enough case to amend the current arrangements.

UR decision for RP7 – Capex asset replacement (substitution mechanism)

4.132 We intend to maintain the current substitution arrangements in place for RP7.

Transmission capacity and capability projects (D5 projects)

NIE Networks proposals – Transmission capacity and capability projects

4.133 NIE Networks has noted that the expenditure forecasts in its RP7 business plan exclude costs (both direct and indirect) associated with potential load-related projects which are uncertain and have not yet been approved by UR.

4.134 NIE Networks notes that SONI is responsible for the planning and design of these projects, which can take many years to proceed through a number of key stages, including an initial identification of the need; a detailed process of evaluating technical design options; extensive consultation with stakeholders and the public; and a rigorous assessment of environmental impacts.

4.135 NIE Networks noted that UR will assess the relative merits of these projects, on a case by case basis, having regard to the project costs and benefits. However, considering the scale and volume for D5 projects, the company has proposed minor changes to the D5 mechanism in relation to the approval of pre-construction costs, which it believes will drive efficiencies. It has described this process as its ‘minimum value submission’ proposal.

4.136 Under this mechanism proposed by the company, it would only seek prior approval for pre-construction costs, where these are expected to exceed £3m. NIE Networks would seek allowances for all other D5 pre-construction

works during the construction phase with the regulatory assessment of pre-construction costs based on outturn costs, as opposed to forecasts. The company suggested that this would help secure timely delivery of a large programme of work critical to the delivery of net zero.

UR consideration – Transmission capacity and capability projects

4.137 The RP5 and RP6 price controls did not include ex-ante allowance for this category of project because their costs are large and uncertain. The need and scope of works (determined by SONI) was not within the control of NIE Networks. Instead, ex-ante allowed capex was determined through subsequent decisions when the scope had been defined and detailed cost estimates prepared. We agree with NIE Networks proposal that this mechanism continues to be applied in the RP7 period.

4.138 We note the company's 'minimum value submission' proposal for pre-construction costs whereby pre-construction costs less than £3m would be determined during the construction phase with the regulatory assessment of pre-construction costs based on outturn costs as opposed to forecasts. The company has suggested that removing the need to seek approval at pre-construction stage would reduce regulatory burden and allow it to be more agile as it delivers a major programme of work.

4.139 We understand the potential advantages of the proposal put forward by the company. However, we also recognise that it also creates its own risks and process issues:

a) First, the scale of investment which might flow through this pass-through mechanism is not insignificant. Based on D5 pre-construction approvals to date and the potential scale of the D5 programme in RP7, a rough order of magnitude of pass through costs under the proposed mechanism is £25M.

b) Secondly, the company will have to make its own ex-ante decision on the pre-construction costs for a project to determine whether it should seek an ex-ante decision from UR or seek to recover costs incurred ex-post.

c) Third, there is no absolute definition of what is included in the scope of pre-construction costs and subsequent construction costs. This creates a risk of uncertainty over whether costs should be included in an ex-post decision or, alternatively, whether the company had completed all work necessary during the pre-construction phase to mitigated construction phase risks and arrive at a robust construction estimate.

d) Fourth, it creates a category of internal staff costs which are pass-through, requiring the company to record time for all internal staff activities to ensure that the allocation to this narrow category of pass through cost is reasonable.

4.140 However, we believe that there is merit in the approach proposed by the company, subject to further constraints to secure efficient delivery as follows:

a) Pre-construction costs should only be determined on an ex-post basis when the pre-construction cost estimate is expected to be less than £1.5M. We estimate that this would be about half the D5 projects proposed for RP7 and would cover all additional small projects.

b) The company should maintain a clear programme of future projects with its best estimate of pre-construction costs. Once the company has decided to carry out pre-construction work which will be determined ex-post on the basis of costs incurred, it will not seek an ex-ante pre-construction allowance part way through the work.

c) Pre-construction will include all investigations, surveys, design, procurement and agreements necessary to define the scope of works, mitigate key risks and arrive at a robust cost estimate. We would not expect the company to seek funding for works which should have been completed in the pre-construction phase through an ex-ante construction cost decision. We would not intend to approve high levels of contingency in construction allowances because insufficient pre-construction work had been completed.

d) The aggregate ex-post allowed capex for pre-construction works will not exceed 12.5% of the total allowed capex for these projects. This will be assessed over time on an aggregated basis. If, at any time there is reason to believe that this threshold has been exceeded in a sustained way, UR will make a negative adjustment to individual ex-ante decisions to secure this threshold, subject to on-going cumulative review. As a result, 50/50 cost risk sharing would apply to costs in excess of this threshold.

e) Maintain records which will allow staff time and cost to be allocated to individual activities.

4.141 We consider that the approach set out above provides a balance of providing the flexibility and agility highlighted by the company while securing efficient delivery with little regulatory burden.

UR decision for RP7 – Transmission capacity and capability projects

4.142 We propose to allow the company to seek approval of allowances for pre-construction works for selected projects based on outturn costs as opposed to forecasts subject to the constraints set out above.

Implementation – Transmission capacity and capability projects

4.143 It will be necessary to amend Paragraph 4.35 of Annex 2 of the transmission licence to reflect the constraints on pre-construction costs approval on an ex-post basis outlined above. Subject to these constraints, allowed capex for D5 pre-construction costs will continue to be determined through the **ACTR_Xt term** of the transmission licence.

Large scale capex asset replacement (D5 projects)

NIE Networks proposals – Large scale capex asset replacement

4.144 NIE Networks has proposed that larger asset replacement projects, where the scope of works cannot yet be determined or where the project scale leads to greater uncertainty in construction cost, would also be accepted as D5 projects in the RP7 period as it believes this will be more effective for management of these projects as they cannot be defined in full detail at this stage. NIE Networks noted that this mechanism has been used during RP6 for two large asset replacement projects.

UR consideration – Large scale capex asset replacement

4.145 Whilst the D5 mechanism was originally designed for projects that added transmission capacity or capability, we recognised in RP6 that some asset replacement projects carry similar risks with respect to uncertainty of final cost due to the complexity of the works. We also noted that, while there was a case for determining allowances at a later date under the uncertainty mechanisms where the scope and/or cost are not well defined, this should not be viewed as the norm. We noted that it is for the company to plan development work on this type of project to ensure that, where possible, ex-ante allowances can be included in the Price Control determination rather than delayed to a later date.

UR proposal for RP7 – Large scale capex asset replacement

4.146 We are content to continue the approach established in RP6 for large asset maintenance projects identified in the RP7 determination.

4.147 We expect the company to set out its long-term plans for large scale asset replacement projects and how it will complete the work necessary in RP7 to

provide robust project estimates which can be included as ex-ante allowances in future price control determinations.

Transmission protection philosophy

NIE Networks proposals – Transmission protection philosophy

4.148 NIE Networks noted that the RP6 price control provides for UR to amend the price control to include an allowance in the event SONI proposes any change to the transmission protection philosophy, and this results in additional works that have not been otherwise funded for in the price control.

4.149 NIE Networks proposed that this mechanism is retained during RP7.

UR consideration – Transmission protection philosophy

4.150 IN RP6, we clarified that investment in response to any change to the transmission protection philosophy by SONI would fall within the scope of the D5 mechanism.

4.151 We recognise the potential financial impact on NIE Networks in the event that SONI changes the transmission network protection philosophy. We recognise that the company is not in control of these decisions and is obliged to implement them. As a result, we intend to maintain the current arrangements for RP7

UR proposal for RP7 – Transmission protection philosophy

4.152 Investment because of changes in transmission protection philosophy will continue to be included in the scope of the D5 mechanism in RP7.

Severe Weather

NIE Networks proposals – Severe weather

4.153 NIE Networks has explained that while the Fault and Emergency category of expenditure covers normal day to day faults, and those faults that result from periods of severe weather places the predominantly overhead network under exceptional strain and can result in widespread damage affecting large numbers of customers.

4.154 NIE Networks has noted that, in Northern Ireland, the threshold for a severe weather event is defined as 13 times the average daily HV fault rate calculated over the previous 10 years, and that this currently stands at 74 HV faults in a 24-hour period.

4.155 NIE Networks noted that, these events are relatively rare but nonetheless a separate funding arrangement is required to deal with the consequences of such events that cannot realistically be planned for.

4.156 NIE Networks also notes that in RP6, an ex-ante allowance of just over £2.8m (2015/16 prices) was allocated to severe weather. NIE Networks explained that it has incurred £3.23m (2015/16 prices) during RP6 to date and should no further severe weather events occur during RP6 it would already be adversely impacted through the 50/50 cost sharing mechanism.

4.157 NIE Networks also highlighted that if the current run rate continues, it is forecast that the outturn cost for severe weather would be circa £5.60m – more than double the allowance for something that is outside of our control.

4.158 NIE Networks has highlighted that they have further reservations with the current approach, primarily centred on the risk that severe weather events are uncertain and unpredictable in nature, and due to climate change are predicted to occur more frequently in future such that ex-ante funding is likely to be inadequate.

4.159 NIE Networks also noted that Ofgem have for RIIO-ED2 implemented a pass-through funding mechanism "*to allow for the recovery of efficient costs directly incurred as a result of a storm event that meets severe weather thresholds*". NIE Networks has argued that this change in approach (previously Ofgem had similarly established an ex-ante allowance) was also predicated on the difficulties of setting an allowance for such unpredictable events outside of the control of the DNOs.

4.160 NIE Networks has proposed that costs attributed to qualifying severe weather events in RP7 are treated as pass through costs, rather than an ex-ante allowance.

UR consideration – Severe weather

4.161 We note the concerns with a pass-through mechanism for severe weather costs as set out by the CC at RP5 and as we outlined in our RP6 final determination[12] i.e.

a) wherever possible we should avoid cost pass-through which could expose consumers to unnecessarily high costs; and

[12] As referenced in paragraph 6.13 and 6.14 of the RP6 final determination.

b) The definition of a major storm event could give rise to perverse incentives when considered alongside treatment of normal or typical expenditure. For example, if storms costing more than £1 million are passed through but storms costing less than £1 million are subject to an ex ante allowance, NIE Networks would face an incentive to increase the cost of storm events to the £1 million pass-through threshold.

4.162 As a result, the CC decided it was appropriate to set an ex-ante allowance, while recognising the difficulties in setting the allowance.

4.163 We note that the different definitions of a severe weather event may also impact the approach taken to allowances for severe weather, specifically the much higher level of severity in defining a severe weather event in GB means that they experience these costs much more infrequently than NIE Networks. As NIE Networks has noted the definition in Northern Ireland is 13 times the average daily HV fault rate over the previous 10 years whereas, in GB it is 42 times its mean daily HV fault rate within a 24-hour period. As a result, notwithstanding the Ofgem decision, GB DNOs remain exposed to an element of the costs covered in ex-ante allowances for NIE Networks.

4.164 We note that Ofgem's principal concern in moving away from an ex-ante allowance was that the GB DNO's were being indirectly rewarded for events not occurring[13]. There is less risk of this occurring in Northern Ireland, given the threshold for a severe weather event in Northern Ireland is much lower than in GB.

UR proposal for RP7 – Severe weather

4.165 For RP7 we are minded to continue with the approach in RP6, and provide an ex-ante allowance over the RP7 period. This allowance is based on recent experience of costs incurred by NIE Networks for extreme events as increase over the comparable allowance in RP6. Our minded to position retains the RP6 position of an ex-ante allowance subject to the 50:50 risk sharing mechanism.

Distribution undereaves

NIE Networks proposals – Distribution undereaves

4.166 NIE Networks proposed RP7 strategy is a continuation of the RP6 programme of works with the focus on completely replacing all single- PVC

[13] Page 203-205 of Ofgem RIIO-ED2 draft determination – core methodology document

undereaves wiring on the LV network by the end of RP7. 9,500 units will be addressed in RP6 which will leave 25,000 to be addressed in RP7.

4.167 NIE Networks estimate they will address 8,000 units as part of the LV OHL refurbishment programme, leaving 17,000 to be addressed under the stand-alone undereaves programme. However, as the exact number remains uncertain, NIE Networks has proposed retaining the undereaves volume driver to allow flexibility to adjust the volume addressed under the undereaves programme.

UR consideration – Distribution undereaves

4.168 A volume-driven allowance for undereaves replacement works was introduced in RP6 due to the uncertainty over the number of single layer/non-effectively insulated undereaves conductors on the network. Asset inspection programmes during RP6 has provided greater certainty on the number remaining to be addressed.

4.169 In RP6, the unit rate for distribution undereaves was included under the **Distribution undereaves allowance unit cost (UAU_2016)** term at Annex 2 Paragraph 4.35 Table 5 of the current Distribution Licence. These unit rates were subject to a cost frontier shift.

4.170 The cap for the volume of properties with undereaves services and / or mains replaced was included under the **UVt** term and was originally capped at 19,500 properties. This was extended to 22,500 properties under the RP6 Extension decision.

UR proposal for RP7 – Distribution undereaves

4.171 All undereaves replacement works should be reported under the standalone undereaves programme.

4.172 We have deducted £5.014m from NIE Networks proposed ex-ante allowance for LV OHL calculated from the volume of undereaves NIE Networks forecast to address under its LV OHL programme multiplied by its proposed undereaves unit rate.

4.173 The ex-ante allowance for all undereaves replacements will be determined through the standalone undereaves volume driver with the volume capped at 25,000 properties.

4.174 As with RP6, adjustments to allowed expenditure will be based on actual reported volumes and our determined unit rate, which is detailed in the Undereaves section of our published draft determination document Annex P: Assessment of RP7 Network Investment Direct Allowances.

Implementation – Distribution undereaves

4.175 We intend updating the UVt term to include a cap for 25,000 properties for the RP7 period.

4.176 We intend to update the UAU_2016 term to UAU_2022 to reflect the 2022 price base and replace table 5 to include the unit cost for UAU_2022 for each reporting year in RP7. Consistent with RP6 these unit costs would be subject to frontier shift.

Cluster developments

NIE Networks proposals – Cluster developments

4.177 NIE Networks noted that the expenditure forecasts in its RP7 business plan exclude costs associated with future cluster infrastructure potential projects which are uncertain and have not yet been approved by UR.

4.178 The purpose of grouped or 'clustered' connections is to reduce the number and length of new overhead lines needed for the connections. The clustering approach facilitates the connection of renewable respecting Northern Ireland's landscape.

4.179 Clustering large generators also offers advantages in managing information and control related to that part of the system and could permit single point rather than distributed solutions to other engineering problems arising from high levels of renewable energy penetration.

4.180 During RP6, a process of project-by-project approval by UR has operated in respect of clusters. NIE Networks proposed that this mechanism continues during RP7 and NIE Networks will not incur any expenditure in relation to new cluster developments without UR's approval.

UR proposal for RP7 – Cluster developments

4.181 For RP7 final determination we intend to maintain the connections cluster charging methodology. This means connecting customers bear the costs of clustered developments through the NIE Networks statement of charges and any unrecovered costs are added to the RAB.

4.182 We are currently undertaking a separate consultation on whether distribution demand connections should be permitted to clusters and the basis on which the cost of any such connections would be recovered[14]. This may result in changes to the cluster methodology section of NIE Networks' Statement of

[14] Consultation on proposed changes to NIE Networks' cluster methodology in NI within the Statement of Charges | Utility Regulator (uregni.gov.uk)

Charges, if the outcome of this has any impact on NIE Networks RAB, we may be a need to amend the RP7 Price Control when this review has concluded. However, until this work is done it is not possible to include a specific re-opener mechanism in RP7.

Distribution connection charging policy

NIE Networks proposals – Distribution connection policy

4.183 NIE Networks noted that its expenditure forecasts in its RP7 business plan assume no change in relation to the current connections charging policy in Northern Ireland. However, NIE Networks has suggested that this is a major issue for many customers and, following consultation, concluded that many of its customers would wish to see a change in this policy. NIE Networks recognised that this is a government policy consideration, so the timing and nature of any change is uncertain.

4.184 NIE Networks noted that the introduction of a revised connections charging policy could have a potentially significant impact on its load and capacity programmes, as well as asset replacement costs. In the event that the policy changes, NIE Networks expected that the RP7 allowances will need to be adjusted to reflect the revised investment cost expectations it expects to engage with UR to agree the appropriate regulatory mechanisms to support this policy initiative.

UR consideration – Distribution connection policy

4.185 UR and the Department for the Economy (DfE) are consulting on a review of the connection policy framework in Northern Ireland. This work is currently at 'call for evidence' stage[15]. This will consider what individual connectees will pay for future connections, and what costs will be socialised and recovered from all consumers.

4.186 Our draft determination for the RP7 Price Control is based how connections costs are addressed in the current connection policy. It does not anticipate future development of connection policy and how connections costs will be funded.

4.187 We agree that there may be a need to amend the RP7 Price Control when this review has concluded. However, until this work is done it is not possible to include a specific re-opener mechanism in RP7.

[15] https://www.uregni.gov.uk/consultations/call-evidence-electricity-connection-policy-framework-review

UR proposal for RP7 – Distribution connection charging policy

4.188 We will consider whether further licence modifications will be necessary to secure the ability of NIE Networks to recover reasonable costs incurred, and finance its functions, once the on-going review of the connection policy framework is complete.

Meter installations / replacement

NIE Networks proposals – Meter installations / replacement

4.189 NIE Networks noted that during RP6 the price control allowances for metering installations and replacements have been based on per unit allowances, and that in their view structuring the allowances in this way mitigates against uncertainty in forecasting the annual volume of activity through the regulatory period. NIE Networks proposed that this mechanism is retained during RP7.

4.190 NIE Networks proposed adding three new LCT related meter categories to the existing mechanism. These are more specialised metering configurations, such as multi-rate or multi-element meters, for which NIE Networks predicts increased demand.

4.191 NIE Networks also noted that its expenditure forecasts in this plan assume no change in relation to NIE Networks' metering obligations during RP7. In particular, no provision has been made for the potential roll out of smart meters to customers in Northern Ireland, and that this is a government policy consideration.

4.192 NIE Networks noted that the introduction of smart metering could have a potentially significant impact on its metering, meter reading, and IT costs. Once DfE decides how smart metering will be implemented, NIE Networks expects that the RP7 market operations allowances would be adjusted accordingly and that NIE Networks would engage with UR to agree the appropriate regulatory mechanisms to support this policy initiative.

4.193 NIE Networks also proposed that UR include a mechanism with the RP7 price control which would provide for a review of metering unit costs within the period of the price control. NIE Networks proposed that this review be on a symmetrical basis and would take account of both increases and reductions in unit costs. This proposal came after the NIE Networks RP7 business plan submission, and reflected NIE Networks view that there are new and additional significant risks in relation to the availability and cost of procuring meters going forward due to the reduced availability of traditional

(non-smart) meters and the increasing costs of electronic components used in electricity meters and other supply chain costs increases.

UR consideration – Meter installations / replacements

4.194 We agree with NIE Networks that price control allowances for metering installations and replacements based on per unit allowances mitigates against uncertainty in forecasting the annual volume of activity, through the regulatory period, and therefore are minded to continue with this approach for RP7.

4.195 However, we do not agree with the proposal for a review of unit rates during the price control, as this lessens the incentive for NIE Networks to control and reveal lower costs which would benefit consumers in the future. Our approach for our minded to position on metering unit rates can be found in Annex O: Metering.

4.196 We note NIE Networks revised submission regarding potential increases in unit costs for credit meters as manufacturers focus on the provision of smart metering and the market of existing types of meters diminishes. Our initial view is that it is NIE Networks responsibility to maintain a reliable source of meters from the market.

UR proposal for RP7 – Meter installations / replacements

4.197 Our minded to position for metering installations/replacements is to retain the RP6 approach on basing allowances on unit rates. We are also minded to maintain the meter replacement for theft programme for RP7.

4.198 We are not minded to include new LCT meter categories proposed by NIE Networks. Additional unit cost categories, and cost rate, for these specialised configurations may be prove necessary when we complete our review of the connection charging methodology or as smart metering is implemented. However, pending the outcome of that work, we do not intend to make any specific provision for these changes in the RP7 price Control. The existing licence already makes provision for additional meter categories and unit cost rates to be added as the need arises through a decision by UR.

Implementation – Meter installations / replacements

4.199 We intend to remove the Recertification: Commercial: Teleswitch/Telemeter replacement programme and the Recertification: Commercial: Northern Customer Load Profiles categories within Table 8 for **Metering Category C.**

4.200 We intend to update the remaining categories in Table 8 for **Metering Category C** with new unit rates. Consistent with RP6 these unit rates in Table 8 would be subject to an updated frontier shift.

4.201 We intend to update the first metering allowance in Table 6 and the second metering allowance in Table 7 of Annex 2 of the transmission and distribution licences.

4.202 We intend to update Paragraph 4.48 of Annex 2 of the transmission and distribution licences to reflect the volume driven allowance for meter replacement for theft in the RP7 period.

Smart Metering

NIE Networks proposals – Smart metering

4.203 NIE Networks noted in its RP7 Business Plan submission that a model for smart metering in Northern Ireland has yet to be agreed by stakeholders, including UR, DfE, electricity suppliers, and NIE Networks. The costs and benefits of smart metering will vary depending on the model, and detailed design to be applied, and therefore remain uncertain at the time of our RP7 Business Plan submission.

4.204 NIE Networks noted that because of this uncertainty that it agreed with UR's proposal to include a re-opener type mechanism in the RP7 Price Control to determine the additional costs and benefits of smart metering at a future date. This mechanism will allow these costs and benefits to be assessed more accurately when there is greater certainty on the model and the detailed design of the smart metering solution for Northern Ireland.

4.205 NIE Networks highlighted that it sees merit in considering a three-phase approach for the project, partly akin to the two stage D5 arrangements for major transmission network projects. In such a three-phase approach, the first stage would provide for appointment of specialist advisors and engagement with stakeholders to determine the high-level model, the second stage would facilitate detailed design, project planning and procurement etc., and the third stage would facilitate implementation of the project.

UR consideration – Smart metering

4.206 Our RP7 final approach document set out our intention to include a re-opener mechanism in the RP7 price control, to address additional costs and savings arising from future decisions on smart metering.

4.207 On the 28 June of 2023, DfE announced that it will develop a plan for the implementation of electricity smart meters in Northern Ireland[16]. However, at this stage the model (including the role of NIE Networks) and timing for electricity smart metering for Northern Ireland remains uncertain. Therefore,

[16] https://www.economy-ni.gov.uk/articles/smart-meters-update

we have concluded that we do not have sufficient information to structure an uncertainty mechanism which would cover the wide range of possible options for delivery of smart metering and the impact this could have on the activities which NIE Networks might undertake in the future, including the consequential impacts such as the impact on the IT programme, and market operations.

UR proposal – Smart metering

4.208 Given the uncertainty over the future development of smart metering, and the impact it might have on NIE Networks activities, and costs, we have concluded that it is not possible to include a smart metering re-opener mechanisms in the licence at this time.

Implementation – Smart metering

4.209 Once a model is selected for electricity smart metering, and the role of NIE Networks within the model is more clearly defined, we would consult on licence modifications that may be required to take account of NIE Networks updated role.

I-SEM

NIE Networks proposals – I-SEM

4.210 NIE Networks noted that the RP6 Price Control contains a provision (the **ESt** term) that serves to allow for amendments to be made to the price control, in the event there are cost implications arising from changes to the wholesale market. NIE Networks proposed that this provision is retained during RP7.

UR consideration – I-SEM

4.211 The **ESt** term was consulted on as part of the consultation and subsequent decision on new IT requirements[17] in March 2021, after the RP6 Price Control. The **Est** term related to the allowed opex for the Enduring Solution in respect of any significant changes in the specification of the service that the Licensee is required to provide in relation to the Enduring Solution market opening system.

UR proposal for RP7 – I-SEM

4.212 We consider that it is appropriate to retain the **ESt** term for the RP7 Price Control, to take account of any significant changes in the specification of the service that NIE Networks is required to provide in relation to the Enduring

[17] https://www.uregni.gov.uk/consultations/consultation-nie-networks-licence-modifications-new-it-requirements

Solution market opening system, and which are not covered by the Enduring Solution allowances provided for in the RP7 final determination.

IT systems

NIE Networks proposals – IT systems

4.213 NIE Networks noted the RP6 price control contains a provision (the NESt term) that serves to allow for amendments to be made to the price control in the event there are cost implications arising from unexpected IT investments, arising from new energy strategy decisions made by government, and/or any significant changes needed for the purposes of providing the Market Data Service or the Market Registration Service. NIE Networks proposed that this provision is retained during RP7.

4.214 NIE Networks also proposed that the RP6 mechanism could be refined to incorporate the delivery of the S/4 HANA project in RP7. NIE Networks explained that to meet vendor support timelines, NIE Networks will incur costs during the RP6 Extension Year, to progress requirements discovery and procurement processes to appoint a system integrator. NIE Networks explained that the provision of an initial allowance to commence this phase will be sought as part of the RP6 extension year assessment, in advance of the draft determination.

4.215 NIE Networks then envisaged that as part of the final determination it would will seek confirmation of the allowance for a proportion of the submitted project costs which will enable the procurement and design phases of the project to complete by Q1 2026, and the solution build to commence.

4.216 Following this, NIE Networks envisaged that following detailed design phases, project costs will be finalised, and remaining allowances will then be sought during the initial RP7 period for separate implementation phases of the various projects, most likely to happen in Quarter 2 2026, and Quarter 1 2028. NIE Networks considered that this approach to funding the complex S/4 HANA project, which will be delivered over many years, best protects customers, and NIE Networks from windfall gains or windfall losses.

UR consideration – IT systems

4.217 We engaged with NIE Networks on the rationale outlined in the business plan submission. We have reviewed NIE Networks proposal for the RP6 extension year and will publish an approval for the appropriate allowances.

4.218 We agreed with NIE Networks that due to the high level of uncertainty a revised approach should be taken to the assessment of the 99 IT projects submitted, and that it was appropriate that an allowance would be made for a

proportion of the requested allowanced to enable the procurement and design phases to progress to cover the first two years of the price control period.

4.219 We accept further allowance will be required within the RP7 period and propose a reopener for the remainder of the costs, however we consider there is a high level of uncertainty in relation to the costs for these years.

4.220 An allowance will be provided for the first two years of the price control and a reopener mechanism will be put in place to approve future costs. This review will consider the delivery and benefits of approved IT projects delivered up to the review date, as well as reviewing a submission from NIE Networks of remaining IT projects to be delivered in the RP7 period (taking into account any impact of smart metering).

UR proposal for RP7 – IT systems

4.221 An allowance will be provided for the first two years of the price control, and a reopener mechanism will be put in place to approve future costs. This reopener will include a review of the delivery and benefits of approved IT project costs within the first two years of the price control.

Implementation – IT systems

We intend to retain the NESt term for the RP7 price control and amend its scope to include approval of IT allowances for Year 3 and beyond of the RP7 price control.

Injurious affection

NIE Networks proposals – Injurious affection

4.222 During RP5 and RP6, NIE Networks received numerous compensation claims from landowners in respect of the diminution in the value of their property (injurious affection), caused by the existence of NIE Networks equipment located on their lands under, or in the shadow of, compulsory powers. The first four injurious affection test cases were heard by the Lands Tribunal in November 2014, and were subsequently appealed by NIE Networks.

4.223 Whilst the appeals were successful in part, the Court of Appeal ruled that NIE Networks was still required to pay compensation to the property owners who had a tower located on their lands in close proximity to their dwelling. This established a precedent for future similar claims during RP6.

4.224 Furthermore, in 2021 the Lands Tribunal awarded compensation to a property owner whose dwelling house was traversed only by overhead electric conductors. Whilst NIE Networks decided not to appeal against this decision, it has continued to reject claims for compensation in similar cases, arguing that the 2021 Lands Tribunal decision was one based purely on the specific circumstances of that case. Whilst no further similar claims against NIE Networks has been referred to the Lands Tribunal to date, it may face future claims into RP7 and beyond.

4.225 The RP6 price control allows efficient injurious affection costs to be recovered as a pass-through cost. This has allowed NIE Networks to seek recovery of efficiently incurred costs in respect of injurious affection on an annual basis (specifically, costs in defending and minimising the compensation due, and also the cost of compensation itself). NIE Networks proposed that this mechanism is retained during RP7.

UR consideration – Injurious affection

4.226 We agree with the position on injurious affection claims as set out by NIE Networks. We agree that there is a potential for NIE Networks to incur costs in respect of injurious affection claims in the future. These costs are uncertain and no allowance has been made for them in the allowed capex and opex figures we intend to include in the licence. We have concluded that existing provisions in the licence which allow efficiently incurred costs to pass through to consumers should be maintained.

UR proposal for RP7 – Injurious affection

4.227 We do not intend to make any changes to the licence in respect of injurious affection claims. We would intend to retain the **ACIA_Xt** term for allowed capex (if any) in respect of Regulatory Reporting Year t, for injurious affection claims, and the **IAt** term for allowed opex (if any) amount in Regulatory Reporting Year t for injurious affection.

Business rates

NIE Networks proposals – Business rates

4.228 NIE Networks has proposed that the Business Rates it pays to Land and Property Services (LPS) should be recovered through revenues as a pass-through cost. It has suggested that UR adopts the approach commonly used in GB to allow for pass-through of business rates, subject to the company demonstrating that it has taken appropriate actions to minimise valuations.

4.229 NIE Networks considers that business rates are an uncontrollable cost because both elements of the liability calculation i.e. the rateable value (RV)

and poundage rates, are set by external bodies and are outside of its control. NIE Networks noted that it can seek to influence the RV by proactively engaging with LPS. However, ultimately the decision on the appropriate level of RV is a matter for LPS.

4.230 NIE Networks noted that the poundage rates (regional and local rates) are set by central and local government and are also completely outside of NIE Networks' control. Business rates are therefore a cost over which it has minimal control.

UR consideration – Business rates

4.231 In RP6, expenditure on Business Rates was included as part of ***The qualifying opex expenditure amount – QOEt*** at Annex 2, Paragraph 6.2, of both the current Distribution Licence and current Transmission Licence. This is defined in the respective Licences as be the value of opex incurred by the Licensee excluding pass through opex and various other categories of opex which are covered by other mechanisms. As a result, expenditure on Business Rates are included in the general opex amount which is subject to the 50/50 cost risk sharing mechanism for opex against the ***Allowed opex amount – AOt*** defined in Annex 2, Paragraph 6.12 of the Distribution Licence and Transmission Licence.

4.232 The company's proposal to move this category of expenditure to a pass-through mechanism reduces risk and reward for the company, and weakens the incentive to challenge and minimise costs, which would provide long term benefits to consumers.

4.233 When considering the company's proposal, we note that:

a) As NIE Networks has stated in its Business Plan submission:

(i) The rates liability for NIE Networks is set by multiplying the RV of NIE Networks assets by both the regional rate and the district rate, all set by the relevant authority.

(ii) The poundage rates (regional and local rates) are set by central and local government and are also completely outside of NIE Networks' control.

(iii) NIE Networks can seek to influence the RV by proactively engaging with LPS. However, ultimately the decision on the appropriate level of RV is a matter for LPS.

b) UR has already adopted a pass-through approach for Business Rates for Gas Distribution companies, and economic regulators of similar network companies in GB (Ofwat, Ofgem and WICS) already allow Business Rates as a pass-through cost, subject to some level of check on the effectiveness of the company's challenge of RV.

c) NIE Networks actual rates bill has fluctuated significantly upwards and downwards in the RP6 period, with actual bills being impacted by both revaluations both in 2020 and 2023, and the level of non-domestic rate in the pound. It is possible that there will be further non-domestic rates revaluations both in 2026 and 2029.

4.234 On the balance of the considerations above, we have concluded that it is appropriate to amend the current licence mechanisms so that efficiently incurred Business Rates becomes a pass-through cost subject to some level of check on the effectiveness of the company's challenge of RV.

UR proposal for RP7 – Business rates

4.235 For RP7, we intend to adjust the current licence mechanism so that efficiently incurred Business Rates becomes a pass-through opex subject to a review of the effectiveness of the company's challenge of RV. The costs of managing and challenging Business Rates would continue to form part of ***the qualifying opex expenditure amount – QOEt*** subject to the 50/50 cost risk sharing mechanism.

Implementation – Business rates

4.236 To give effect to our proposals, it would be necessary to:

a) Amend the definition of ***the qualifying opex expenditure amount – QOEt*** at Annex 2, Paragraph 6.2, of both the current Distribution Licence and current Transmission Licence to exclude Business Rates.

b) Exclude Business Rates (being the amount paid to the relevant authority) from the ***Allowed opex amount – AOt*** defined in Annex 2, Paragraph 6.12 of the Distribution Licence and Transmission Licence. We have, however, included an estimate of Business Rates in our assessment of future expenditure for the purpose of assessing financeability. This estimate is based on the actual 2023 -24 NIE Networks business rates. We may update this figure for the RP7 final determination.

c) Add a further term to the ***Pass through opex expenditure amount – PTOEt*** at Annex 2, Paragraph 6.6, of both the current Distribution Licence and current Transmission Licence (say **OBRt)**, developing an appropriate definition to cover Business Rates.

d) Make the Licence term for the pass through of Business Rates subject to a test that NIE Networks has acted reasonably when challenging revaluations and maintaining good records and challenging rates bills. This would include the ability of UR to allow a lower amount than that actually paid if it considers it appropriate, subject to the condition that it explains its reasons for any adjustment and allows NIE Networks to make representations in advance of making a final decision.

Corporation tax

NIE Networks proposals – Corporation tax

4.237 NIE Networks proposed that its allowance for corporation tax should be based on the applicable tax rate in Northern Ireland, as specified from time to time. It noted that any changes to the tax rate are outside its control.

UR consideration – Corporation tax

4.238 We agree with the proposal set out by the company.

4.239 The calculation of revenues under the licence includes:

a) an amount in respect of a real rate of return calculated using a vanilla (post tax) weighted average cost of capital (WACC); and,

b) a separate amount for tax.

4.240 The tax amount is calculated using the corporation Tax Rate applicable in Northern Ireland in Regulatory Reporting Year, as specified from time to time by HMRC.

UR proposal for RP7 – Corporation tax

4.241 We intend to maintain the existing provisions of the licence which allows the calculation of the tax amount recovered through revenue to reflect the corporation tax rate applicable at the relevant time.

Pension historic deficit repair.

4.242 See Section 11 below.

Licence fees

NIE Networks proposals – Licence fees

4.243 NIE Networks has proposed that the Licence fees it pays to UR should continue to be recovered through revenues as a pass through of costs incurred. NIE Networks based their forecast annual licence fees costs for RP7 on actual licence fees incurred in 2021-22.

UR consideration – Licence fees

4.244 NIE Networks proposal on Licence fees reflects the existing price control mechanism for RP6. It reflects common regulatory practice that the amount of Licence fees is determined by UR and largely outside the control of the regulated company. We also take account of the fact that the costs are clearly defined and there is no risk that the cost recovered will not be affected by judgements made on the allocation of costs.

4.245 In these circumstances, we consider it appropriate that a pass-through mechanism continues in RP7.

UR proposal for RP7 – Licence fees

4.246 We intend to continue to use a pass-through mechanism for Licence Fees in RP7. We intend to maintain the existing provisions in the licences whereby licence fees are included as pass through opex in the ***Pass through opex expenditure amount – PTOEt*** at Annex 2, Paragraph 6.6, of both the current Distribution Licence and current Transmission Licence. Specifically, this includes a term ***OLFt*** defined in the subsequent paragraphs of the respective licences as *the opex licence fee amount in Regulatory Reporting Year t, being the licence fee apportioned or allocated to or required from the Licensee under Condition 7 of this Licence.*

Change of law

NIE Networks proposals – Change of law

4.247 The RP6 price control contains a provision that serves to allow for amendments to be made to the price control in the event of a change of law that triggers a change in required expenditure levels. The purpose of this provision is to ensure the company is left no better or worse off than if the change of law had not occurred.

4.248 NIE Networks has proposed that the Change of Law mechanism included in the RP6 Distribution and Transmission Licences is retained during RP7.

UR consideration – Change of law

4.249 A Change of Law provision already exists in the NIE Network Licence. As noted by NIE Networks, it allows amendments to be made to the price control in the event of a change of law that triggers a change in required expenditure levels. We believe that it continues to be a necessary safeguard for RP7.

4.250 In the current licences, the Change of Law mechanism is given effect through two terms:

a) ***The allowed capex amount for changes of law – ACCOL_Xt*** in Annex 2, paragraph 4.36 for the Distribution Licence and Annex 2, Paragraph 4.36 of the Transmission Licence; and

b) ***The allowed opex amount for changes of law – COLt*** Annex 2, Paragraph 6.16 for the Distribution Licence and Annex 2, Paragraph 6.16 of the Transmission Licence

4.251 Each term being an amount (positive or negative) determined by UR in respect of a ***Relevant Change of Law*** in accordance with the various matters set out in the existing licence. The definition of a Relevant Change of Law is defined in relation to a Provision of Law which is defined to include *any direction of a competent authority other than the Authority or the Department*. We consider the definition of the scope of the mechanism to be sufficient to allow NIE Networks to funded for necessary changes and to protect consumers from funding changes the company might wish to make at its own discretion.

4.252 The current licence does not place any limit on the amount which can be requested or determined in respect of the Change of Law mechanism. This creates a risk (which has not materialised to date) of changes of law which result in small changes of costs triggering this mechanism on a frequent basis. We believe that there is a case for placing a materiality threshold on the amount considered in any decision under this mechanism. This will:

a) Address the potential asymmetry of applications which might not identify small reductions in costs arising from minor changes in law.

b) Reduce the administrative burden on NIE Networks and UR in developing, challenging and completing applications and decision.

4.253 Therefore, we plan to introduce a materiality threshold on the Change of Law mechanism of £125,000 for any one event. To avoid further complexity, this threshold will be maintained in nominal terms for the duration of the RP7 price control.

4.254 We note that the definition of Provision of Law includes *any regulation made by the Council or the Commission of the European Union or any decision taken by the Commission*. We will consider how this might need to change in light of the latest legal framework following the UK's exit from the European Union (EU).

UR proposal for RP7 – Change of law

4.255 UR intends to maintain the existing licence pass through mechanism for Change of Law in RP7 with the addition of a materiality threshold and with changes to the definition of Provision of Law to reflect the legal framework following the UK's exit from the EU.

Implementation – Change of law

4.256 To give effect to our proposals, it would be necessary to retain the mechanism in the existing Licences with the following amendments and additions:

a) In the definition of Provision of Law, point (b), *any regulation made by the Council or the Commission of the European Union or any decision taken by the Commission,* will be amended to reflect the legal framework following the UK's exit from the EU.

b) In respect of the ***allowed capex amount for changes of law – ACCOL_Xt*** and the ***allowed opex amount for changes of law – COLt*** add a materiality threshold such that changes of law which change expenditure by less than, or equal to, £125,000 will not be considered.

Price Indexation

NIE Networks proposals – Price indexation

4.257 In its RP7 business plan submission NIE Networks noted that its price controls have used the Retail Prices Index (RPI) to adjust allowances for general wide inflation/deflation. It noted UR's intention to index the RP7 price control to the Consumer Prices Index including housing costs (CPIH).

UR consideration – Price indexation

4.258 We set out our intention to use Consumer Prices Index including housing costs (CPIH) as the measure of general inflation in RP7 when we published our Approach to RP7.

4.259 NIE Networks current licences for transmission and distribution use the RPI as a general measure of inflation. However, RPI is no longer recognised as

a national statistic. Following a House of Lords Economic Affairs Committee report "Measuring Inflation", published in January 2019, the Chair of the UK Statistics Authority, wrote to the Chancellor of the Exchequer on 4 March 2019 with the following recommendations:

a) that the publication of the RPI be stopped at a point in the future; and

b) in the interim, the shortcomings of the RPI should be addressed by bringing the methods of the CPIH into it.

4.260 In September 2019, the Chancellor of the Exchequer announced his intention to consult on whether to bring the methods in CPIH into RPI between 2025 and 2030. At that time, the UK Statistics Authority noted that*: "We have been clear that the RPI is not a good measure, at times significantly overestimating inflation and at other times underestimating it, and have consistently urged all – in Government and the private sector – to stop using it."*

4.261 Following the consultation, which closed in November 2020:

a) the Chancellor of the Exchequer concluded that he would be unable to offer his consent to the implementation of a proposal (such that the UK Statistics Authority intends to make) before the maturity of the final specific index-linked gilt in 2030.

b) in light of the clarification provided by the Bank of England, and given the UK Statistics Authority's position to address the shortcomings in the RPI in full at the earliest practical time, the Authority Chair replied to the Chancellor informing him that the Authority would be able to legally and practically implement its proposal to the RPI in February 2030.

4.262 While it is now clear that RPI will continue to be calculated and published in its current form until 2030, we think that it is reasonable to plan on the assumption that UK Statistics Agency intends to bring the methods and data sources of the Consumer Prices Index, including owner-occupiers' housing costs (CPIH), into RPI shortly thereafter.

4.263 In view of both the UK Statistics Agency's intent to align RPI with CPIH from 2030, and the Agency's view that RPI is not a good measure of inflation, we have concluded that we should replace RPI, with CPIH as the measure of general inflation in RP7. Not only will this use a more robust measure of general inflation in our decisions, but it will also ensure that the level of inflation of network prices will follow the general Consumer Prices Index (CPI) which is becoming the commonly quoted measure of inflation and a benchmark for increases in pensions, benefits, and wages.

4.264 Changing from RPI to CPIH as a general measure of inflation changes how the cost of networks is paid for by consumers today, and in the future. Because CPIH is generally lower than RPI, there will be an increase in revenue and tariffs for today's consumers while future consumers will pay less. However, with the likelihood that continuing investment in future price controls will continue to increase network costs, we do not think it appropriate to continue to use a measure of inflation which no longer considered robust.

4.265 Finally, we note that other regulatory authorities have already moved to CPIH as the general measure of inflation for price controls. Our recent GD23 price control for gas distribution networks also changed the general measure of inflation from RPI to CPIH as the general measure of inflation.

UR proposal for RP7 – Price indexation

4.266 In view of the reasons set out above, we have decided to adopt CPIH as the general measure of inflation in RP7.

Implementation – Price indexation

4.267 In the determination of the amounts, values and other key decisions underpinning this draft determined we have:

a) calculated real rates of return on capital on a CPIH stripped basis;

b) calculated the frontier shift on a CPIH basis; and

c) ensured that the opening Regulatory Asset Base for RP7 continues to take account of RPI through the RP6 period;

4.268 As we develop detailed licence modifications for RP7, we will amend references to RPI in both text and formulae to CPIH as appropriate.

4.269 We also intend to amend the Rate of Return Adjustment Mechanism for RP7 to adjust for inflation using CPIH. This will:

a) correct for forecasting risk in the calculation of the (real) return amount recovered through revenue; and,

b) ensure that the calculation of this amount is consistent with the inflation of the Regulatory Asset Base using actual CPIH.

4.270 Further information on the changes proposed to the Rate of Return Adjustment Mechanism are set out in Chapter 13 of the draft determination.

Real price effects

NIE Networks proposals – Real price effects

4.271 NIE Networks proposed that UR follows the approach used by Ofgem to determine RPE allowances in its RIIO-2 price controls.

4.272 NIE Networks noted that in RIIO-2, Ofgem continues to set an ex-ante allowance for RPEs based on differences between forecast movements in input-price indices and forecast inflation. This ex-ante RPE allowance is then adjusted ex-post using actual differences between the chosen input-price indices and inflation and in their view this method ensures there is no windfall gain or loss to the Network Company, and vice-versa for customers, arising simply from deviations in forecast versus outturn movements in price indices.

4.273 NIE Networks considers that this approach will help mitigate risks associated with the current (and expected future) supply chain uncertainties and pricing volatility.

UR consideration – Real price effects

4.274 We queried NIE Networks how its envisaged mechanism might work for RP7. NIE Networks stated:

"*We suggest following Ofgem's precedent. Ofgem has indicated that there will be an annual true-up of the RPE allowances after the relevant index/indices are published each year, and a final true-up will occur at the end of RIIO-2 as part of the close-out process.*

To true-up the RPEs allowance, the Annex [for allowances] would need to contain a repeat of the above calculations but using actual data for the indices as opposed to forecasts. This will drive different catch-up efficiency / frontier shift factors and compound efficiency effect factors, which will in turn drive a different allowance for RPEs."[18]

4.275 A 'true-up' device is a reasonable suggestion. However, we have followed the GD23 approach and not adopted such a mechanism. It is our expectation that such an approach has various flaws. For instance:

1) Given that the indices are a proxy for electricity industry costs, any adjustment will not be perfect. The evidence presented on actual contractor costs for the RP6 extension year highlights this issue as they were of a different magnitude to labour indices.

[18] Response to query UR-0018.

2) The mechanism would add significant complication to the annual tariff process. Not only would it require interaction with at least eight different indices, but each have different publication dates and processes (such as provisional figures) which may not be conducive to annual adjustments.

3) In contrast to the NIE Networks view, we would expect a significant regulatory burden. Annual reporting would have to be amended to accommodate such detail as the existing reports do not split costs in the same fashion as the RPE analysis. This is demonstrated by the problems NIE Networks has had with assessing the current cost splits.

4) Not being national statistics, it is possible that some of the indices may become defunct. This occurred during RP6 for the machinery and equipment index.

4.276 There is risk to both NIE Networks and consumers in setting ex-ante allowances for RPEs. However, the existing approach represents a fair allocation of risk that we consider to be justified. The risk is also reduced by virtue of various factors such as the 50:50 sharing mechanism, NIE Networks control over its own labour costs and linking contractor spend to general inflation uplifts. Therefore, we are minded to continue with the existing approach in setting ex-ante allowances for RPEs.

5. Other RP7 Licence Modifications

Evaluative Performance Framework

5.1 We have proposed an Evaluative Performance Framework as part of the NIE Networks RP7 Price Control. Annex V identifies the principles for the EPF, and provides guidance on how the assessment of NIE Networks performance will operate, timelines, incentive/penalty methodology, and the nature of the EPF Panel.

5.2 The framework will aim to incentivise NIE Networks to take advantage of new opportunities, proactively progress initiatives in areas that will bring the greatest benefit to Northern Ireland customers, and ensure we continually adapt to the emerging energy landscape. A key element of the EPF is to bring additional skills, insights, and knowledge to UR's review of NIE Networks' performance.

5.3 In order to implement an Evaluative Performance Framework for NIE Networks we consider the following amendments would be required to the NIE Networks distribution licence.

a) Definitions to include "Requirements and Guidance on the Evaluative Performance Framework under the definitions section of Annex 2 – Distribution Charge Restrictions Conditions; and,

b) An **EPt** term in Annex 2 for the Evaluative Performance Amount with a cap/collar of +/-£3m per annum in 2021/22 prices (as per guidance).

Issues arising from RP6 extension proposal

5.4 During our consultation on the RP6 extension NIE Networks noted that in their view additional licence modifications were required in three areas i.e.

- Landbank
- Introduction of a Use of Shared Service O&M charge
- Contestability – enhancing the scope

5.5 We agree that licence modifications are required for these issues and we set out our approach below:

Landbank

5.6 NIE Networks noted that the disapplication date needs to be amended from 2017. We agree that the disapplication needs to be updated.

Use of Shared Service - O & M charge

5.7 For the UoSAC, a new term can be introduced at RP7 which would be the equivalent of the **CCSA_Xt** term at Paragraph 4.21 of Annex 2, inserted into Section 6 of Annex 2 i.e. adding an equivalent opex term as the existing capex term.

Contestability

5.8 For the Contestability item, a new term should be introduced at RP7 in the opex section of Annex 2 of the Licence(s)

TUoS revenue collection

5.9 As part of SONI's 2020 to 2025 price control, we proposed to move the NIE Networks TUoS revenue collection risk from SONI to NIE Networks, reducing SONI's risk and overall costs to consumers. We plan a further consultation on appropriate licence modifications.

General Updates

5.10 We recognise that some general updates, such as date references relevant to a new price control period, will be required to the NIE Networks distribution and transmission licence. We will detail these when we publish proposed licence modifications with the RP7 final determination.

6. Introduction to Licence Annex 2 and General Changes

Introduction to Annex 2: Charge restriction condition

6.1 Annex 2 of the transmission and distribution licences sets out in detail how the maximum regulated revenue charged by NIE Networks is calculated from the determined values, unit costs and other amounts which are a key output of the RP7 price control determination.

6.2 When we publish our final determination for RP7, we will also publish and consult on proposed modifications to the respective licences which will give effect to the determination. Much of the proposed modifications will be to Annex 2 of the licences, amending the various formula, definitions and conditions which determine revenue.

6.3 In this and the subsequent sections of this annex, we have set out the modifications we intend to make to Annex 2 of the licences to give effect our determination including changes to various mechanisms described in Sections 4 and 5 above.

6.4 In this and subsequent sections we provide a summary of how the various parts of Annex 2 operate, quoting text from the licences as necessary. However, these sections should be read in conjunction with the detail of the transmission and distribution licences for completeness and a full understanding of the formulae used to calculate revenue.

6.5 In this section, we consider Paragraphs 1 (Definitions), Paragraph 2 (Introductory Provisions) of Annex of the Licences and other general changes which will apply across Annex 2.

Paragraph 1 - Definitions

6.6 We propose to make the changes to the definitions Section 1 of Annex 2 of the transmission and distribution licences set out in Table 6.1 below.

New or amended term	Definition
Average specified rate	***amended definition*** means the arithmetic mean of the daily base rates of the Bank of England ~~Danske Bank Limited~~ (or such other bank as the Authority shall specify from time to time) current from time to time during the period in respect of which the calculation falls to be made.
"CPIHt"	***new definition*** means the Consumer Prices Index including owner occupiers' housing costs (L522: 2015 = 100) published by the Office for National Statistics (or successor body) for the October month in each Regulatory Reporting Year t and is therefore to be read such that: a reference to 'CPIH t = 2022' is to the CPIH figure for October 2021.
"Evaluative Performance Framework Model"	***new definition*** means the document of that name, prepared and published by the Authority following consultation with the Licensee (which consultation may take place before or after this condition comes into force), which sets out the principles and methodology for determining the allowed amount in respect of the Evaluative Performance Framework incentive.
"RP7"	***new definition*** means the period commencing on 1 April 2025 and ending on 31 March 2031
"RP7 Model"	***new definition*** means the document of that name, prepared and published by the Authority following consultation with the Licensee (which consultation may take place before or after this condition comes into force), which sets out the principles and methodology for determining the actual entitlement for RP7 in respect of each of the entitlement lines specified in the document.

Table 6.1: New and amended definitions for Annex 2 of the licences

Paragraph 2 – Introductory provisions

6.7 We propose to amend Paragraph 2.2(a) of the transmission and distribution licences to reflect the base year for the determined values of the price control of 2021/22 (in October 2021 prices) to read as follows:

*all monetary figures in this Annex are stated in **2021/22** prices; and*

General changes to Annex 2

6.8 Where appropriate, dates in the licence will be amended to:

a) reflect the start date for RP7 of 1 April 2025; and,

b) remove text and calculations in the current licences which were necessary to give effect to the half year at the start of RP6 which began on the 1 October 2017, and ran for six months to 31 March 2018.

6.9 The various determined allowances and unit cost in Annex 2 are stated in 2021/22 prices, consistent with the RP7 determination. Maximum Regulated Revenue is calculated in nominal terms. In RP6, RPI was used to convert from base year to nominal prices. For RP7, for the reasons given in Section 4 above, we have decided to the consumer prices index including owner occupiers' housing costs (CPIH) as the general measure of inflation. We intend to amend Annex 2 of the licences to change references to RPI to CPIH as appropriate to give effect to this decision.

7. The Maximum Regulated Revenue

The Maximum Regulated Revenue for the Tariff Year

7.1 Section 3 of Annex 2 of the current transmission and distribution licences sets out how the maximum regulated revenue which NIE Networks can recover from consumers will be calculated.

7.2 The Regulatory Year runs from 1 April to 31 March of the subsequent year. The Tariff Year runs from 1 October to 30 September of the subsequent year. We intend to maintain the process set out and Paragraph 3.2 of the Annex 2 of the current transmission and distribution licences whereby the Maximum Regulated Revenue for a Tariff Year is half the Maximum Regulatory Revenue of each Regulatory Year falling in that Tariff Year.

The Maximum Regulatory Revenue for the Regulatory Reporting Year

7.3 The maximum regulated revenue for the regulatory reporting year in RP7 will be calculated using the formulae set out below:

for the distribution licence

$RP7R_t = DEP_t + RET_t + BD_t + RI_t + EPF_t + O_t + P_t + TAX_t - RPSI_t + K_t$

for the transmission licence

$RP7R_t = DEP_t + RET_t + BD_t + O_t + P_t + TAX_t + K_t$

Where:

DEPt means the depreciation amount in Regulatory Reporting Year t, see Section 8 below;

RETt means the return amount in Regulatory Reporting Year t, see Section 9 below;

BDt is the allowed opex amount (if any) in Regulatory Reporting Year t, for Uncollected Revenue, being the amount appropriate for the Licensee to recover in that Regulatory Reporting Year, in respect of Uncollected Revenue, less any amount or part of an amount treated as Uncollected Revenue in respect of a preceding Regulatory Reporting Year t that has been paid to the Licensee in Regulatory Reporting Year t;

RIt **(for the distribution licence only)** is the allowed amount (if any) in Regulatory Reporting Year t, being the amount, the Authority determines in a published decision to be appropriate for the Licensee to recover in respect of the reliability incentive in that Regulatory Reporting Year t, as calculated by the Authority under and in accordance with the Reliability Incentive Model;

EPFt **(a new term for RP7 for the distribution licence only)** is the allowed amount (if any) in Regulatory Reporting Year t, being the amount, the Authority determines in a published decision to be appropriate for the Licensee to recover in respect of the Evaluative Performance Framework incentive in that Regulatory Reporting Year t, as calculated by the Authority under and in accordance with the Evaluative Performance Framework Model;

Ot means the opex amount in Regulatory Reporting Year t, see Section 10 below;

Pt means the pension deficit amount in Regulatory Reporting Year t, see Section 11 below;

TAXt means the tax amount due in Regulatory Reporting Year t, see Section 12 below;

RPSIt **(for the distribution licence only)** means the revenue protection services incentive amount, in Regulatory Reporting Year t, see Section 13 below;

Kt means the correction factor amount (whether a positive or negative number), see Section 14 below.

7.4 These formulae follow those used in RP6, with the addition of the Evaluative Performance Framework incentive amount to the distribution licence formula.

8. The Regulatory Asset Bases

Regulatory Asset Base

8.1 Section 4 of Annex 2 of the current transmission and distribution licences sets how out a regulatory asset value is maintained and how that value is depreciated. It secures the remuneration of capex through a return of capex (depreciation) and a return on capex (by maintaining a residual asset value to which a cost of capital is subsequently applied).

8.2 The depreciation of the regulatory asset base is recovered in the Maximum Regulatory Revenue through the **DEPt** term. A cost of capital is applied to the average regulatory asset value (as described in Section 9 below) to calculate the Return Amount which is also recovered in the Maximum Regulatory Revenue through the **RETt** term.

8.3 We intend to maintain this approach in RP7, continuing to maintain and depreciate five RABs defined in Table 1 of Annex 2 of the distribution licence and four RABs defined in Table 1 of Annex 2 of the transmission licence as follows:

RAB name	RAB_X
Distribution licence Regulatory Asset Base	
Distribution RAB	RAB_DN
Enduring Solution RAB	RAB_ES
Metering RAB	RAB_MTRN
Rathlin RAB	RAB_RT
5 Year D.RAB	RAB_D5Y
Transmission licence Regulatory Asset Base	
Transmission RAB	RAB_TN
Renewables RAB	RAB_RN
Old NS Interconnector RAB	RAB_NSI
5 Year T.RAB	RAB_T5Y

Table 8.1: Regulatory Asset Bases

8.4 We intend to maintain the general principles and formulae for calculating the value of the asset base and depreciation set out in the current transmission and distribution licences. For each RAB and each year of the price control:

a) The calculation is maintained in nominal terms by inflating the closing value of each RAB to establish the opening value for the next year using the general measure of inflation for the price control (CPIH).

b) An amount is deducted from the RAB for depreciation.

c) Additional capex expenditure in the year is added to the regulatory asset value, subject to the deduction of any expenditure which is determined to be demonstrably inefficiency and wasteful within the definition set out in the licence.

d) A capex disposal amount is deducted, being the value from the disposal of any relevant assets (including Land, Buildings, Plant, Equipment, but not comprising Land Bank premises, or scrap) minus any costs of such disposal that were reasonably incurred by the Licensee for the year 5 years before the Regulatory Year. This mechanism allows the company to retain five years' worth of the return amount on relevant asset disposals and provides an incentive to dispose of surplus assets and return value to consumers.

e) The addition (or deduction) of an incentive amount representing 50% of the difference between qualifying capital expenditure and a pre-determined capex allowance. This mechanism provides a strong incentive for the company to deliver capex efficiency and defer investment to the long-term benefit of consumers. It also provides some protection to the company by muting the impact if actual expenditure exceeds the allowed capex determined through the price control.

The Regulatory Asset Base for existing assets

8.5 The calculation of the value of the RAB and depreciation is in two parts:

a) First, that related to existing assets, being the value of the RAB at the end of RP6.

b) Second, that related to additional assets, being the value of assets added to the RAB during RP7.

8.6 The opening value of regulatory assets for RP7 will be the sum of the closing value of the existing asset base for RP6 and the closing value of the additional asset base for RP6 as calculated in accordance with the relevant sections of the Licences in effect at the time of the final determination. These opening values will be calculated on the completion of RP6, adjusting for inflation.

8.7 The depreciation of the RP7 existing asset base will be fixed amounts for each year of RP7, calculated in accordance with RP5, RP6, and RP7 Models

as notified by NIE Networks by UR. These opening values will be calculated on the completion of RP6.

8.8 The RAB and associated depreciation, which reflects capital investment before the start of RP7, does not need to be adjusted for additional expenditure in RP7.

The Regulatory Asset Base for additional assets

8.9 The RAB for Additional Assets represents the regulatory value and depreciation of capital investment from the beginning of RP7.

8.10 Capex expenditure incurred in RP7 will be divided into two categories: "qualifying capex" and "pass through capex". Both categories of capex are subject to the deduction of any expenditure determined to be demonstrably inefficient and wasteful under the licence.

8.11 The opening value for Additional Assets in RP7 will be zero. In subsequent years, the opening value for Additional Assets is the closing value of the previous year updated for inflation.

8.12 The calculation of the closing value for additional assets is the mechanism whereby:

a) additional investment is added to the RAB (net of demonstrably inefficient and wasteful expenditure),

b) depreciation included in revenue is deducted from the RAB; and,

c) a capital disposal amount is deducted (with a lag of 5 years).

8.13 The closing value for Additional Assets in RP7 is calculated for each RAB in each year of RP7 using the using the formula set out below:

$$CADD\_Xt = OADD\_Xt + QCE\_Xt - DIQCE\_Xt + PTCE\_Xt - DIPTCE\_Xt - DEPADD\_Xt - CD\_Xt + CI\_Xt$$

Where, for each RAB X and each Regulatory Year t:

OADDt means the opening value of additional assets calculated in accordance with the licence;

QCEt means the qualifying capex expenditure amount, calculated in accordance with the licence;

DIQCEt means the demonstrably inefficient qualifying capex expenditure amount, calculated in accordance with the licence;

PTCEt means the pass-through capex expenditure amount, calculated in accordance with the licence;

DIPTCEt means the demonstrably inefficient pass through capex expenditure amount, calculated in accordance with the licence;

DEPADDt means the depreciation amount for additional assets, calculated in accordance with the licence;

CDt means the capex disposal amount, calculated in accordance with the licence; and

CIt means the capex incentive amount, calculated in accordance with the licence.

8.14 The capex incentive amount creates an incentive for the company to out-perform the capex allowances set in the determination ("allowed capex" as defined in the licence). The **CIt term** is 50% of the difference between the determined allowances and the qualifying capital expenditure (net of demonstrably inefficient and wasteful expenditure.

Allowed distribution capex

8.15 Allowed capex is defined in the licence through determined fixed amounts, amounts calculated through volume drivers using determined cost rates or additional amounts for defined activities determined through reopener mechanisms. It sets UR's reasonable expectation of the cost of capital investment. These pre-determined amounts become a target costs against which the capex incentive (cost risk sharing) amount is determined.

8.16 The distribution allowed capex is currently defined through:

a) Three terms which include a combination of pre-determined amounts, amounts calculated through determined unit rates applied to volume drivers and re-opener mechanisms relating to individual RABs as follows:

   (i) **AC_D5Yt term** in respect of allowed capex for RAB_D5Y;

   (ii) **AC_DNt term** in respect of allowed capex for RAB_DN;

   (iii) **AC_MTRNt term** in respect of allowed capex for RAB_MTRN (metering);

b) Four general re-opener mechanisms which might apply to any RAB as follows:

(i) **ACIA_Xt term** in respect of injurious affection claims;

(ii) **ACES_Xt term** in respect of significant changes in the specification of the service that the Licensee is required to provide in relation to the Enduring Solution market opening system;

(iii) **ACDR_Xt term** in respect of any amount determined by the Authority to be appropriate within the definition of the term included in the licence;

(iv) **ACCOL_Xt term** in respect of changes of law as determined by the Authority to be appropriate within the definition of the term included in the licence.

AC_D5Yt term in respect of allowed capex for RAB_D5Y

8.17 The allowed capex for distribution RAB_D5Y is defined in the licence as:

a) **AC_xxxx_Xt term** which is a determined amount in base year prices for each Regulatory Year. These amounts exclude any amounts which will be determined through the various additional allowed capex mechanisms such as:

(i) additional allowances for innovation projects which will be determined under the **ACDR_Xt term**; and,

(ii) future IT investment from year 2027/28 onwards which will be determined through an amended **ACNES_Xt term** described below.

b) **ACNES_Xt term**, a re-opener mechanism currently defined as allowed capex amount for RAB_T5Y in respect of

(i) any New Energy Strategy IT Solution; or,

(ii) any significant changes required to the specification of the information technology systems utilised by the Licensee for the purposes of providing the Market Data Service or the Market Registration Service.

We intend to amend this term to include future IT investment from year t=2028 which have not been included from the determined amounts under the **AC_xxxx_Xt term.**

8.18 Our draft determination of the amounts, in base year prices, for the **AC_xxxx_Xt term** are shown in Table 8.2 below. These values will be reviewed and updated in line with the final determination.

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
for RAB_D5Y	25.083	29.456	5.825	5.754	5.392	5.330

Table 8.2: The Distribution Owner Business allowed capex per RAB_D5Y for each Regulatory Reporting Year t (£ million, 2022 prices)

AC_DNt term in respect of allowed capex for RAB_DN

8.19 The allowed capex for the RAB_DN term is currently the sum of an allowed capex amount (the **ACA_DNt term**) and a volume driven allowance for the replacement of undereaves cables determined using unit costs (the **UVAt term**). We propose to maintain this approach in RP7 and add additional volume drivers.

8.20 We intend to add additional volume drivers in RP7 to:

a) determine allowed capex for the new secondary load related volume driver (new **SLREt term**) described in Section 4 above beginning at paragraph 4.24.

b) determine allowed capex for the new low rated cut-outs volume driver relating to cut-outs replaced due to new low carbon technology connections (new **LRCt term**) described in Section 4 above beginning at paragraph 4.32.

c) determine allowed capex for the new looped services volume driver (new **LSRt term**) described in Section 4 above beginning at paragraph 4.49.

8.21 Our draft determination of the amounts, in base year prices, for the **ACA_DNt term** are shown in Table 8.3 below. These values will be reviewed and updated in line with the final determination.

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
for RAB_DN	135.693	147.821	145.025	142.366	143.483	139.265

Table 8.3: The Distribution Business allowed capex for RAB_DN for each Regulatory Reporting Year t (£ million, 2022 prices)

8.22 Our draft determination of the undereaves unit cost, in base year prices, for the purposes of calculating the **UVAt term** are shown in Table 8.4 below.

These values will be reviewed and updated in line with the final determination.

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
UAU_2022 cost rates	0.603	0.606	0.606	0.606	0.605	0.604

Table 8.4: The Distribution Business undereaves allowance unit cost for UAU_2022 for each Regulatory Reporting Year t (£k, 2022 prices)

Our draft determination of the secondary load related allowance unit costs, in base year prices for the purposes of calculating the new **SNRAt term** are shown in Table 8.5 below. These values will be reviewed and updated in line with the final determination.

$SNRU\_2022\_A_t$	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
PM TX (per MVA)	89.191	89.625	89.667	89.577	89.487	89.397
GM TX (per MVA)	83.467	83.873	83.913	83.828	83.744	83.659
HV UG (per km)	99.806	100.292	100.340	100.238	100.137	100.037
HV OH (per km)	59.322	59.611	59.639	59.579	59.519	59.459
LV UG (per km)	105.843	106.358	106.408	106.301	106.194	106.087

Table 8.5: The Secondary Network Reinforcement allowance unit cost for XXXX_2022 for each Regulatory Reporting Year t (£k, 2022 prices)

8.23 Our draft determination of the low rated cut-out unit cost, in base year prices, for the purposes of calculating the new **LRCt term** are shown in Table 8.6 below. These values will be reviewed and updated in line with the final determination.

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
LRC_2022 cost rates	0.300	0.302	0.302	0.301	0.301	0.301

Table 8.6: The Distribution Business low rated cut-out allowance unit cost for XXX_2022 for each Regulatory Reporting Year t (£k, 2022 prices)

8.24 Our draft determination of the looped services unit cost, in base year prices, for the purposes of calculating the new **LSRt term** are shown in Table 8.7 below. These values will be reviewed and updated in line with the final determination.

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
LSR_2022 cost rates	1.183	1.189	1.190	1.188	1.187	1.186

Table 8.7: The Distribution Business looped services allowance unit cost for XXX_2022 for each Regulatory Reporting Year t (£, 2022 prices)

AC_MTRNt term in respect of allowed capex for RAB_MTRN

8.25 The allowed capex for the MTRNt (metering RAB) is currently defined as the sum of a first metering fixed allowance (the **FMFAt term**), a second metering fixed allowance (the **SMFAt term**) and a volume driven allowance (the **MVAt term**) based on the number of meters installed or exchanged. The defined amounts for these terms are expressed in base year prices and are subject to a real price effect and productivity factor for each Regulatory Reporting year.

8.26 The real price effect and productivity factors used to calculate the allowed capex for the MTRNt term will be cumulative frontier shift factors for capex from the 2021/22 base year.

8.27 Our draft determination of the amounts, in base year prices, for the **FMFAt term** and **SMFAt term** are shown in Table 8.8 below. These values will be reviewed and updated in line with the final determination.

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
for **FMFAt**	1.107	1.118	1.237	1.122	1.039	1.035
for **SMFAt**	2.112	1.847	1.807	1.834	1.864	2.080

Table 8.8: The Distribution Business first and second metering fixed allowances for each Regulatory Reporting Year t (£ million, 2022 prices)

8.28 Our draft determination of the metering allowance unit cost, in base year prices for the purposes of calculating the **MVAt term** are shown in Table 8.9 below. These values will be reviewed and updated in line with the final determination.

Period	Metering allowance unit cost
Meter Installs/Changes: Credit	£27.770
Meter Installs/Changes: Keypad	£68.156
Meter Installs/Changes: Commercial	£165.464
Recertification/certification: Credit	£29.107
Recertification: Keypad	£76.911
Recertification: Commercial	£153.491
Recertification: Commercial: 110/33kv Bulk Supply Point and Sub- Station metering	£1771.023
Recertification: Commercial: Power Stations >100MW Metering	£6089.779
Recertification: Commercial: Generator metering <100MW and >1MW	£848.287
Recertification: Commercial: HV Demand customer Metering >1MW	£429.556
Recertification: Commercial: HV Demand customer Metering <1MW	£353.983
Recertification: Commercial: Teleswitch/Telemeter replacement programme	£0
Meter Replacement for theft	£126.214

Table 8.9: The Distribution Business allowed capex for RAB_MTRN for each Regulatory Reporting Year t (£ allowance per unit cost, 2022 prices)

General re-opener terms

8.29 We intend to maintain the **ACIA_Xt term** (for injurious affection), the **ACES_Xt term** (for the enduring solution for market opening) and the **ACCOL_Xt term** (for change of law) as defined in the current distribution licence. However, we intend to adjust the change of law term to place a materiality threshold on applications and decisions as described at paragraph 4.247 above.

8.30 We intend to amend the scope of the **ACDR_Xt term** (at Paragraph 4.37 of Annex 2 of the current distribution licence) to:

a) Remove from scope “nominated distribution projects” because it is not our intention to identify any such projects in our determination for RP7.

b) Clarify that funding for trials to assess and demonstrate innovative future investment under this mechanism will be limited to additional funding for additional trials over, and above those already funded in the determination.

c) Remove from scope projects to address load growth due to the introduction of low carbon technologies because other determined amounts and mechanisms in RP7 allow for load growth relating to low carbon technologies.

d) Remove from scope projects to address congestion on the 33kV network relating to generation connections. In our view, the primary network re-opener mechanism makes this part redundant.

e) Add to the scope of this term the reopener mechanism for additional investment due to load growth on the primary distribution network as described in Section 4 above, beginning at paragraph 4.5.

f) Add to the scope of this term the reopener mechanism for additional investment (if any) on sub-sea cables following surveys planned in RP7 as described in Section 4 above, beginning at paragraph 4.80.

g) Add to the scope of this term the reopener mechanism for additional investment related to net-zero as described in Section 4 above, beginning at paragraph 4.60.

h) Add to the scope of this term the reopener mechanism for additional investment in respect of telecoms as described in Section 4 above, beginning at paragraph 4.86.

8.31 We intend to amend the limitations and constraints placed on the values which may be determined under the **ACDR_Xt term** (at Paragraph 4.38 of Annex 2 of the current distribution licence) as follows:

a) Remove Paragraph 4.38(b) referring to “nominated distribution projects” because it is not our intention to identify any such projects in our determination for RP7.

b) Remove Paragraph 4.38(c) because it is not our intention to place a limit on the value of trials to assess and demonstrate innovative future investment. We recognise the need for innovation on the path to net zero. We expect assess and approve proposals based on their individual economic merit.

c) Remove paragraph 4.38(d) which limits years in which additional load growth investment related to low carbon technologies can be determined. This was relevant to RP6, but given the adjustments to scope proposed above, no longer relevant to RP7.

Allowed transmission capex

8.32 The allowed transmission capex is currently defined through:

a) A single term covering all transmission RABs which is a combination of pre-determined amounts and re-opener mechanisms.

b) Four re-opener mechanisms to provide for additional allowed capex which might apply to any RAB as follows:

(i) **ACIA_Xt term** in respect of injurious affection claims;

(ii) **ACES_Xt term** in respect of significant changes in the specification of the service that the Licensee is required to provide in relation to the Enduring Solution market opening system;

(iii) **ACTR_Xt term** in respect of any amount determined by the Authority to be appropriate within the definition of the term included in the licence;

(iv) **ACCOL_Xt term** in respect of changes of law as determined by the Authority to be appropriate within the definition of the term included in the licence.

Allowed capex for each RAB

8.33 The allowed capex for each transmission RAB (RAB_TN and RAB_T5Y) is defined in the licence as:

a) **AC_xxxx_Xt term** which is a determined amount in base year prices for each RAB and each Regulatory Year. These amounts exclude any amounts which will be determined through the various additional allowed capex mechanisms such as:

(i) Additional allowances for transmission capacity and capability projects which will be determined under the **ACTR_Xt term**; and,

(ii) future IT investment from year t=2028 onwards which will be determined through an amended **ACNES_Xt term** described below.

b) **ACNES_Xt term**, a re-opener mechanism currently defined as allowed capex amount for RAB_T5Y in respect of any New Energy Strategy IT Solution. We intend to amend this term to include future IT investment from year t=2028 which have not been included in the determined amounts under the **AC_xxxx_Xt term.**

8.34 Our draft determination of the amounts, in base year prices, for the **AC_xxxx_Xt term** are shown in Table 8.10 below. These values will be reviewed and updated in line with the final determination.

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
for RAN_TN	17.759	18.686	23.189	22.628	20.902	20.872
for RAB_T5Y	2.123	2.322	0.311	0.306	0.305	0.304

Table 8.10: The Transmission Owner Business allowed capex per RAB_X for each Regulatory Reporting Year t (£ million, 2022 prices)

General re-opener terms for transmission capex

8.35 We intend to maintain the **ACIA_Xt term** (injurious affection), the **ACES_Xt term** (enduring solution and market opening) and the **ACCOL_Xt term** (change of law) as defined in the current transmission licence. However, we intend to adjust the change of law term to place a materiality threshold on applications and decisions as described at paragraph 4.247 above.

8.36 We intend to maintain the general scope of the **ACTR_Xt term** (at Paragraph 4.34 of Annex 2 of the current distribution licence) which covers:

a) any project to address transmission system capacity or capability;

b) any project to address major transmission system replacement requirements; and

c) trials undertaken to assess and demonstrate innovative future investment in the transmission system.

8.37 We intend to amend the scope of the **ACDR_Xt term** (at paragraph 4.37 of Annex 2 of the current distribution licence) to:

a) Clarify that funding for trials to assess and demonstrate innovative future investment under this mechanism will be limited to additional funding for additional trials over and above those already funded in the determination.

b) Add to the scope of this term the reopener mechanism for additional investment related to net-zero as described in Section 4 above, beginning at paragraph 4.60.

c) Allow NIE Networks to apply for transmission pre-construction funding for defined projects on the basis of costs incurred subject to the constraints set out in Section 4 beginning at paragraph 4.137.

8.38 We intend to amend the limitations and constraints placed on the values which may be determined under the **ACTR_Xt term** (at Paragraph 4.35 of Annex 2 of the current distribution licence) as follows:

a) Remove Paragraph 4.35(e) because it is not our intention to place a limit on the value of trials to assess and demonstrate innovative future investment. We recognise the need for innovation on the path to net zero. We expect assess and approve proposals based on their individual economic merit.

Pass through capital expenditure

8.39 The current licence allows for certain categories of expenditure to be incurred by the Licensee to added to the RAB (net of Demonstrably Inefficient and Wasteful Expenditure) as pass through expenditure. These categories of expenditure are not subject to the capex cost risk sharing incentive. This pass-through capex expenditure includes the following

a) The capex connections amount (the **CC_Xt term**) being the net costs (or net contributions) relating to the following types of connections:

(i) Housing sites with 12 or more domestic premises (distribution licence only).

(ii) Approved Generation Cluster infrastructure.

b) The capex connections shared asset amount (the **CCSA_Xt term**) in relation to the connection to parts of the network that has been funded by a third party under a connection agreement with the Transmission System Operator.

8.40 We do not intent to make any changes to the licence in respect of pass through capital expenditure.

9. The Return Amount

9.1 Section 5 of Annex 2 of the current transmission and distribution licences set out the calculation of the return amount (**RET$_t$**) which is a component of the Maximum Regulated Revenue.

9.2 This amount is provided to secure the ability of NIE Networks to finance its operations. It represents a real rate of return (net of inflation), calculated using a vanilla weighted average cost of capital (WACC), and applied to the average Regulatory Asset Value for the Regulatory Reporting Year.

9.3 In addition to a real rate of return (net of inflation) recovered through revenue, the Regulatory Asset Value is inflated by a defined interest rate each year. The combination of a real rate of return recovered through revenue and progressive inflation of the RAB, helps secure inter-generational equity with consumers paying their fair share of the cost of assets over the time they are used.

9.4 The use of a vanilla WACC to calculate the return amount means that the return amount does not include any allowance for tax. Separate provision is made for a tax amount in the Maximum Regulated Revenue as described in Section 12 below.

9.5 We intend to maintain the process for calculating the return amount in the RP7 licence.

9.6 The WACC used to calculate the Return Amount is amended during the course of the price control through a Rate of Return Adjustment Mechanism. In RP6, this mechanism adjusts for benchmark interest rates at the time NIE Networks raises finance. In RP7, we propose to amend this mechanism to update for inflation (and therefore real rates of interest) as described in Chapter 13 of the draft determination.

10. The Opex Amount

The Opex Amount

10.1 Section 6 of Annex 2 of the current transmission and distribution licences set out the calculation of an opex amount (**Ot term**).

10.2 Opex expenditure incurred is divided into two categories: “qualifying opex” and “pass through opex”. Both categories are subject to the deduction of opex with is determined to be demonstrably inefficient in accordance with the licence.

10.3 The opex amount is calculated using the formula set out below:

Ot = QOEt – DIQOEt + PTOEt – DIPTOEt + OIt

Where:

QOEt means the qualifying opex expenditure amount, calculated in accordance with the licence;

DIQOEt means the demonstrably inefficient qualifying opex expenditure amount, calculated in accordance with the licence;

PTOEt means the pass through opex expenditure amount, calculated in accordance with the licence;

DIPTOEt means the demonstrably inefficient pass through opex expenditure amount, calculated in accordance with the licence; and

OIt means the opex incentive amount in Regulatory Reporting Year t, calculated in accordance with the licence.

10.4 The opex amount **Ot** includes an opex incentive amount which is 50% of the difference between a determined “allowed opex amount” and the qualifying opex net of demonstrably inefficient expenditure. The effect of the opex incentive amount is to allow NIE Networks to retain 50% of out-performance against a pre-determined opex allowance (after adjustment for any demonstrably inefficient expenditure) or return 50% of expenditure in excess of the pre-determined allowance to consumers.

10.5 We propose to maintain the calculation of the opex amount set out in the licence, including the 50% cost risk sharing mechanism

Allowed opex

10.6 Allowed opex is defined in the licence through fixed amounts or additional amounts for defined activities determined through reopener mechanisms. These pre-determined amounts become a target costs against which the opex incentive (cost risk sharing) amount is determined. In this regard, the licence distinguishes between an allowed opex amount (the **AOt term**) which is pre-determined opex allowance and an allowed opex other amount (the **AOOt term**) which are a series of additional amounts determined through defined re-opener mechanisms.

10.7 Our draft determination of the amounts, in base year prices, for the **AOt term** are shown in Table 10.1 for distribution and in Table 10.2 for transmission. These values will be reviewed and updated in line with the final determination.

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
for 'AO_2022t_DL	49.927	48.919	44.377	44.416	44.286	44.090

Table 10.1: The Distribution Owner Business allowed opex amount for each Regulatory Reporting Year t (£ million, 2022 prices)

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
for 'AO_2022t_TL	4.626	4.417	3.833	3.718	3.690	3.676

Table 10.2: The Transmission Owner Business allowed opex amount for each Regulatory Reporting Year t (£ million, 2022 prices)

10.8 The allowed opex other amount (the **AOOt term**) is currently the sum of four items:

ESt **(distribution licence only)** the allowed opex (if any) amount in Regulatory Reporting Year t, for the Enduring Solution, being the additional amount that the Authority determines in a published decision, to be appropriate for the Licensee to recover in that Regulatory Reporting Year in respect of any significant changes in the specification of the service that the Licensee is required to provide in relation to the Enduring Solution market opening system;

IAt is the allowed opex (if any) amount in Regulatory Reporting Year t, for injurious affectation, being the amount that the Authority determines in a published decision to be appropriate for the Licensee to recover in respect of injurious affectation claims in that Regulatory Reporting Year;

COLt is the allowed opex (if any) amount for changes of law, in an amount determined by the Authority to be appropriate in accordance with paragraph 6.16; and

NESt is the allowed opex amount (if any) in Regulatory Reporting Year t, up to and including Regulatory Reporting Year t=2025 only, being the amount the Authority determines in a published decision, to be appropriate for the Licensee to recover in respect of:

(a) a New Energy Strategy IT Solution; or

(b) any significant changes required to the specification of the information technology systems utilised by the Licensee for the purposes of providing the Market Data Service or the Market Registration Service.

10.9 We intend to maintain the scope of the allowed opex other amount (the **AOOt term**) subject to the following amendments:

a) We intend to amend the change of law term to place a materiality threshold on applications and decisions as described at paragraph 4.247 above.

b) Add to the scope of the **AOOt term** the reopener mechanism for additional opex related to net-zero as described in Section 4 above, beginning at paragraph 4.60.

c) Add to the scope of the **AOOt term** the reopener mechanism for additional investment in respect of telecoms as described in Section 4 above, beginning at paragraph 4.86.

d) Clarify that the **NESt** term will include additional IT opex from year t=2028 which have not been included from the determined amounts under the **AOOt term**.

Pass through opex expenditure

10.10 The current licence allows for certain categories of opex expenditure to be incurred by the Licensee to added to the RAB (net of Demonstrably Inefficient and Wasteful Expenditure) as pass through expenditure. These categories of expenditure are not subject to the opex cost risk sharing incentive. This pass through opex expenditure includes the following:

a) Licence fees paid to UR under Condition 7 of the licences (**OLFt term**).

b) The opex connections amount (the **OCt term**) being the net costs (or net contributions) relating to the following types of connections:

(i) Housing sites with 12 or more domestic premises (distribution licence only).

(ii) Approved Generation Cluster infrastructure.

10.11 We intend to add additional categories of pass through opex for RP7:

a) An opex connections shared asset amount (an **OCSA_Xt term**) in relation to the connection to parts of the network that has been funded by a third party under a connection agreement with the Transmission System Operator. Our reasoning for this change is set out at Paragraph 5.7 above.

b) An opex business rate amount (an **OBRA_Xt term**) covering costs of business rates incurred, subject to the company demonstrating that the costs were efficiently incurred. Our reasoning for this change is set out at Paragraph 4.228 above.

11. The Pension Deficit Amount

11.1 Section 7 of Annex 2 of the current licence sets out the calculation of a pension deficit amount (**Pt**) which is then included in the calculation of Maximum Regulated Revenue. The amount is specified in the licence for each regulatory year in base year prices which is adjusted for inflation.

11.2 In the Competition Commission's final determination for RP5, the Commission divided the pension scheme deficit into two areas:

a) an historic deficit (representing the difference between assets and liabilities attributable to pensionable service up to 31 March 2012 and 100% funded by consumers); and,

b) an incremental deficit (representing the difference between assets and liabilities for pensionable service from the 1 April 2012 and 100% funded by shareholders;).

11.3 The Competition Commission also identified an Early Retirement Deficit Contribution liability (ERDCs), which was an enhancement to pension benefits with no additional funding, due to the scheme being in surplus that occurred between 1997-2003, of which an element was funded by shareholders. Based on the evidence, and payment profile, it was decided that 30% of the historic deficit repair allowance, would be disallowed and be funded by shareholders.

11.4 In RP5 and RP6, provision was made for additional revenue to repair the historic deficit, subject to an ERDC deduction.

NIE Networks proposals – pension deficit amount

11.5 NIE Networks has proposed that the principles established in RP5 (and retained in RP6) to split the deficit between historic and incremental deficits using the Ofgem PDAM methodology should be retained.

11.6 NIE Networks proposed that the historic deficit repair allowance should match the deficit repayment profile agreed with the trustees of the pension scheme. NIE Networks has noted that the current Triennial Valuation agreed between the Trustees and the Company projects that the historic deficit will be fully addressed before the start of RP7. Accordingly, the ex-ante allowance NIE Networks is currently seeking through the RP7 price control is zero. Because the company received funding in RP6 which it did not need to address its pension deficit, it proposed returning an equivalent amount to consumers at the start of RP7. We have adopted the value proposed by the company in the draft determination. The company has recently provided an

updated calculation of this excess value. We will review this for the final determination, including an NPV neutral adjustment, to arrive at a determined value for the final determination.

11.7 However, NIE Networks noted that the deficit can move significantly due to factors outside the control of the Trustees and it may be required that a deficit will arise in the future that will need to be funded by the Company. Given that the deficit will be driven by the historic benefits committed to and provided for participants in the scheme, the Company may be required to re-commence deficit funding following the next, or subsequent, Triennial Valuations.

11.8 Under such circumstances, NIE Networks considers it is appropriate for such amounts to be funded through the regulatory settlement; and therefore, it proposes a re-opener is included during RP7 that will cater for this. NIE Networks consider that such an approach would be consistent with the principles followed by Ofgem.

11.9 NIE Networks noted that there is currently a Pensions Monitoring Framework within the RP6 price control, whereby the Company can request engagement with UR if an increase in the deficit leads to a funding ratio below a certain threshold. NIE Networks considers that the threshold funding ratio set at RP6 of 75% is inappropriately low given the size of the pension scheme. For example, the seismic swing in the funding ratio following the March 2020 Triennial Valuation – where the deficit increased to £200m – would not have been enough to activate the conditions of the Pensions Monitoring Framework.

11.10 Accordingly, NIE Networks proposed that there is no funding ratio threshold in any future re-opener and allowances for pensions are reviewed in line with each Triennial Valuation, as they consider that this would be consistent with the approach followed by Ofgem.

UR consideration – Pension deficit amount

11.11 The NIE Networks submission reflects that, due to deficit repair payments (c.£19-20m a year paid over the period 31 March 2020 to 30 September 2023) and improvements in market returns, the historic deficit will be eliminated by the commencement of the RP7 period. In the RP7 Business Plan, the company has proposed a refund in pension allowances during the first year of the RP7 period (split between £19.8 million distribution, and £6.1million for transmission). There is no amount requested for ERDC disallowance (compared to a £30 million request for RP6).

11.12 We have noted costs of service accrual in the NIEPS have increased significantly, and that NIE Networks should explore if they can provide these benefits in future, at a lower upfront cost.

11.13 We believe that, if necessary over the RP7 period, NIE Networks should indicate to UR in a timely manner the scheme is in surplus, or that it is considered it could be in the foreseeable future. If doing so, they should accompany this with appropriate proposals to benefit the consumer.

UR proposal for RP7 –Pension deficit amount repair

11.14 We propose to maintain the general approach to the pension deficit amount set out in the existing licence following the principles set out in Annex F of the draft determination.

11.15 We propose to continue to apply a 30% allocation to EDRCs, and to accept the NIE Networks proposal to simplify the Regulatory Fraction to 100%, from the current Regulatory Fraction of 102.96%.

11.16 We do not consider the NIE Networks proposal of no funding ratio threshold in any future re-opener to be necessary at this point, and propose retaining the same 'trigger' framework as in RP6.

Implementation –Pension deficit amount

11.17 We will amend the inflation formula in Paragraph 7.1 of Annex 2 of the transmission and distribution licences and associated text to reflect the base year for RP7 of t=2022.

11.18 We will replace the relevant tables in Section 7 of Annex 2 of the transmission and distribution licences with the below which reflect the value of the historic deficit repair allowances included in RP6 which were not needed to reduce the historic deficit to zero (net of EDRC).

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
Historic deficit repair	-29.717	0.000	0.000	0.000	0.000	0.000
ERDC disallowance	8.545	0.000	0.000	0.000	0.000	0.000
Pension deficit amount (P_2022_t)	-21.172	0.000	0.000	0.000	0.000	0.000

Table 11.1: The distribution business pension deficit amount for each Regulatory Reporting Year t (£million, 2022 prices).

Period	t=2026	t=2027	t=2028	t=2029	t=2030	t=2031
Historic deficit repair	-9.054	0.000	0.000	0.000	0.000	0.000
ERDC disallowance	2.526	0.000	0.000	0.000	0.000	0.000
Pension deficit amount (P_2022t)	-6.528	0.000	0.000	0.000	0.000	0.000

Table 11.2: The transmission business pension deficit amount for each Regulatory Reporting Year t (£million, 2022 prices).

11.19 We intend to update these values for the final determination, taking account of the recent updates provided by the company and any subsequent updates, including an NPV neutral adjustment to reflect the timing of RP6 allowances.

12. The Tax Amount

12.1 The Rate of Return included in the Maximum Regulated Revenue is calculated from a vanilla weighted average cost of capital (WACC) which does not allow for tax. Section 9 of Annex 2 of the current licence sets out the calculation of a tax amount (**TAX_t**) which is a component of the Maximum Regulated Revenue.

12.2 The tax amount is calculated using the formula set out below:

$$TAX_t = TR_t / (1-TR_t) *(RET_t + DEP_t – INT_t – CA_t)$$

Where:

TR_t means the corporation Tax Rate applicable in Northern Ireland in Regulatory Reporting Year t, as specified from time to time by HMRC;

RET_t means the return amount in Regulatory Reporting Year t, calculated in accordance with paragraph 5.1 of Annex 2 of the Licence;

DEP_t means the depreciation amount in Regulatory Reporting Year t, calculated in accordance with paragraph 1.1 of Annex 2 of the Licence;

INT_t means an amount equal to the Interest on the value of the average of all RABs.

CA_t means an amount equal to the value of regulatory capital allowances in accordance with guidelines published by HMRC for the purposes of calculating Maximum Regulated Distribution Revenue in respect of that Regulatory Reporting Year, calculated on a notional basis, under the hypothetical assumptions set out in detail in the Licence which include the use of an opex amount and capex amount calculated in according to the methodology set out in the licence.

12.3 The interest rate term **INT_t** in the equation above is calculated from the average RAB multiplied by the gearing for the notional company and the nominal cost of debt as determined from Rate of Return Adjustment Mechanism.

12.4 In principle, the tax amount is calculated for the notional company. This is likely to be different from the actual tax paid by the Regulated Company

which will be calculated from actual as opposed to notional company values for key inputs and will reflect other choices the company is allowed to make when managing its tax affairs. Under Paragraph 12.34 of the existing licences, the company provides UR with (amongst other things) information submitted to HMRC on the Licensee's tax affairs; and information used for the calculation of the tax element of the Licensee's Maximum Regulated Distribution Revenue, as calculated at Paragraph 9 of this Annex.

NIE Networks proposals – Tax Amount

12.5 NIE Networks proposed to retain the corporation tax mechanism as it was applied in RP6, continuing to ensure that any HMRC corporation tax rate changes were accounted for.

UR consideration – Tax Amount

12.6 In RP7, we propose to continue to apply a vanilla WACC when calculating the return amount included Maximum Regulated Revenue. Therefore, it is necessary to make separate provision for the remuneration of tax.

12.7 UR completed an analysis of the tax reports received from NIE Networks prior to publication of the draft determination. We noted differences between actual corporation tax paid and the regulatory tax amount calculated in accordance with the licence. However, we recognise that this is to be expected given the timing differences between statutory accounting periods and the regulatory accounting period.

12.8 Differences were also noted between actual and regulatory capital allowances due to:

a) the capex incentive mechanism which isn't applied to actual tax but is applied to regulatory tax; and,

b) domestic contributions which are claimed on the tax return but not in regulatory capital allowances.

These two items worked contra to one another, going some way to reducing the differences.

12.9 UR considered these differences when reviewing the tax reports from years April 2012 to March 2020. The difference in the aggregated regulatory tax amount and corporation tax paid by the company over that full period combined was immaterial. Therefore, we have concluded that the regulatory mechanism is reasonably consistent with the actual tax paid by the company over the medium term. On this basis, we have concluded that we should

retain the principles underpinning the calculation of the tax amount (**TAX_t**) as set out in Section 9 of Annex 2 of the existing licence.

UR proposal for RP7 – Tax Amount

12.10 UR agrees with NIE Networks proposal to retain the corporation tax mechanism as it was applied in RP6.

12.11 The notional gearing of 45% for RP6, written into paragraph 9.1 of Annex 2 of the current licence will be amended to the gearing used in the calculation of the rate of return for the RP7 final determination. The notional gearing used in the draft determination was 55%. This will be subject to review and a determined value confirmed in the final determination.

12.12 UR intends to complete further work in the review of tax in the early approach stage to RP8, including a review of the inclusion of the capex incentive mechanism and domestic contributions in the tax calculation.

13. Revenue Protection Service Incentive Amount

13.1 Section 10 of Annex 2 of the current distribution licence sets out the calculation of a revenue protection incentive amount (**$RPSI_t$**) in respect of:

a) any money recovered by the Licensee from an electricity consumer in the exercise of the Licensee's powers in relation to illegal abstraction of electricity;

b) any money recovered by the Licensee from third parties to cover the cost of the network repairs or other repairs associated with illegal abstraction; and

c) any income generated by the Licensee from the provision of revenue protection services to third parties.

13.2 To incentivise NIE Networks to identify illegal abstractions and recover revenue due, the Section 11 of Annex to of the Licence allows NIE Networks to retain 50% of the additional revenue recovered.

13.3 We intend to retain this Revenue Protection Service Incentive in RP7.

14. The Correction Factor Amount

14.1 Section 11 of Annex 2 of the current licence sets out the process for calculating a revenue correction amount which is added to the Maximum Regulatory Revenue which may be recovered for a Regulatory Year to reflect the difference between the Maximum Distribution Revenue for the previous Regulatory Year and the actual Regulated revenue recovered, subject to an adjustment for interest at a defined Average Specified Rate.

14.2 The correction factor corrects for forecasting errors both in the calculation of Maximum Distribution Revenue and customer numbers and volumes at the time tariffs were calculated. It returns the company to the position it would have been in had it been possible

14.3 We propose to maintain the calculation of a correction factor amount (Kt) using the methodology set out in the current licence. We will amend Section 11 of Annex 2 to align dates and years to reflect the RP7 period, and amend the name of the KRP5 term to KRP6.

14.4 The Average Specified Rate ($\mathbf{I_t}$) is currently defined in Section 1 of Annex 2 of the Licence as:

means the arithmetic mean of the daily base rates of Danske Bank Limited (or such other bank as the Authority shall specify from time to time) current from time to time during the period in respect of which the calculation falls to be made.

14.5 In line with other recent licence modifications by UR for other network companies, we propose to modify the Average Specified Rate to replace the use of daily base rates of Danske Bank Limited with daily base rates of the Bank of England. This will remove reliance on a named bank and maintain consistency of approach by UR on the use of base interest rates across price controls.

15. Duration of the Charge Restriction Conditions

Duration of the charge restriction condition

15.1 The duration of the charge restriction condition set out in Annex 2 of the current transmission and distribution licences is limited by Section 15 of Annex 2 of the current Licence – Duration of the charge restriction condition. For the current RP6 period, which ends on the 31 March 2025, the Distribution Charge Restriction Conditions outlined in Paragraph 3.2 of Annex 2 do not apply to tariff years from 1 October 2025 onwards. In the absence of modifications to those provisions, the Licensee shall not be able to increase (in nominal terms) any of the tariffs or charges contributing to its Regulated Distribution Revenue above the levels applicable on 1 October 2024.

15.2 We propose to modify the relevant dates in Paragraph 15.2 of Annex 2 of the current licence to the 1 October 2031 and 1 October 2030 respectively to reflect the proposed end date of RP7 of 31 March 2031.

15.3 This condition provides certainty on the restriction on charges in tariff years after the end of RP7 if the licence has not been modified to give effect to a new price control.

Disapplication

15.4 The process for “disapplication” in Section 15 of Annex 2 of the current Licence allows the Licensee to ask for the Charge Restriction Conditions to seek to have effect (in whole or in part, as may be the case). In effect, this gives the Licensee the ability to secure modifications to the Charge Restriction Conditions for the period after the end of the current price control either by UR, or failing that, the Competition and Mergers Authority (CMA).

15.5 Paragraph 15.5 of Annex 2 of the current licence shall not have effect shall have effect earlier than the date which is the later of: a) the date occurring 18 months after delivery of the Disapplication Request; and b) 31 March 2025.

15.6 We propose to modify the relevant date in Paragraph 15.2 of Annex to the 31 March 2031, consistent with the end date of RP7.

16. Next Steps

16.1 This annex to the RP7 draft determination sets out our proposals on the design of the price control. Its focuses how we intend to either maintain or modify Annex 2 of the existing transmission and distribution licences which sets out how the Maximum Regulatory Revenue will be calculated from the decisions and determined values of the RP7 determination. It includes a description and explanation of the mechanisms which may be used to vary the price control during its implementation.

16.2 It is published for consultation and we welcome feedback from consumers, stakeholders and NIE Networks on how we propose to develop the design of the price control for RP7 including our proposals to amend the various mechanism which allow the price control to be varied.

16.3 When we publish the RP7 final determination we will also consult on modifications to the licence which will give effect to the final determination.

16.4 In the interest of transparency and in line with best practice regulation, we consider it important to give NIE Networks appropriate notice of any licence modifications we intend to make and to offer adequate opportunities for engagement on such proposals. Therefore, we intend to provide NIE Networks with details on the proposed licence modifications, including advance sight of the proposed tracked changes to its licences in advance of the consultation. While this is not intended to achieve agreement on the scope and effect of the licence modifications, it will help ensure that there is a clear understanding of the proposed modifications and, to the extent possible, agreement on wording and formulae before we published licence modifications for consultation.