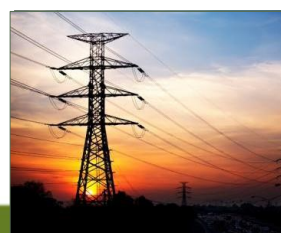


# Requirements and Guidance on Excluded SSS/TUoS costs

Exhibit 2 – Dt 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 cost recovery of uncertain revenue (D<sub>i</sub>) 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 for Excluded SSS/TUoS Costs [Dt Applications]

## Overview of cost recovery process for Dt submissions

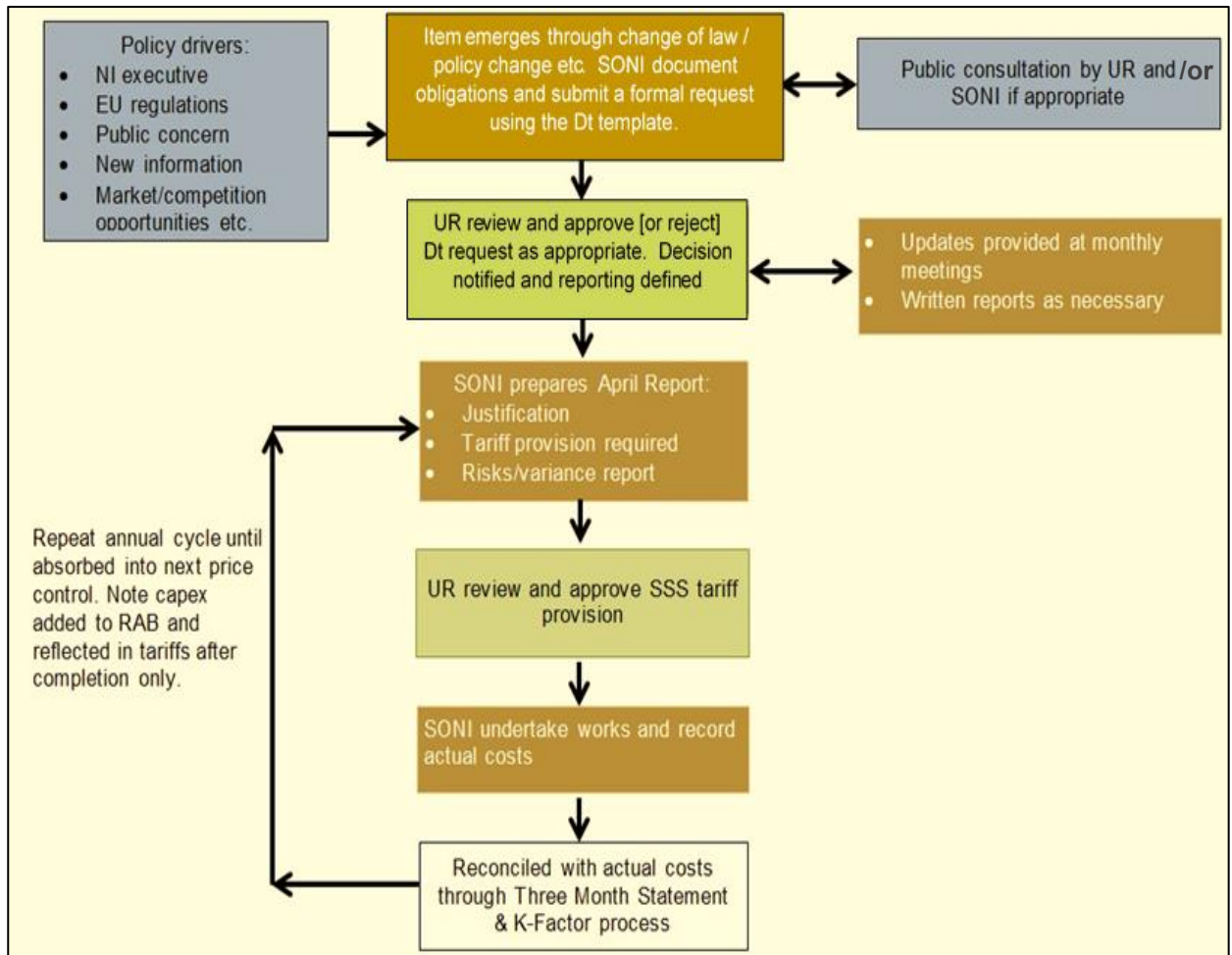
- 1.1 The following requirements and guidance apply to applications by SONI for the approval of  $D_t$  submissions. The purpose of this document is to codify the processes by which SONI can recover its costs in respect of  $D_t$  submissions.<sup>1</sup>
- 1.2 This document also provides guidance on how we will apply these processes and on what information SONI should provide to us. We recognise that  $D_t$  submissions will concern costs which are by their nature uncertain.
- 1.3 SONI must make a  $D_t$  application under paragraph 8.1 of Annex 1 to its licence. We expect SONI to be able to recover its efficiently incurred costs up to the approved cap. The guidance sets out that SONI may recover efficiently incurred costs in the following circumstances:
  - Up to the approved cap;
  - Where the cap has been amended subject to approved  $D_t$  variations; and;
  - Where the cap has been amended subject to retrospective UR approval.
- 1.4 We note that some  $D_t$  applications largely fall outside of SONI's control, for example, because they relate to statutory obligations or are needed to satisfy public policy perspectives. Where appropriate, these costs may be treated more akin to a managed pass through.
- 1.5 The template should be completed for every  $D_t$  project. However, it is recognised that large projects (over £1m) may require more in-depth justification and supporting documentation. This should be submitted alongside the template for the UR's consideration.

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

1.6 The basic process is set out as follows:

**Figure 1: Overview of D<sub>t</sub> cost recovery process**



1.7 In summary this can be defined as follows:

- Step 1 – Issue identified. Consult with stakeholders as necessary.
- Step 2 – SONI submit formal D<sub>t</sub> request using template.
- Step 3 – The UR review and approve (or otherwise) a capped amount.
- Step 4 – Decision published and reporting requirements set.
- Step 5 – Approved amounts included in tariffs.
- Step 6 – SONI undertake work and report actual costs.
- Step 7 – SONI detail the K-factor in event of underspend.

- 1.8 Given the differences between projects and spends, it is likely that bespoke reporting arrangements will be required. We intend to notify SONI of our expectations around reporting at the time of decision publication.

### **Ex-ante approval of $D_t$ spends**

- 1.9 As identified above, SONI must apply to the UR for approval for each  $D_t$  by submitting required information (e.g. on need, estimated costs, timelines and risks) as defined in the template.
- 1.10 Within four months of the UR receiving the submission, we will either approve the application (and set an initial budget cap for the project) or reject it (setting out the reasons).
- 1.11 If the submission does not contain the required detail, the UR will request this from SONI. In certain circumstances the UR may request a re-submission in which case a decision will be taken on the updated application within four months of resubmission.
- 1.12 For smaller projects it is anticipated that the approval time could be reduced to two months, though the formal four month timeframe will apply. Circumstances which could facilitate a quicker assessment may include:
- a) Lower value projects (which could potentially be approved by the CEO or Director, rather than the Board).
  - b) Less complex projects (which are easier to justify and assess).
  - c) Projects which SONI have previously engaged with the UR on (i.e. the UR would not expect applications or their content to come as a surprise).

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

- 1.13 Ideally submissions should be made six months ahead of project initiation. Submissions can be received at any time throughout the year. However any proposal received after the 1 April in any year may not have the required approvals in place for the next tariff year.
- 1.14 In these circumstances the UR may exercise discretion as to what is allowed through tariffs in the following year. This may in any event be different from the approved cap and would be subject to K-factor adjustment accordingly.

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

- 1.15 Formal submission should be made using the attached template.

Supporting detail may also be required for more complex projects or where different options are considered. This detail should be submitted at the same time as the formal template, though the UR may request clarifying material. Except in certain circumstances as indicated by the UR, this clarifying material does not constitute a re-submission for the purposes of calculating timelines for approval.

1.16 Additional detail might include where relevant:

- NPV analysis (if costs being incurred over a number of years);
- Cost Benefit Analysis (CBA);
- Supporting justification / calculations;
- Cost profile (if being incurred over a number of years); or
- Option / Risk analysis.

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

1.17 The UR will assess SONI's application in line with its duties. At an early stage, we will review the completeness of the information provided by SONI.<sup>2</sup>

1.18 If required detail is missing, the UR will request SONI resubmit the application or provide further data. Where further data is requested, we would anticipate that SONI should be able to facilitate any requests within ten working days in order to aid timely approval of submissions.

1.19 Where appropriate, the UR and/or SONI will publicly consult on the D<sub>t</sub> application, though this is unlikely to be required in most circumstances.

1.20 During the course of the assessment, and ahead of any decision, the UR may engage with SONI regarding the application. For example, to request clarification on, or expansion of, any information that is unclear or potentially inadequate.

1.21 The UR will raise any potential concerns over the application (e.g. as to the choice of the preferred option or the forecast of costs) or objections with SONI during the assessment. We may also decide to use external advisers to support assessment of SONI's applications. The UR will comply with its

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<sup>2</sup> UR would aim to undertake such a review and notify SONI within one month of application, if a full resubmission is required.

legal obligations in terms of Freedom of Information and may withhold commercially sensitive information from publication where lawful and appropriate.

- 1.22 Confirmation will be provided in writing to SONI as to the outcome of the assessment. For each approved application, we will set a maximum amount of expenditure that can be recovered through tariffs.
- 1.23 Approved expenditure is recoverable in the first instance through tariffs. Subsequent adjustments are then made using the K-factor for actual expenditure that is properly and necessarily incurred (up to the capped maximum). The  $D_t$  approval letter will also be published on the UR's website.
- 1.24 In the event that the UR is minded to not approve the project, this will be confirmed in writing to SONI along with supporting rationale. Decisions will be published on the UR website, subject to SONI views on redactions. Ahead of publication, these will be shared with SONI, providing them the opportunity to identify any publication concerns.

### ***Reporting on approved costs***

- 1.25 SONI must provide reports to the UR in such a format, and by such times as specified by the UR as part of its approval decision. Any detail requested will be proportional and necessary for the purposes of regulatory scrutiny and oversight.
- 1.26 It is our intention to advise and agree reporting requirements with SONI on approval of any costs.

### ***Annual reporting***

1.27 Ongoing reporting will include:

- 1) The April Submission (before 1 April each year) consisting of:
  - Information relating to current  $D_t$  projects and those expected in the next 18 months.
  - Completed formal  $D_t$  requests for the upcoming year.
  - A summary of outturn for the previous year.
  - Latest best estimate of current  $D_t$  project spends.
- 2) The Three Month Statement (before 31 December each year) consisting of:



- Actual cost data for any  $D_t$  items in the completed year.
- K-factor adjustments for the previous tariff year.
- Auditor's Report.

1.28 The UR will review actual spend and consider whether the amounts are below the cap and that none of the expenditure is demonstrably inefficient or wasteful (DIWE).

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

### **Project variation**

1.30 The UR recognises that some  $D_t$  costs can be uncertain or outside SONI's control. In the event that the approved cost cap will be breached, SONI may submit an application to increase the cap. SONI can make such variation requests at any time, but should endeavour to do so in advance of the cap being exceeded.

1.31 To apply for a variation, SONI should resubmit the pro-forma in Annex (c) to this document identifying that it is a variation on an existing cap. This should be provided alongside an explanation, supported by evidence, as to why additional spend is both efficient and necessary (or mandatory).

1.32 The pro-forma should cover the full costs of the project (not just the additional costs subject to the variation application). The UR will evaluate and approve (or reject) in line with the process detailed above.

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

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

1.35 Where costs are within SONI's control, overspend without approval will not be allowed in tariffs. The risk of overspend of uncertain allowances is recognised. However this has been separately remunerated and accounted

for by the CMA and the UR in the revised licence N<sub>t</sub> term.<sup>3</sup>

### **Ex-post process for review of approved Dt costs**

- 1.36 The UR will review actual spend as reported in the Three Month Statement. In conducting the review, the UR will consider whether the amounts are not greater than or below the cap and that none of the expenditure is demonstrably inefficient or wasteful (DIWE). This review will be conducted in line with the guidance and procedures published by the UR on DIWE.<sup>4</sup>
- 1.37 Consideration may be given to further information requests being made to the TSO. The UR may also employ a third party to conduct an audit of the relevant detail.
- 1.38 Should we have concerns around the potential for costs to be assessed to be DIWE, these will be raised with SONI who will be given opportunity to respond. This response will be considered prior to any decision being made.
- 1.39 In the event that reductions are sought we will write to SONI and advise of the rationale and quantum of said adjustment. The intention is that this decision will generally be published and changes factored into the K-factor calculation for future tariffs.

### **Review of and amendments to this Guidance**

- 1.40 These requirements and guidance apply to the process for SONI's applications for D<sub>t</sub> items in the current price control period, which ends on 30 September 2020.
- 1.41 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 should be applied in the next price control, which is due to take effect from 1 October 2020.

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<sup>3</sup> See CMA final determination, p276, para 12.77.

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