

NI TSO Price Control SECG3 28 November 2018



Agenda

Time	Topic	Presenters(s)
10:00	Registration/tea/coffee at UR	
10:05	Review agreed actions and markers	Tanya Hedley
10:10	TSO services and good outcomes	SONI and UR
12:30	Lunch and refreshments	
13:00	Business plan assessment, assurance and transparency	Ciaran MacCann

UR chair will begin to close the SECG session at 2.30

TSO services and achieving good
outcomes

A nighttime aerial photograph of a city and harbor, likely San Francisco, viewed from a hillside. The city lights are reflected in the water, and the sky is a deep blue with some clouds. The foreground shows dark, silty hills.

SONI: Performance - Expectations and Evolution?

SONI Price Control Stakeholder Expert Challenge Group

28 November 2018



Context



Purpose of presentation

Transparency and Accountability

- We welcome discussion on where we should be prioritising effort and innovation to drive additional value for NI consumers in terms of the services that SONI TSO provides.

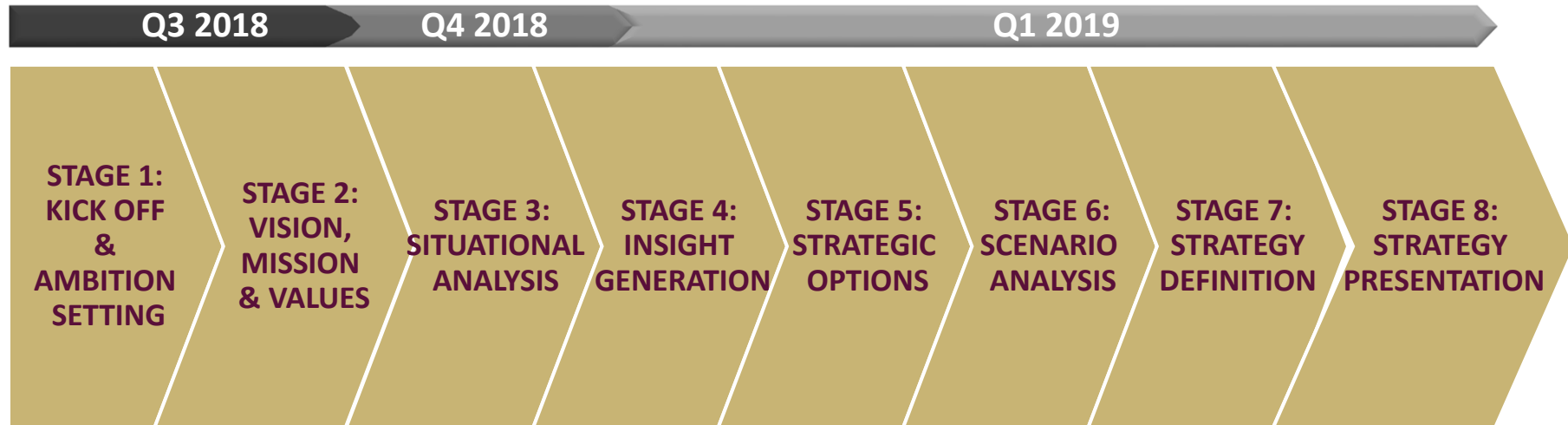
Evolution:

The 2025 SONI TSO

- We welcome views on what is expected from SONI as TSO as a minimum and where improvements could be driven.



Strategy Development Process



↑
We are here

STAKEHOLDER ENGAGEMENT

Staff Engagement

External Stakeholder Engagement



Refresh of SECG 2

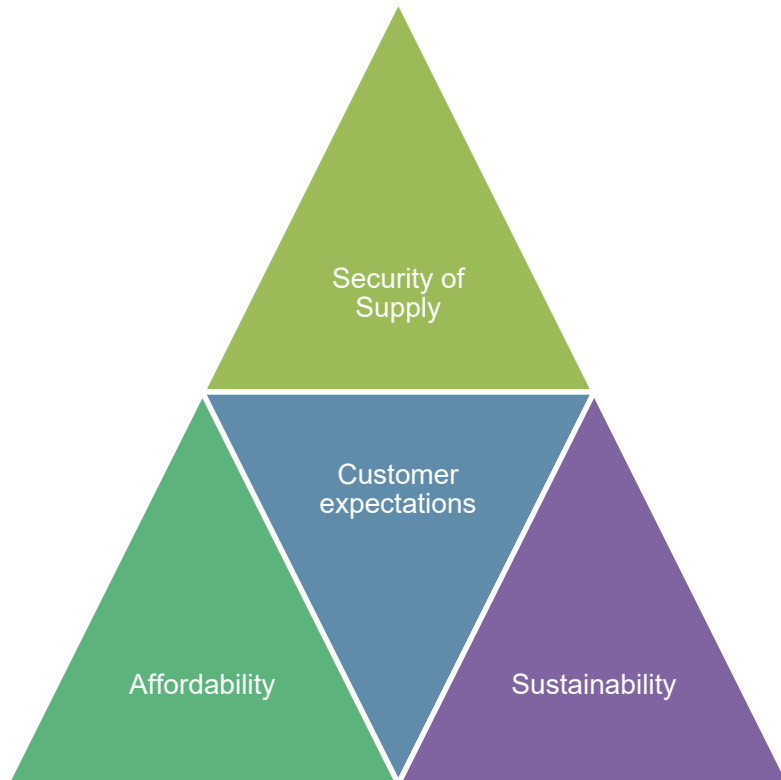
Questions which were posed for consideration by SECG participants

- **Expectations:**
 - What works well?
 - What should be prioritised?
- **Value & Consequences:**
 - Existing framework
 - Impact on bills v importance of services
- **Evolution:**
 - Performance metrics?
 - Incentivisation?

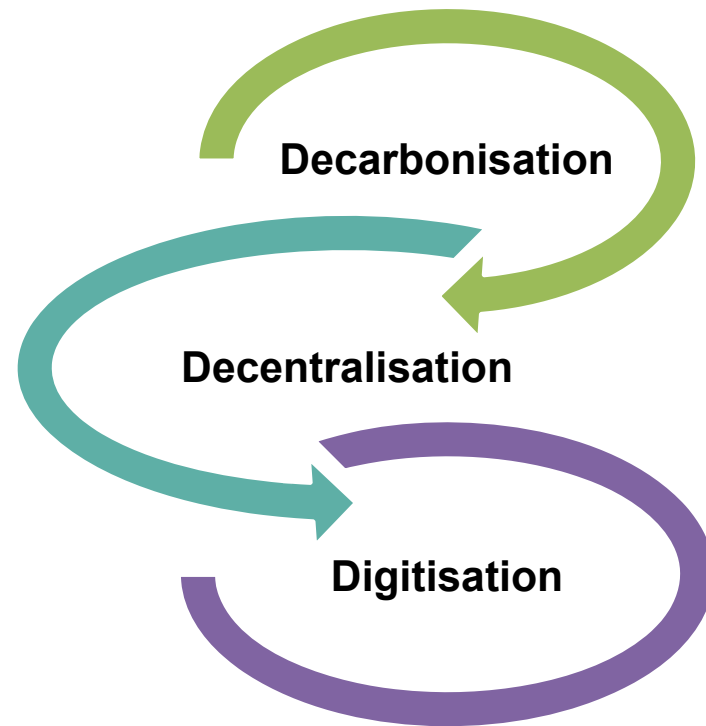


Continuing Changing Landscape

Balance of obligations



“Three D’s”



Evolving engagement

Stakeholder engagement

- Legislative requirement for public consultation
- Political pressures driving more involvement
- Accepted practice in industry

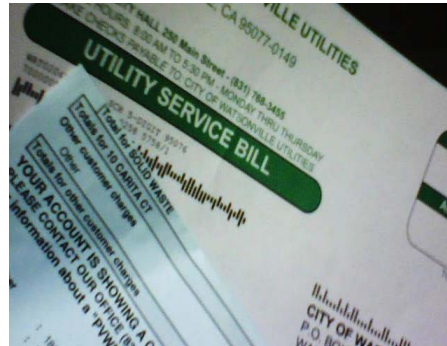
General consumer interest

- “Prosumers”
- Media and education
- Push for energy efficiency
- Uptake of Evs
- More opportunities for consumers to be involved



Impact and Influence

Now



Future



or



Expectations and Evolution

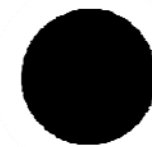


Consumer Choices

MARKS &
SPENCER



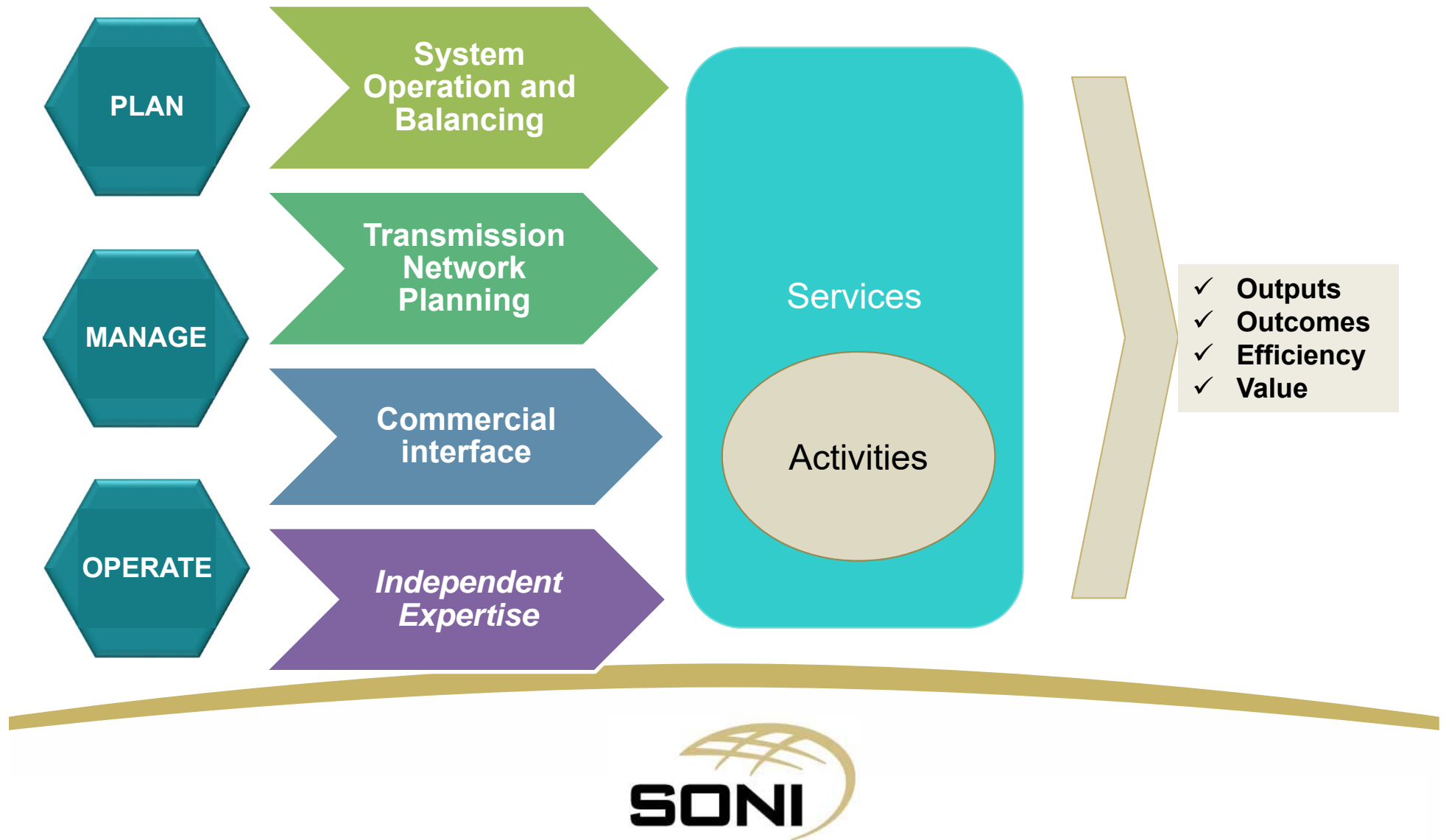
Harrods



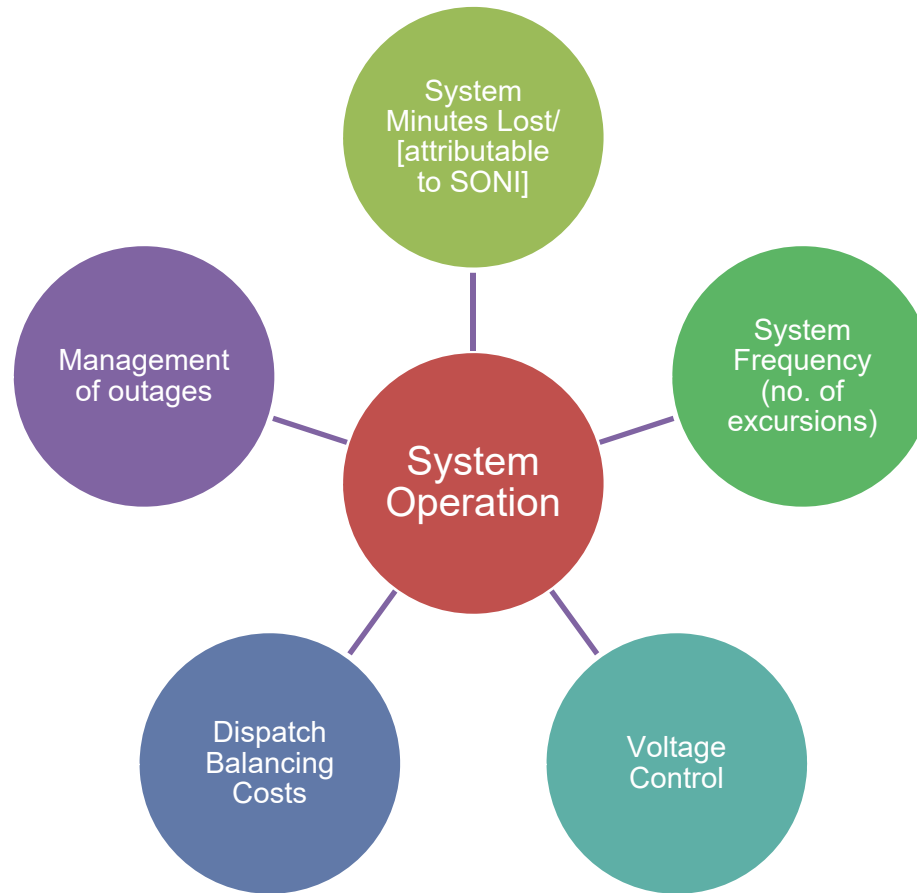
Sainsbury's



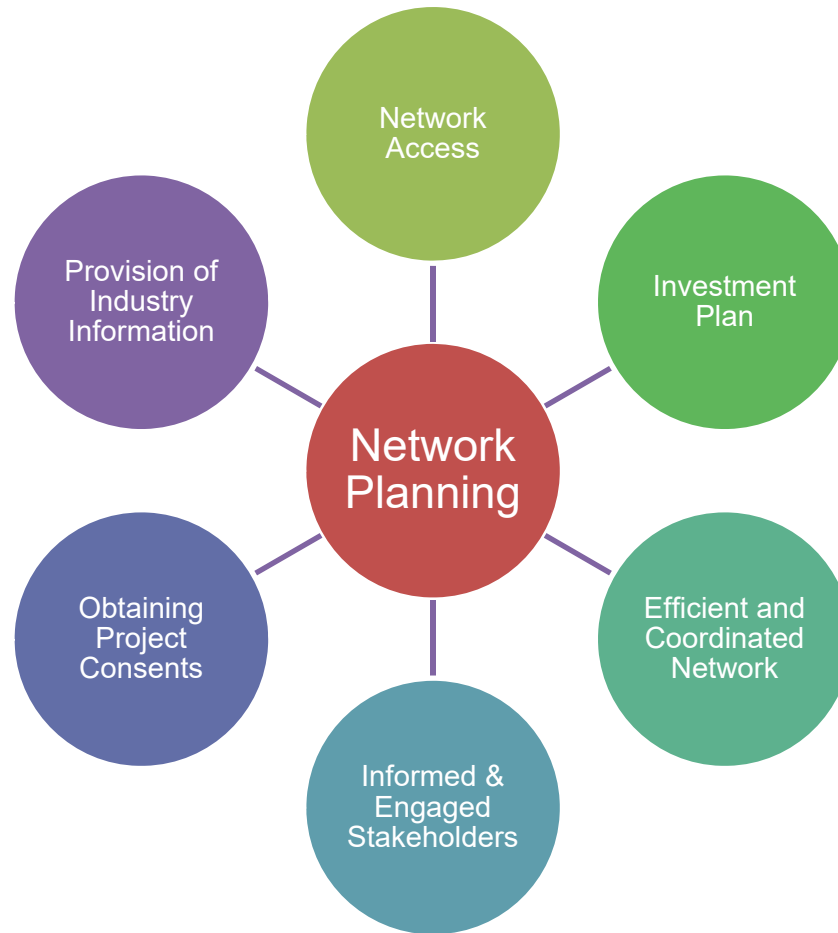
Overview of key roles and services



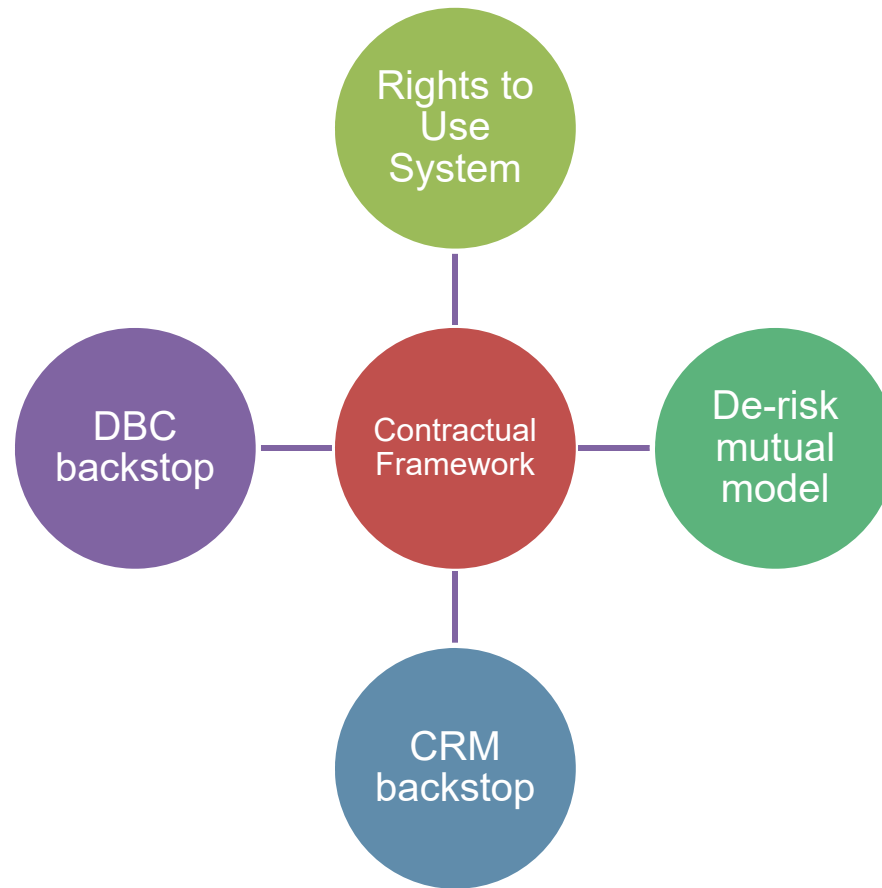
Operating the Transmission System



Outputs: Network Planning



Outputs: SONI as a Commercial Interface



Outputs: SONI is a trusted, independent, expert voice

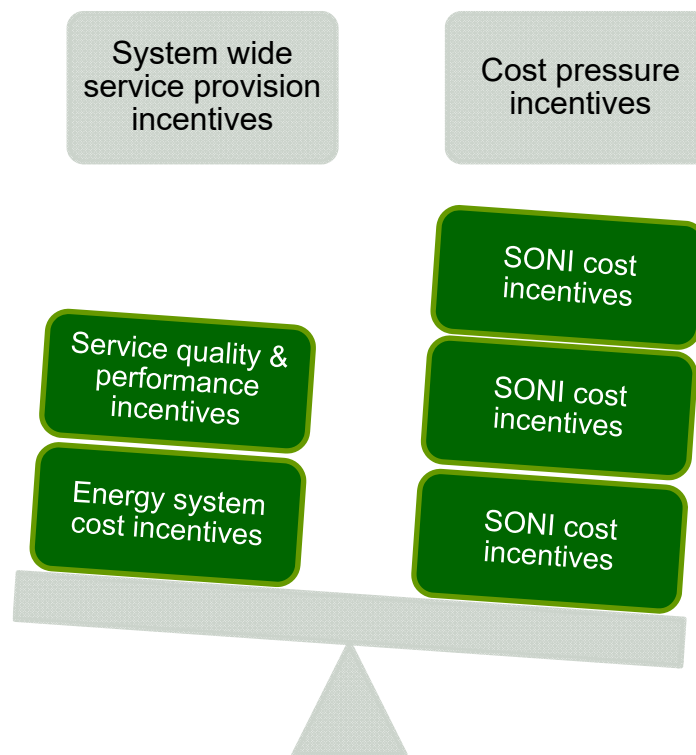


**Thank You for listening and
contributing**



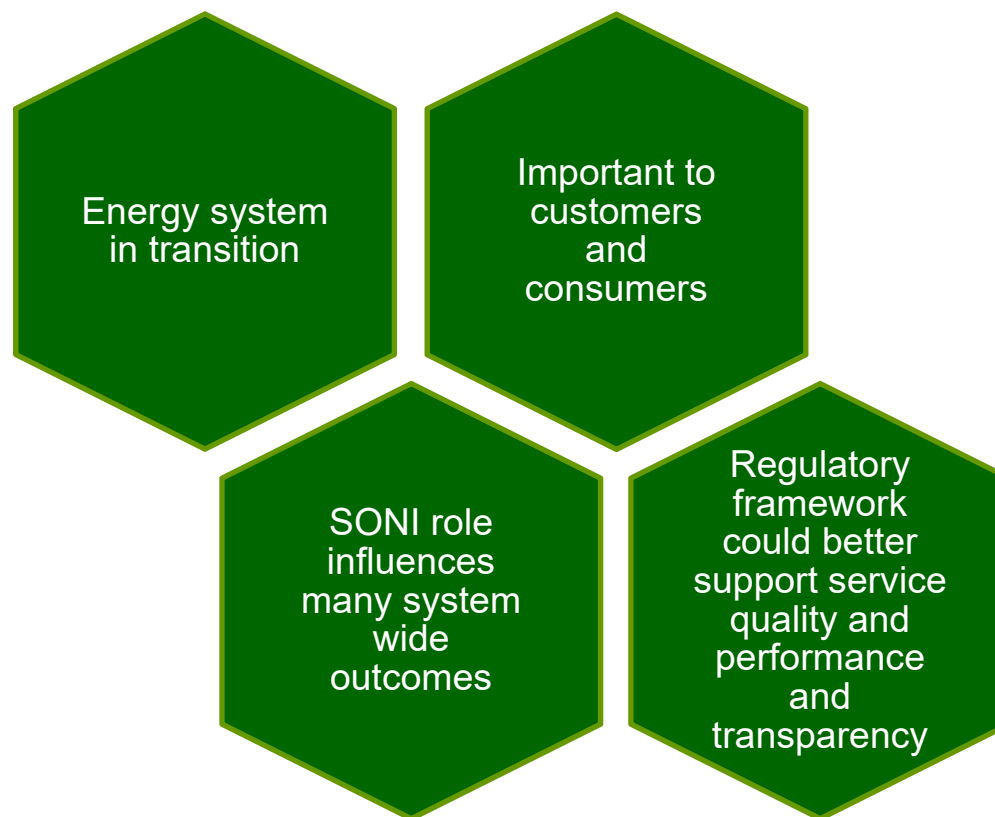
Regulatory framework to support good outcomes: overview

We want a regulatory framework which supports the right customer and consumer outcomes across the electricity system



Achieving a balance which incentivises good outcomes across electricity system whilst ensuring consumers are protected from inefficiency is important

Greater role for encouraging effective TSO service quality and performance?



How should we be thinking about SONI's role in affecting system wide outcomes?

October SECG discussed TSO roles and services in a number of ways:

e.g. Interactions with various industry players and market participants

e.g. decision making across a number of TSO service areas (e.g. network design and system planning)

System wide thinking?

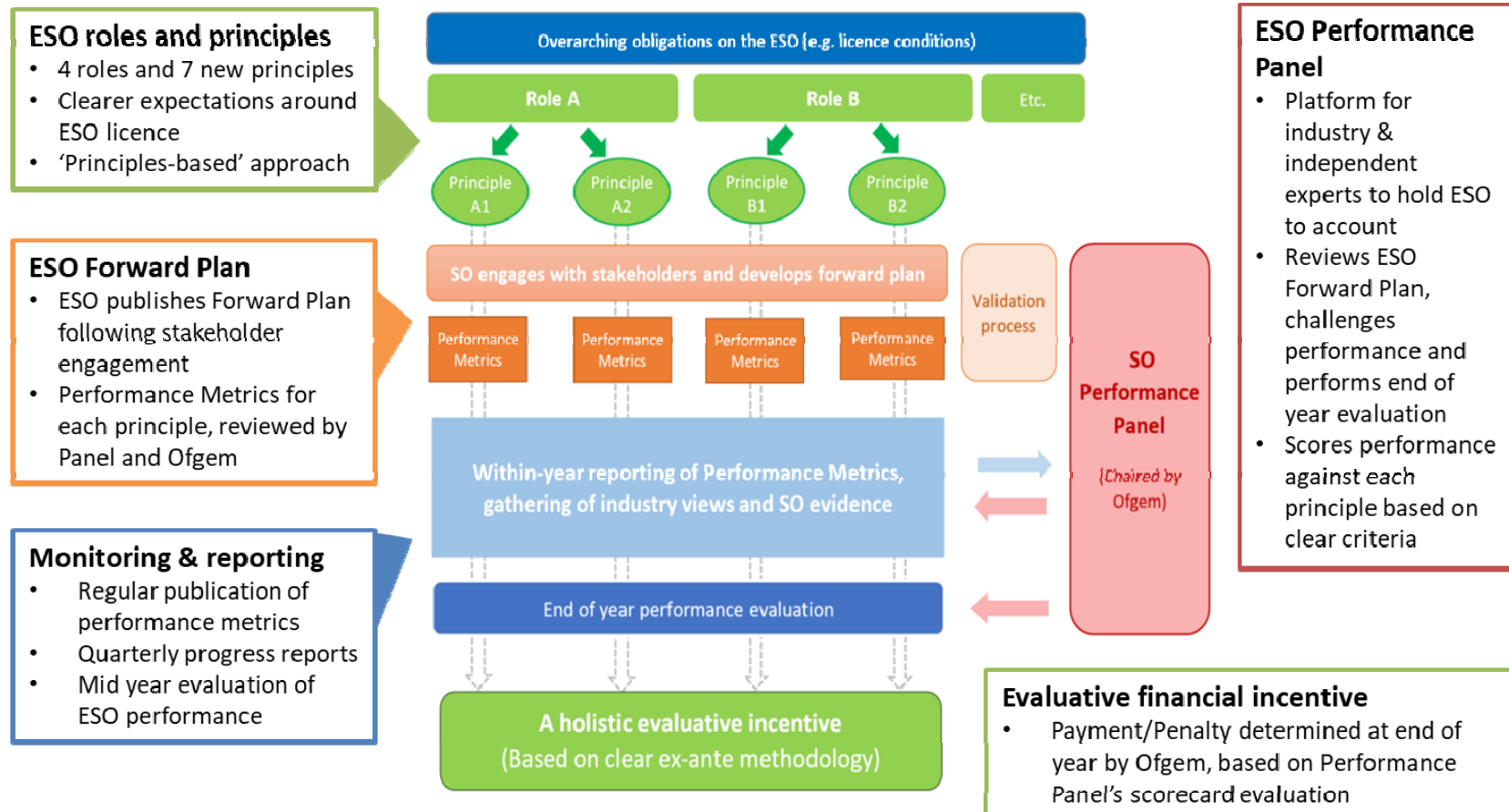
(Performance and service quality depends on TSO taking a system wide perspective when making decisions and taking actions)

System wide development?

(Performance and service quality depends on TSO developing things, which system users need and which are good for the energy system, in a timely, efficient and effective way)

e.g. processes for achieving system change across different areas

Case study: Ofgem incentives framework



What type of regulatory arrangements may work and where are they suited?

We want a framework which **reassures** consumers and customers that excellent service and performance is being **demonstrably** delivered over time



SONI TSO cost recovery and efficiency framework

Broad structure of current framework:

1. Ex-ante allowance (with risk sharing)
2. Managed pass through (no risk sharing)
3. Straight pass-through

See annex for how SONI's different service costs are treated according to these 3 buckets and an explanation of how managed pass-through currently works

How should we protect consumers from inefficiency whilst supporting service quality and performance?



- Do you consider a system of three broad types of buckets: ex-ante, managed pass-through and pass-through should be used?
- Are there adaptations required to current arrangements so that **service outcomes could be demonstrably improved**, whilst still ensuring **customers are protected from inefficiency**?
 - E.g. different risk sharing balance within different structures?
 - E.g. Should different types of service cost be treated differently (recovered under a different bucket)?
- How should we be assessing costs and protecting consumers from inefficiency across each of the three buckets?

Business plan assessment

Plan ownership and regulatory intervention



- We envisage an approach in which the TSO takes **ownership** of its business plan
- Combined with regulatory framework we set out in our approach decision document, the business plan can produce a complete price control package for the 5-year period
- We will assess what **interventions** it should make to the business plan, given the UR's objectives and desired outcomes from the TSO control (informed by its statutory duties)
- Proportionality is key:
 - The overall quality of the plan affects the extent of intervention needed from the UR
 - We can allocate time and resource across different parts of the plan according to the need for scrutiny and intervention in different areas
- Our business plan review can make use of a categorisation of the overall plan, built up from an assessment of the quality of the plan across each of the specified test areas

Encouraging a high-quality business plan

- SONI's TSO business role, services and activities should be well aligned with the interests of customers, consumers, other stakeholders and the wider energy system
- The approach we envisage entails a number of channels through which the TSO might be motivated to submit a high-quality price control business plan
 1. TSO has ownership of its plan and is answerable to stakeholders for what follows from it
 2. Lesser regulatory intervention expected in the TSO's business plan if it is of higher quality
 - Gives TSO greater opportunity to shape its role over the price control period, what activities and level of service is funded through the price control, and aspects of the regulatory framework
 3. Higher degree of trust in TSO if it's business plan is of higher quality
 4. Reputational incentives arising from regulatory assessment of business plan quality
 5. Possible role for financial incentives on business plan quality

Initial view of test areas

1. Delivering value for money
2. Engaging customers, consumers and other stakeholders
3. Delivering services and outcomes
4. System wide thinking and system development
5. Ensuring resilience and governance
6. Securing cost efficiency
7. Managing uncertainty
8. Aligning risk and return
9. Accounting for past delivery
10. Securing confidence and assurance

Illustrative examples of test questions

How well has the TSO identified the range of people and organisations to engage with and the issues which matter to them?

What is the quality of the TSO's engagement and how well is it incorporated into its business plan and ongoing business operations?

How well-evidenced, efficient and challenging are the TSO's projections of the costs of delivering its proposed services?

How well has the TSO demonstrated that its proposed services and tariffs will provide value for money?

To what extent has the TSO's Board provided comprehensive assurance to demonstrate that all the elements add up to a business plan that is high quality and deliverable?

Possible categories for plan assessment

Category	Features
A: Exceptional	<ul style="list-style-type: none">• Exceptional and stretching business plan• Excellent responses across most test areas• Limited regulatory intervention to translate to price control package• Relatively high degree of trust in company
B: Good	<ul style="list-style-type: none">• Good plan but falling short of being an exceptional and stretching plan• Excellent responses in some test areas• Greater regulatory intervention and less trust than category A
C: Below expectations	<ul style="list-style-type: none">• Plan not aligned well with the how best to serve customers and stakeholders• Significant concerns and lack of excellent responses across test areas• Greater regulatory intervention and less trust than category B
D: Very poor	<ul style="list-style-type: none">• Self-serving business plan with poor responses in multiple test areas• Extensive regulatory intervention to translate to price control package• Severe concerns about company's ability to deliver outcomes for stakeholders• Requirement for detailed monitoring of company during the price control period

Possible role for financial incentives

Some concerns about following Ofwat and applying financial incentive for exceptional plans

- More difficult to make assessment for the TSO, which is a single company in the price review process, versus the water companies that Ofwat can compare directly against each other
- A decision to apply penalty or reward could prove controversial with the TSO and stakeholders, especially without a close yardstick to compare the TSO with and given novelty of approach in NI
- Financial incentive could be a distraction from other reasons for the TSO to submit a high-quality plan

Despite the above, our **emerging view** is that there is a strong case for a modest financial incentive relating to the outcome of the business plan assessment

- The quality of the business plan, and the information contained within it, is important for achieving good outcomes from the price control process, especially given time constraints
- We are looking for a real step-change in the nature and quality of the business plan
- It costs time and money to develop an exceptional plan; a financial incentive can help motivate this
- A poor quality plan causes substantial customer detriment, especially given role and influence of TSO
- It is difficult to know whether other drivers of behaviour (e.g. reputational effects, plan ownership) will be sufficient on their own, and a financial penalty/reward structure can provide additional leverage

Benchmarks from Ofwat's approach

Ofwat “We have ... decided that an exceptional business plan will receive an amount equivalent to a 20 basis points (bp) to 35bp addition to the return on regulated equity (RoRE) over the whole price review period, based on the notional gearing of 60%”

What might this approach mean for the TSO if its plan were exceptional?

SONI RAB	20bp on RAB: total over 5 years (at assumed 0% gearing)	35bp on RAB: total over 5 years (at assumed 0% gearing)
£10m	+£100,000	+£175,000
£15m	+£150,000	+£262,500
£20m	+£200,000	+£350,000
£25m	+£250,000	+£437,500

Business plan incentive: possible options

Tables below provides some options for discussion on financial incentive for TSO business plan quality, each involving a total reward or penalty according to regulator's assessment of business plan (amount could be lump sum or smoothed over 5-year price control)

Category following plan assessment	Symmetric option (1)	Symmetric option (2)	Asymmetric option
A	+£250,000	+£500,000	+250,000
B	+£100,000	+250,000	+100,000
C	-£100,000	-£250,000	N/A
D	-£250,000	-£500,000	N/A

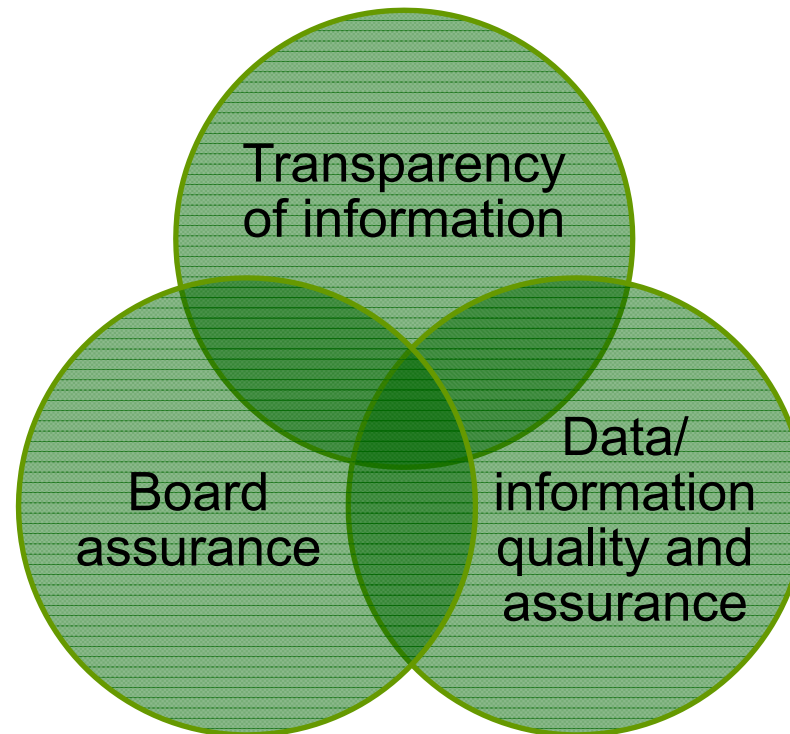
Questions and discussion

- Do you agree with the broad approach?
- Do you have any initial views on the potential business plan incentives?

Business plan assessment: securing
confidence and assurance test area

What this is and why it is important for NI TSO price control

This is particularly important for SONI TSO customers, consumers and stakeholders to support effective decision making and participation in TSO processes



Important to bring confidence and accountability in price control decision making; and support smooth processes and limit burden (in price control or other processes)

Wide ranging regulatory precedent

Aspect	Non-exhaustive regulatory examples (UR, Ofgem and/or Ofwat)
Data and information quality and assurance	<ul style="list-style-type: none">• Company responsibility for reliable, clear, consistent, accurate, assurance, timeliness of information (e.g. price bases, cost allocations, assurance, ownership of data tables)• Ofwat assesses quality assurance by 'track record' & 'in round' (takes account of information submitted to stakeholders and regulator more widely than purely business plan submission)
Transparency	<ul style="list-style-type: none">• Regulatory transparency: framework, models, guidance & (Ofwat) approach methodology Q&A process on clarifications• Company transparency: publication of business plans (GB water companies have published online full business plans and suites of supporting documents and data tables (with only limited redactions))
Board assurance	<ul style="list-style-type: none">• Board ownership and responsibility for business plan

Initial views on implications for SONI TSO price control



- We are furthering transparency and will consider further measures if in consumer, customer and stakeholder interest
 - e.g. we are publishing SECG material & guidance, plan to publish relevant commissioned expert reports, and models.
 - Are there any further proportionate and appropriate measures we should consider in our own price control processes?
- Business plan not published as part of last TSO review. We see value in setting expectations for SONI TSO to publish whole business plan when submits to UR
 - If company seeks to redact for publication, we would expect strong supporting reasoning.
- We see value in setting strong and robust expectations for company (and SONI board ownership) and assurance of plan.
 - When assessing data quality assurance as part of price control review, should we take account of information submitted/published to stakeholders and UR more widely than business plan submission? If so how and what information could we refer to?

Thank you for your time!

Annex: linking Roles and Services to existing price control framework

Price Control Framework

The existing framework (post CMA decisions) consists of a number of different elements and results in the following licence revenue formula:

$$M_{TSOt} = A_{TSOt} + B_{TSOt} - BI_t + D_{TSOt} + K_{TSOt} + INCENT_t + N_{TSOt} + PCR_t + AB_PC_t$$

The formula represents the maximum regulated revenue (M_t) and is made up of the following components:

- 1) A_t term – Ancillary services, sundry items and TUoS.
- 2) B_t term – Business-as-usual opex and capex.
- 3) BI_t term – 50/50 risk reward share for controllable costs.
- 4) D_t term – Re-openers for unexpected or uncontrollable costs over £40k.
- 5) K_t term – Correction factor between collected and allowed revenues.
- 6) $INCENT_t$ term – Incentive scheme for dispatch balance costs (DBC).
- 7) N_t term – Decisions arising from the CMA referral.
- 8) PCR_t term – Return on pre-construction projects.
- 9) AB_PC_t term – Revenue to cover abandoned projects.

Key

Cost Recovery Framework	Licence Terms
Ex-ante allowance (with risk sharing)	Bt
Managed pass through (no risk sharing)	Dt and $PCRt$
Straight pass through	At
Specific arrangements	Nt

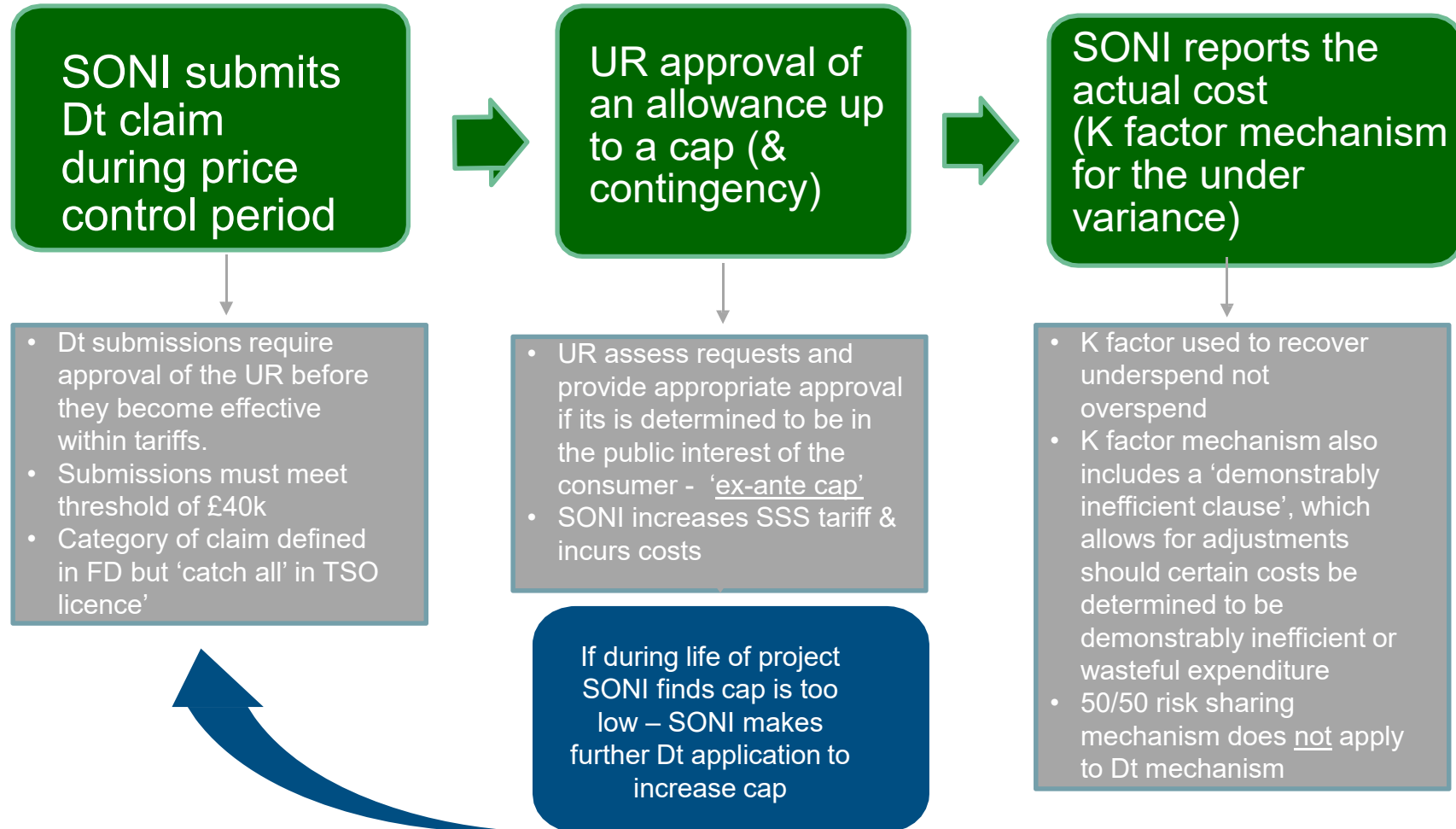
Annex: Linking Roles and Services to Revenues

TSO Roles	TSO Service Scope	TSO Activities Scope	Existing Licence Revenue Stream
System Operation and Balancing	System Balancing	System Security (continuous analysis & system service requirements).	Bt
		Priority Dispatch (wind & solar forecasts) – cost impact on DBCs.	Bt
		Least Cost Dispatch (forecasting, merit order, physical notifications).	Bt
	Generation and Network Availability	Outage Planning & System Restoration.	Bt
		Capacity Market Delivery.	Bt
		Generation Capacity Statement.	currently Dt
		Energy System Analysis.	Bt
		System Services Implementation and Procurement Activities.	Bt / Dt
		System Service Payments.	At
	Industry Governance	Grid Code Management.	Bt
		Network Code Implementation.	Bt / Dt
		Transmission System Security and Planning Standards (TSSPS).	Bt
		Operating Security Standards.	Bt
Commercial Interface for Transmission Network	Contractual Interface	Moyle interconnector (Market registration, Error Account, Revenue Shortfall).	Dt
		Transmission Revenue (All-island GTUoS, NI Supplier TUoS, tariffs).	Bt
		Banker/Insurer (MO shortfalls, Tariff Deviation, CRM 'hole in the hedge').	Nt
		Collection agent function.	Nt

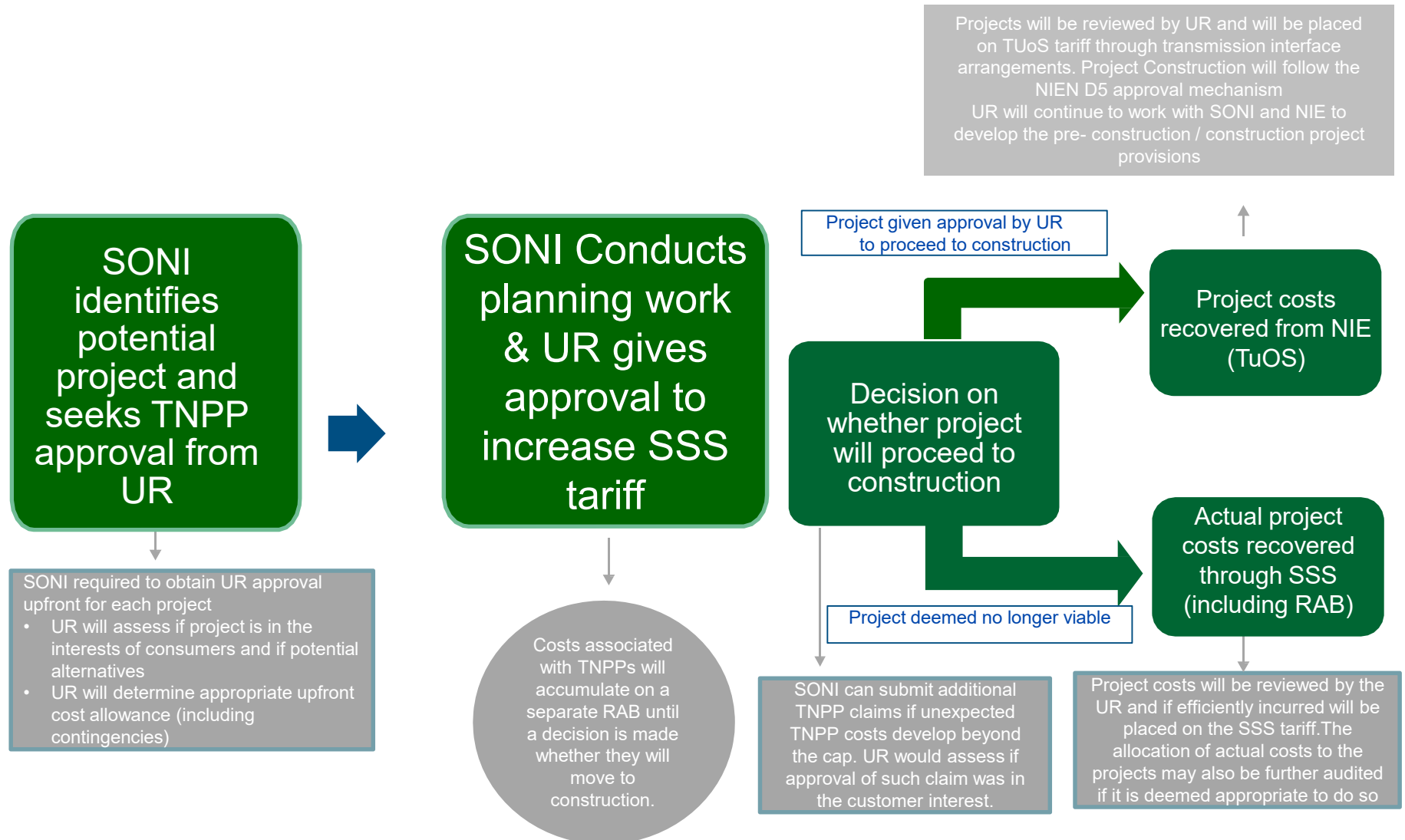
Annex: Linking Roles and Services to Revenues

TSO Roles	TSO Service Scope	TSO Activities Scope	Existing Licence Revenue Stream
Transmission Network Planning	Assess & Communicate System Needs	Future Scenarios.	currently Dt
		Ten Year Transmission Forecast Statement.	Bt
		Transmission Development Plan NI (SEA & public consultation).	currently Dt
		Transmission Investment plan (Joint working with NIE Networks).	Bt
	Planning Network Development	Assessment of Options (stakeholder engagement, Technical assessment, CBA).	Bt + PCRt
		Preferred Option (stakeholder engagement, Technical Assessment, CBA).	Bt + PCRt
		Project Consenting (Planning Permission, Landowner Consents, Route and Site Selection, Environmental Assessment).	PCRt
		Handover to NIE Networks (Confirm CBA, Contractual Documentation).	PCRt
	Connection and Use of System	Connection Offers (Contracts with NIE or Contestable Offer, Grid Code Testing, Telemetry, Connection Offers/Agreements and Bonding).	Connection Fees (Out of scope of licence revenue)
		Access Rights (FAQ Assessment, Assess System impact of customer).	Connection Fees / Bt
		Use of System (Tariffs, TLAFs, Access Rights (TUoS agreement).	Connection Fees / Bt
Independent Expertise	Independent Engagement and Advice	Security of Supply.	Bt
		Market Outcomes.	Bt
		Network development.	PCRt
		Support Government (DfE) Strategy.	Bt
		European Issues e.g. ENTSO-E, CORESO etc.	Bt / Dt
		Special project implementation / uncertainty mechanism.	Dt

Annex: Managed pass-through: Dt process



Annex: Managed pass through: TNPP (i.e. 'PCRT') process



Annex: CMA required UR to codify Dt and TNPP separately via guidance and licence

