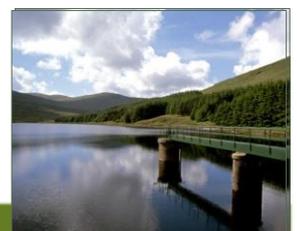


Requirements and Guidance  
on Transmission Network  
Pre-construction Projects costs

Exhibit 1 – TNPP Guidance Document  
09 March 2018



# About the Utility Regulator

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

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

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

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

## Our Mission

Value and sustainability in energy and water.

## Our Vision

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

## Our Values

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

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

## Abstract

This paper sets out the Utility Regulator's (UR's) guidance for TNPP (Transmission Network Pre-Construction Projects) applications by the electricity Transmission System Operator for Northern Ireland (SONI).

The process has been formalised to implement the Competition Markets Authority (CMA)'s decisions on the SONI Price Control 2015-2020 appeal.

## Audience

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

## Consumer impact

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

# 1. Requirements and Guidance on the Cost Recovery Process for TNPPs

- 1.1 The following requirements and guidance apply to applications by SONI for the approval of costs in relation to Transmission Network Pre-Construction Projects (TNPPs). The purpose of this document is to codify the process by which SONI can apply to UR to recover its costs for TNPPs, in order to provide certainty.<sup>1</sup>
- 1.2 It also provides guidance on how we will apply this process and on what information SONI should provide to us. In this regard, we recognise that the work is uncertain and evolves over time. We further recognise that these submissions will need to be consistent with other statutory requirements that SONI is obliged to comply with.
- 1.3 A TNPP is defined in paragraph 1.1 of Annex 1 to SONI's electricity transmission licence<sup>2</sup> as follows:

*'a transmission network project:*

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

- 1.4 Under paragraph 9.1 of Annex 1, SONI may apply to the UR, in accordance with these requirements and guidance, for the approval of activities which:
- a) it has or will carry out in respect of a project which is necessary for the purposes of developing the transmission system, and

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<sup>1</sup> In accordance with the Final Determination and Order from the Competition and Markets Authority dated 10 November 2017.

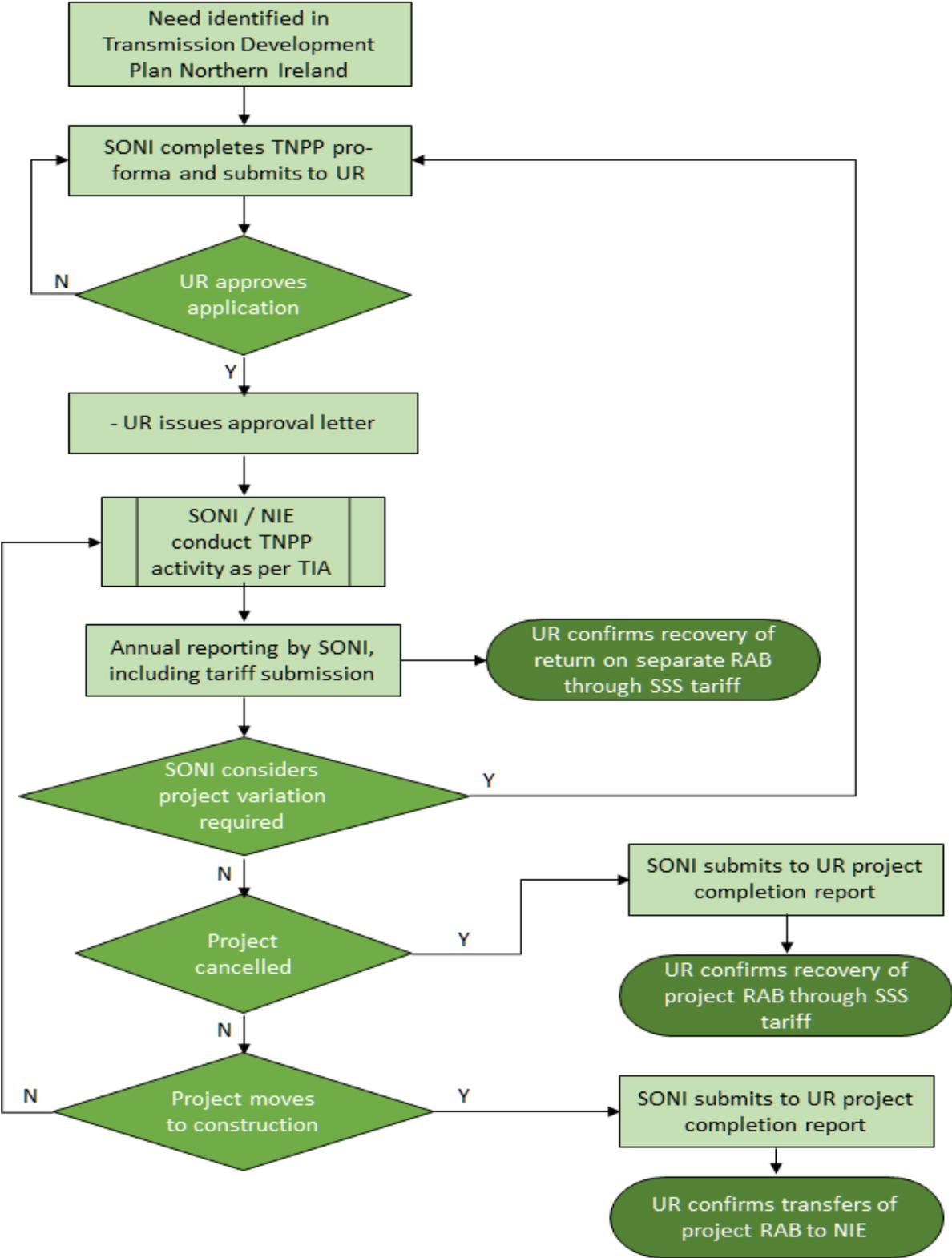
<sup>2</sup> Note: the text presented in this section (and references to licence conditions) is based on the licence modifications currently being consulted on.

- b) were or are required to progress the project from the conceptual design stage to, but not including, the construction stage.
- 1.5 Under paragraph 9.2 of Annex 1, SONI may make a claim to the UR, in accordance with these requirements, for the approval of an amount of costs incurred, or to be incurred, by it in undertaking those activities.
- 1.6 Paragraph 10.2(b) of Annex 1 requires SONI to provide to the UR all information specified in this document.
- 1.7 This document sets out the information that must be provided by SONI in an application for approval of each TNPP and the estimated costs associated with it, and the process which the UR will follow in deciding on that application.
- 1.8 It also sets out the information that SONI is required to provide during the life of a TNPP and the process for applying for variation to the cost cap approved for each TNPP. Finally, this document provides guidance on the UR's approach to reviewing the costs of approved TNPPs.
- 1.9 We recognise that under other aspects of the legal framework applicable to SONI, the Transmission System Operator [TSO] is required to keep an open mind about the eventual outcomes of some of the processes it will follow to deliver the pre-construction activities.

### **Overview of cost recovery process for TNPPs**

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

**Figure 1: Overview of TNPP cost recovery process**



## **Ex-ante approval of pre-construction projects**

### ***SONI's application for approval***

- 1.11 SONI (in consultation with NIE Networks and the Republic of Ireland TSO) will identify the need for the development of the transmission network through the Transmission Development Plan Northern Ireland (TDPNI) – as required under Condition 40 of SONI's Transmission Licence. This requirement for SONI to develop, consult on and publish annually a ten-year TDPNI came into effect on 30 November 2017.
- 1.12 The TDPNI should identify efficient measures to guarantee the adequacy of the transmission system and security of supply, within the context of SONI's licensed activities. SONI is expected to publish a draft of the plan for consultation each year and a final version, following approval by the UR, in line with a timetable agreed with the UR.
- 1.13 Where SONI has identified the nature of a project(s) to address a need, and expects to start incurring pre-construction costs in the near future, it should apply to the UR for approval. That application must take the form of the submission to the UR of the pro-forma for TNPPs appended to this document, and discussed further below.
- 1.14 The costs of SONI's initial activities in developing and completing the pro-forma for TNPPs are covered by its ex-ante opex allowance. External cost [not allowed for in the price control] may be incurred as part of the completion of the application. Where this is the case, this should be explained, separately identified and included in the TNPP capital cost submission.
- 1.15 Following approval by the UR, SONI's TNPP costs (not including the costs of its application for approval) are remunerated through a return on a side-RAB for TNPPs as set out in SONI's licence.

### ***Timing of application***

- 1.16 SONI can submit these pro-forma(s) at any time but should use its best endeavours to submit completed pro-forma templates:
- a) at least six months in advance of project initiation; and
  - b) by 1 April in each year if they are to be included in tariffs from the following October.
- 1.17 For applications submitted after 1 April and which do not have required

approvals in place for the next tariff year, the UR may exercise discretion as to what can be recovered from tariffs in that year. Any difference between this and the UR's subsequent approval will be subject to the correction factor.

### ***Format of application***

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

- Project Plan;
- Risks and opportunities;
- Budget.

1.22 The pro-forma is a general template covering the minimum requirements. SONI should complete all sections. SONI may modify or enlarge the tables and sections, as required, to provide information to justify the pre-construction activities necessary to develop the project to the point of handover for construction, including the forecast expenditure.

1.23 This pro-forma should be used for all TNPPs, regardless of scale or complexity. However, we would expect SONI to be able to justify the need for expenditure on smaller and less complex TNPPs more briefly than for larger and more complicated TNPPs.

1.24 Ahead of SONI initiating the pre-construction activities, we recognise that some of the information it is required to provide will be uncertain (for example, the preferred solution, which is dependent on public consultation, may be unknown). Within its application SONI can address uncertainty in several ways:

- a) SONI is required to provide an assessment of the risks and unknown factors associated with the pre-construction activities, along with the likelihood of the risk and the impact if it is realised, that can be used to inform the extent of uncertainty (for example, on costs or timelines).
- b) In relation to its cost forecasts, SONI can include contingency. Allowances for contingency should be explained and justified by reference to the risks.
- c) Once a TNPP has been pre-approved, if there are changes in the scope and/or costs of the project such that SONI considers it might exceed the budget cap we have set for the project, SONI can apply for a project variation. This part of the process is separately considered further below.

## **The UR's assessment and response**

1.25 Through the TDPNI and other engagement with SONI, the UR would expect to be aware of the need for, and have some knowledge of, any proposed TNPPs ahead of SONI's application.

1.26 The UR will assess SONI's application in line with its duties. If the TNPP is

considered a matter for the SEM Committee, the UR will forward the application to the SEM Committee for decision, and the process described herein may not apply unless the SEM Committee decides that it should apply.

- 1.27 At an early stage, the UR will review the completeness of the information provided by SONI. If required information is missing and could reasonably be expected to be available, the UR may request SONI to provide additional information or resubmit the application. UR will inform SONI if the request is part of the process or if a resubmission is required [in which case the timetable will be reset].
- 1.28 Where appropriate, the UR will publicly consult on the TNPP in SONI's application. During the course of the assessment, and ahead of any decision, the UR may engage with SONI, NIE Networks and other relevant stakeholders, while being mindful of the obligations placed on SONI to consult with stakeholders as part of the pre-construction process.
- 1.29 The UR will request clarification on, or expansion of, any information that is unclear or, potentially, inadequate. The UR will raise any potential concerns over the application (e.g. as to the choice of the preferred option or the forecast of costs) or objections with SONI during the assessment, noting the obligations placed on SONI to consult with stakeholders around the choice of solution. The UR may decide to use external advisers to support assessment of SONI's applications. The UR will comply with its legal obligations in terms of Freedom of Information and may withhold commercially sensitive information from publication where lawful and appropriate.
- 1.30 The UR will confirm in writing to SONI the outcome of its assessment of the TNPP application within four months of receiving the required information. If circumstances allow, the UR will complete the assessment in less than four months. Circumstances which could facilitate a quicker assessment may include:
  - a) Initial submission of the relevant information required to enable the UR to make a complete assessment.
  - b) Lower value projects (which could potentially be approved by the CEO, rather than the Board).
  - c) Less complex projects (which are more straightforward to justify and assess).

d) Projects which SONI have previously engaged with the UR on (in general, the UR would not expect TNPP applications or their broad content to come as a surprise).

- 1.31 For each approved TNPP, the UR will set a maximum amount of approved expenditure that can be added to the side-RAB for that project. During the life of a TNPP, such expenditure will be remunerated through a return on the side-RAB in line with paragraph 2.4 of Annex 1 to SONI's licence.
- 1.32 In the event that the UR is minded to not approve the project, the UR will confirm this in writing to SONI along with its objections and, if appropriate and following the necessary consultation, issue a derogation under Condition 20(6) of SONI's licence<sup>3</sup>.
- 1.33 The UR will publish the outcome of its assessments (both approvals and rejections) of SONI's TNPP applications. Ahead of publication, these will be shared with SONI, providing them the opportunity to identify any publication concerns.
- 1.34 In the case of project approvals, the UR would expect to include the maximum amount of expenditure that can be recovered through tariffs, but not detailed breakdowns of expenditure.
- 1.35 SONI can proceed with pre-construction activities ahead of our approval, but will do so at risk. In practice, as a result of the TDPNI process and SONI's other engagement opportunities with the UR, this risk ought to be minimal.
- 1.36 However, for the avoidance of doubt, if SONI has conducted work and incurred efficient costs ahead of our decision, then such costs can be recovered, subject to the cap we set, if we approve the TNPP. Conversely, if SONI has conducted work ahead of our decision and we do not approve SONI's TNPP application, then these costs cannot be recovered through tariffs.

## **Reporting on approved TNPPs**

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

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<sup>3</sup> Under Condition 20(6), the UR may relieve SONI of any obligations it has under the Transmission System Security and Planning Standards, the Distribution System Security and Planning Standards, the Grid Code or the Transmission Interface Arrangements (TIA).

## ***Annual reporting***

1.38 SONI must report to the UR annually on the progress of ongoing TNPPs, through completion of the pro-forma at Annex B to this document. The completed pro-forma will provide an overview of the progress in the past year and a comparison to the original baseline. SONI needs to provide in this pro-forma:

- a) Commentary on the progress and status of the project, including review of the cost benefit analysis of the project, if applicable.
- b) An up to date project plan, including commentary on changes.
- c) An up to date risk/uncertainty log, including commentary on changes.
- d) Costs incurred in the year and reasons for any divergences from both the baseline and previous best estimate forecasts.

1.39 In approving the original TNPP we may identify additional reporting requirements if we consider this appropriate. This may be the case, for example, with large projects, or those of particular significance.

1.40 SONI should provide this annual report for each of its approved TNPPs by 1 April of each year. Annual reporting format and submissions may develop over time. This reporting will also be considered in line with ongoing work on TSO cost and output reporting development.

1.41 The UR will review SONI's annual reports. Any costs assessed at that point to be demonstrably inefficient or wasteful (DIWE) will not be included in the side-RAB for TNPPs. This review will be conducted in line with the guidance and procedures published by the UR on DIWE.<sup>4</sup>

1.42 Consideration may be given to further information requests being made to the TSO. The UR may also employ a third party to conduct an audit of the relevant detail.

1.43 Should we have concerns around the potential for costs to be assessed to be DIWE, these will be raised with SONI who will be given opportunity to respond. This response will be considered prior to any decision being made.

1.44 In the event that reductions are sought to adjust for DIWE, we will write to SONI and advise of the rationale and quantum of said adjustment. The

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<sup>4</sup> [DIWE guidance](#).

intention is that this decision will generally be published.

- 1.45 The UR will also review staff costs to ensure that a boundary is maintained between network planning staff funded through ex-ante opex allowances and those funded under the TNPP uncertainty mechanism.

### ***Bi-Monthly oral updates***

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

### **Project variation**

- 1.47 In the event that SONI considers that the approved cost cap set for a TNPP will be breached, it may submit an application to increase the cap. SONI can make such project variation requests at any time, but should endeavour to do so in advance of the cap being exceeded.

- 1.48 To apply for a project variation, SONI should resubmit the TNPP pro-forma in Annex A to this document, along with an explanation, supported by evidence, as to why additional spend is both efficient and necessary. The TNPP pro-forma should cover the full costs of the project (not just the additional costs subject to the project variation application). Although SONI should resubmit the whole pro-forma, the following are the key sections that SONI will need to revisit:

- a) Part B, Section 5: Cost and Benefits Analysis & Identification of Preferred Option. SONI should review the Cost Benefit Analysis (CBA) for the project and confirm that it remains the preferred option, if a CBA is applicable for the project.
- b) Part C, Section 6: Pre-Construction Project Plan. SONI should provide an updated project plan, alongside a commentary on the changes from the plan in the original submission and why these are needed. For example, these changes may relate to additional activities or extension of existing activities to address changes in scope.
- c) Part C, Section 8: Pre-Construction Project Budget. SONI should provide an updated cost forecast, noting the changes from the original forecast and why these are needed. For example, these changes may relate to additional activities required to address

changes in scope, or to increases in costs outside of SONI's control. This commentary can be provided by putting comments against individual cost items in the spreadsheet accompanying this section of the pro-forma, and / or in the comments section in the pro-forma itself. To the extent that actual costs have been incurred, these should be included in the cost spreadsheet.

- 1.49 Our assessment of the project variation will follow that for initial TNPP applications. That is, we will review the completeness of the submission, engage with SONI (if necessary) for any clarifications, review the cost forecasts (reserving the right to call on external support), and confirm the outcome of our assessment (including a revised budget cap) in writing to SONI. We will publish our decision on each project variation application, as with each new TNPP application.
- 1.50 As with the initial TNPP application, we will assess SONI's TNPP project variation applications within four months of the receipt of the required information, but sooner if circumstances allow.
- 1.51 There may be some circumstances in which SONI is required to incur costs beyond its approved cap on an urgent basis. Where SONI cannot make an application to increase its cost cap in advance of incurring costs, it may make an application for variation on a retrospective basis.
- 1.52 Where it does so, we will expect SONI to make an application for variation as soon as possible, and, as part of that application, to justify why costs needed to be incurred urgently.
- 1.53 We would not however ordinarily expect to receive such a retrospective application where a degree of contingency has been included in the initial cost cap.

### **Ex-post process for review of approved TNPPs**

- 1.54 The outcome of each TNPP will be a preferred construction option with a completion report detailing the:
  - a) Project plan and timelines;
  - b) Relevant design information;
  - c) Capital cost estimates;
  - d) Relevant technical assessments;
  - e) Information related to completed activities such as:

- Planning consents
- Environmental constraints
- Permits
- Wayleaves/easements

f) Full detail of the pre-construction phase costs.

- 1.55 Following completion of the TNPP, SONI should submit to the UR its completion report, and a breakdown of costs incurred (as a minimum, the breakdown of costs should be as in Section 4 of the ongoing reporting pro-forma in Annex B).
- 1.56 SONI should provide sufficient information for the UR to adequately perform its review. The UR will engage with SONI if it considers the information provided is unclear or, potentially, inadequate.
- 1.57 To the extent that the information is contained in the Transmission Project Instruction, that SONI is required to provide to NIE Networks under the TIA, or the Transmission Project Agreement, agreed under the TIA, then SONI may submit this to the UR.
- 1.58 The UR will review the costs with a view to determining the final pre-construction RAB associated with the project. In conducting the review, the UR will confirm that the amounts are no greater than or below the approved cap (including any variations) and that none of the expenditure is demonstrably inefficient or wasteful. The UR may decide to use external advisers to support its review and conduct audits of SONI processes and data.
- 1.59 Any transfer of monies between SONI and NIE Networks related to the TNPP work covered by this process must comply with the requirements set out in the TIA and approved by the UR.
- 1.60 Where SONI decides to cancel a previously approved TNPP it must submit to the UR a report detailing the reason for the cancellation, the work undertaken, and a breakdown of the costs incurred (as a minimum, the breakdown of costs should be as provided for in Section 4 of the ongoing reporting pro-forma in Annex B).
- 1.61 SONI should provide sufficient information to enable the UR to review whether any expenditure was demonstrably inefficient or wasteful. In undertaking its assessment that any spend is DIWE, the UR will engage with

SONI if it considers any information that SONI has provided is unclear or, potentially, inadequate.

- 1.62 The UR will review these costs and determine the amount that SONI may recover through the SSS tariff under paragraph 2.2(a)(iv) of Annex 1 to its licence. The UR may decide to use external advisers to support its review.

### **Regularising past TNPPs**

- 1.63 SONI has been undertaking work on TNPPs. In order to recover costs in respect of these currently ongoing projects, SONI must submit TNPP applications using the pro-forma in Annex A to this document for each of its ongoing TNPPs. This may include actual and forecast spends, but should be completed in a consistent price base.
- 1.64 In addition, SONI should submit for each of its ongoing TNPPs a breakdown of actual spend in each year to date. As a minimum, the breakdown of costs should be as in the cost spreadsheet in Section 4 of the ongoing reporting pro-forma in Annex B.
- 1.65 For these purposes, SONI may complete the spreadsheet in Section 4 of Annex B, but SONI does not need to complete the rest of the ongoing reporting pro-forma. For the avoidance of doubt, SONI will have to comply with ongoing reporting for these projects in subsequent years
- 1.66 The UR will review the submissions for ongoing TNPPs, following the process described above, issuing approvals as appropriate. Once approved, the costs incurred on ongoing TNPPs will be added to the side-RAB and SONI will earn a return on those costs.

### **Review of and amendments to these Requirements and Guidance**

- 1.67 This document applies to the process for SONI's applications for TNPPs in the current price control period, which ends in 2020. The first year in which tariff approvals will be informed by revenues related to actual TNPPs, applied for under this document, will be 2018/19.
- 1.68 The UR may update this document, in consultation with SONI, in the light of experience. The UR will also decide, subject to consultation, whether the same overall process for TNPPs should be applied in the next price control, which is due to take effect from 1 October 2020.
- 1.69 This document does not cover any future process for the recovery of costs associated with TNPPs that a party other than NIE Networks takes on

construction. To the extent that the current process for TNPPs changes to accommodate SONI exercising step in rights under the TIA (or an additional process is introduced following approval from the UR), or a third party taking on construction, the UR may amend this document accordingly.

## **SONI's remuneration of approved TNPPs**

- 1.70 Under paragraph 2.4 of Annex 1 to its licence, SONI may recover a return on the efficient costs that it actually incurs on each TNPP up to the cost cap approved by the UR.
- 1.71 Where a TNPP proceeds to construction, SONI will be able to recover the value of its efficiently incurred costs up to the approved cap from NIE Networks under the TIA. The value of those costs will be removed from the TNPP side-RAB and SONI will not earn a future return on them.
- 1.72 The processes that will be followed for NIE Networks will be set out in its licence and related documents. NIE Networks will pay SONI upon project transfer in accordance with the arrangements set out in the TIA once approved by the UR.
- 1.73 If the UR is satisfied that an abandoned project will not proceed to construction [following consultation with SONI] but is not actioned by SONI, the UR may determine that monies should be removed from the side-RAB. Where a TNPP is cancelled by SONI, or by the UR, SONI will be able to recover the value of its efficiently incurred costs up to the approved cap through the SSS tariffs. Again the side-RAB will reduce by a corresponding amount.