PPB Price Control

Utility Regulator's Final Determination

14 January 2019



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; Wholesale; and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our mission

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

Our vision

To ensure value and sustainability in energy and water.

Our values

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

Abstract

The Utility Regulator is publishing its Final Determination on the Power Procurement Business' final price control. This determination is being published following a previous consultation, and describes PPB's allowable revenues from May 2019 until September 2023 (or until the legacy Generating Unit Agreements (GUAs) are cancelled by the Utility Regulator).

Audience

Energy industry stakeholders, electricity licence holders, electricity consumers, electricity consumer representatives and policy makers.

Consumer impact

While the GUAs overseen by PPB can have a material impact on consumers in Northern Ireland, and have had very significant impacts historically, the impact of PPB's price control itself is relatively small, as the business costs around £2m per annum to operate. This paper is focused only on the necessary task of regulating PPB to the end of its life as a business, rather than the potentially more impactful question of cancellation of the GUAs.

Contents

1. Executive Summary

The Power Procurement Business (PPB) was established in 1992 as a guaranteed purchaser following the creation of long term power purchase contracts (known as Generating Unit Agreements (GUAs)) as part of the privatisation of the Northern Ireland electricity industry. PPB was originally a separate regulated business under the Northern Ireland Electricity Transmission and Public Electricity Supply licence, and now sits under the Power NI Electricity Supply licence.

These contracts are due to expire or 2023, or can be cancelled by the Utility Regulator in the meantime. In September 2018, the Utility Regulator consulted on a final price control for PPB, to determine the returns the company should earn under the revised I-SEM arrangements, and to ensure that the interests of consumers are protected.

Consultation Proposals

- Baseline opex of £1.87m, based on actual costs in 2017/18.

- An additional £0.16m for 3.5 employees under the Central Trading Team (a team of nine employees who provide centralised I-SEM operation trading on behalf of both PPB and Power NI).

- £0.30m uplift towards additional general consultancy, IT/telecoms and corporate charges that are not covered by the baseline opex.

- An allowance of £50,000 for costs that were previously recovered under the D_t term of the price control. Items over and above this will be considered separately and on an exceptional basis.

- I-SEM specific costs will be treated as a D_t item, and approval provided once they are finalised.

- The existing RAB will have been depreciated by the start of the new price control, and the allowances for return and depreciation are therefore zero.

- A profit allowance of £0.238m was proposed, based on 10% of forecast opex and capex (£2.38m).

- In concert with the reduction in the profit allowance, an increased allowance of £1.0m for the Working Capital Facility was proposed.

- No pension deficit costs were proposed to be allowed in the new price control.

- PPB's share of the gross surplus to be reduced as follows:
  - (a) where the gross surplus is less than zero: PPB's share = zero;
  - (b) where the gross surplus is greater than zero and less than or equal to £10m: PPB's share = Gross Surplus * 6% (reduced from 20%);
  - (c) where the gross surplus is greater than £10m: PPB's share = £0.6m + ((Gross Surplus - £10m) *3%) (reduced from 10%)

  PPB's maximum share of the gross profit will be capped at £1.8m.

- The introduction of a Z_t term, to be set at £200k, to cover wind-up costs in the final year of the business.

Decision

Two responses (PPB and the Consumer Council) were received to the consultation. Following consideration of the responses, the Utility Regulator has decided to retain most of the proposals put forward in the consultation, with the following exceptions:

- The uplift towards additional general consultancy, IT/telecoms and corporate charges that are not covered by the baseline opex has been increased from £0.30m to £0.45m.

- The allowance for costs that were previously recovered under the D_t term of the price control has been increased from £50,000 to £60,000. Any individual cost item below £30,000 must be recovered from this allowance. Any individual cost items above £30,000 should be submitted to the UR for approval.

- Because the profit allowance is set at 10% of opex, profit is increasing from £0.238m to £0.254m to account for the changes described above.

- An increase in the Z_t term from £200k to £300k.

- The introduction of a Y_t to cover any potential forward pension liabilities at contract cancellation / expiry.

Our final determination is summarised in the following table:

£m	**Deprec.**	**Return**	**Core Allowance**			**Pension Deficit**	**Total**
			Opex	**Working Capital**	**Profit**		
September 2018 Consultation	0.000	0.000	2.380	1.000	0.238	0.000	**3.618**
New Price Control Decision	0.000	0.000	2.540	1.000	0.254	0.000	**3.794**
Difference	0.000	0.000	0.160	0.000	0.016	0.000	**0.176**

2. Introduction and Background

The Power Procurement Business (PPB) was established in 1992 as a guaranteed purchaser following the creation of long term power purchase contracts (known as Generating Unit Agreements (GUAs)) as part of the privatisation of the Northern Ireland electricity industry. PPB was originally a separate regulated business under the Northern Ireland Electricity Transmission and Public Electricity Supply licence, and now sits under the Power NI Electricity Supply licence.

In September 2018, the Utility Regulator consulted on a final price control for PPB, to determine the returns the company should earn under the revised I-SEM arrangements, and to ensure that the interests of consumers are protected.

This document is a decision paper on a new Price Control to be applied to PPB effective from 27 May 2019 to 23 September 2023, or whenever the final GUA is terminated (whichever occurs sooner). It will replace the existing control, which came into force in April 2015.

Since the creation of the Single Electricity Market (SEM), PPB has purchased energy from the independent generators under the long term contracts, while also making payments for availability. PPB sold this energy into the SEM pool, while retaining revenues under the SEM's Capacity Payment Mechanism, as well as any ancillary services revenue.

If there is a mismatch (either positive or negative) between PPB's costs and its revenues, that amount is collected or rebated via Northern Ireland's Public Service Obligation (PSO) levy.

The details of the remaining GUAs are outlined below:

Generating Unit	GUA Contracted Capacity (MW)	Fuel Type	Contract Expiry Date
CCGT 10	106	Gas	23 September 2023
CCGT 20	510	Gas	23 September 2023

These remaining GUAs can be cancelled by the Utility Regulator, subject to a 180 day notification period. The Utility Regulator intends to carry out a comprehensive review of the GUAs within this price control period, considering their value from both an economic and policy perspective.

Two responses (the Consumer Council and PPB) were received to the consultation.

3. Existing Price Control

There are three main elements of the existing price control, which has been in force since April 2015:

1. PPB core allowance
2. Depreciation and return
3. Gain-sharing mechanism

PPB Core Allowance

PPB's core allowance covers:

- Operating Expenditure – for the existing price control, the UR capped PPB's Opex allowance at £1.98m (2014 prices).
- Working Capital Facility – in the existing price control, PPB's Working Capital Facility was set to £0.62m.
- Profit – in the existing price control, PPB's baseline profit was set at £0.93m

The core allowance element of PPB's current price control is the sum of these elements:

£1.98m + £0.62m + £0.93m = £3.53m

Depreciation and Return

The allowances in the current price control (October 2014 prices) were:

	2015/16	2016/17	2017/18	2018/19
Depreciation	£0.292m	£0.292m	£0.293m	£0.073m
Return	£0.044m	£0.028m	£0.012m	£0.002m

Gain Sharing Mechanism

The gain sharing mechanism is structured so that any gross surplus up to £10m is split 80:20 between customers and PPB. Any surplus in excess of £10m is split on a 90:10 basis.

The amount earned by PPB under the gain sharing mechanism since it was introduced is:

Year Ending	**Total Surplus / Deficit**	**PPB's Gain Share Revenue**	**Customer Gain Share**
31 March 2016	-£0.383m	£0.000m	-£0.383m
31 March 2017	£7.048m	£1.410m	5.639m
31 March 2018	£18.299m	£2.830m	£15.469m

The total revenue to PPB under the existing price control since its implementation is:

£m		**2015/16**	**2016/17**	**2017/18**
Depreciation		£0.294	£0.300	£0.313
Return		£0.044	£0.029	£0.013
PPB Core allowance	Opex	£1.990	£2.030	£2.111
	Working Capital	£0.626	£0.639	£0.664
	Profit	£0.938	£0.957	£0.995
Pension Deficit		£0.481	£0.481	£0.481
PPB's share of gross surplus		£0.000	£1.410	£2.830
Total		**£4.373**	**£5.846**	**£7.407**

4. Consultation Proposals

The proposals contained in the September 2018 consultation are summarised below:

- Baseline operating expenditure at £1.87m. This is based on actual costs in 2017/18.

- £0.16m for an additional 3.5 employees under the Central Trading Team. This is a team of nine employees who will provide centralised I-SEM operational trading on behalf of both PPB and Power NI.

- £0.30m uplift towards additional general consultancy, IT/telecoms and corporate charges that are not covered by the baseline opex.

- An allowance of £50,000 for costs that were previously recovered under the D_t term of the price control. Items over and above this will be considered separately and on an exceptional basis.

- I-SEM specific costs will be treated as a D_t item, and approval provided once they are finalised.

- The existing Regulatory Asset Base will have been depreciated by the start of the new price control, and the allowances for return and depreciation are therefore zero.

- A profit allowance of £0.238m was proposed, based on 10% of forecast opex and capex (£2.38m).

- In concert with the reduction in the profit allowance, an increased allowance of £1.0m for the Working Capital Facility was proposed.

- No pension deficit costs were proposed to be allowed in the new price control.

- PPB's share of the gross surplus to be reduced as follows:
  - (a) where the gross surplus is less than zero: PPB's share = zero;
  - (b) where the gross surplus is greater than zero and less than or equal to £10m: PPB's share = Gross Surplus * 6%;
  - (c) where the gross surplus is greater than £10m: PPB's share = £0.6m + ((Gross Surplus - £10m) *3%)

  PPB's maximum share of the gross profit will be capped at £1.8m.

The proposals under the consultation, and comparison to the previous price control are summarised below:

£m	Deprec.	Return	Core Allowance			Pension Deficit	Total
			Opex	Working Capital	Profit		
Current P.C. (2014 prices)	0.293	0.012	1.976	0.622	0.931	0.481	**4.315**
Current P.C. (Oct 2017 prices)	0.313	0.013	2.111	0.664	0.995	0.481	**4.577**
New P.C. (Oct 2017 prices)	0.000	0.000	2.380	1.000	0.238	0.000	**3.618**
Difference	**-0.313**	**-0.013**	**0.269**	**0.336**	**-0.757**	**-0.481**	**-0.959**

PPB can also earn an additional maximum of £1.8m each year under the terms of the gain sharing allowance.

5. Responses to Consultation

Two responses were received to the September 2018 consultation: the Consumer Council and PPB.

Some of the extracts of the responses are provided below, along with the Utility Regulator's comments:

1. *For the Centralised Trading Team, the UR proposes to only allow for an additional 3.5 employees on the basis that one of the employees transferred from PPB. This could be a proxy approach if the 9 employees were paid equally. Hence, deducting on the basis of a simple average is incorrect. A more appropriate adjustment would be a deduction of 2/10ths rather than 2/9ths.*

The UR recognises that not all employees will be paid equally, and that our calculation may result in an imperfect division of the costs of the Centralised Trading Team. However, in the absence of specific salary costs, the Utility Regulator is unable to readily make assumptions as to the split in costs between grades. The Utility Regulator therefore has decided not to amend this allowance.

2. *The UR analysis only considers the cost uplift in 2019/20, whereas in the BEQ salary progression increments are included to reflect the development of these junior analysts into analysts and senior analysts over time. If the UR continues with the approach of adding uplifts to the 17/18 outturn, then the CTT uplift should reflect an average of the uplift over the period from 19/20 to 23/24, which averages £224k, and hence the "adjusted uplift" would be £180k (80% of the BEQ average CTT staff related costs for PPB).*

While the UR acknowledges that there will be staff progression, we would also expect there to be a certain amount of staff attrition and turnover. Where staff leave, we would expect these to be replaced by graduate level employees towards the bottom of the scale. The allowances provided within the price control for Opex will be subject to inflationary increases. The Utility Regulator considers this to be sufficient allowance to cover salary costs.

3. *There is no justification for not providing substantially the full allowance of consulting / legal / IT & telecoms and corporate charges*

   With regard to consulting and legal costs, in 2017/18 these were unusually low. A better indication can be seen by considering the average over the three years of PC15-18, which was £217k.

The average over the three years of PC15-18 is confirmed as £217k. However, this is because of the following profile of costs:

2015/16	**2016/17**	**2017/18**
£k	**£k**	**£k**
530.8	63.3	57.1

The average is therefore skewed by significantly larger costs in 2015/16. If the UR considers 2016/17 and 2017/18 to be typical years, this provides an appropriate baseline. The UR has therefore decided not to make any amendments to the allowed consulting and legal costs.

4. *With regard to I-SEM IT and telecoms costs, these are essential to enable PPB and the CTT to trade in the new markets and there is no justification to disallow such ongoing costs.*

Based upon PPB's response, which contains further details on each component not repeated in this decision paper, as well as further discussions held with PPB, the UR has decided to increase the uplift allowance from £300k to £450k to provide cover for these costs.

5. *In relation to Corporate Charges we had already provided clarification as to the drivers of the increases, where notwithstanding that PPB's overall allocation is lower, the underlying corporate costs are higher, particularly as a consequence of additional compliance requirements relating to risk governance, data protection, health & safety, and cyber security. As a result of these legislation changes and governance enhancements to ensure best practice, the Group has appointed a Risk and Governance Manager, a Group Data Protection Officer and a Health & Safety Officer and also incurs costs for additional expert external advice.*

While these are relevant, the UR is not convinced that these changes in legislation warrant an increase of 40% in PPB's corporate governance costs.

6. *In relation to the allowance for the recovery of costs under the D_t term, the proposed allowance of £50k in aggregate for all costs that are individually lower than £50k potentially provides for only one cost item. This is not a reasonable approach and PPB considers that the allowance for aggregate items less than the threshold should be set at twice the threshold. Hence, where the threshold is £50k (above which claims can be individually made), the allowance should be £100k.*

The Utility Regulator wishes to minimise the possibility for perverse incentives in relation to additional cost items, but is persuaded that a more granular framework such as the one PPB proposes may be preferable to that laid out in the consultation. We have therefore decided to increase the allowance to £60,000. Any individual cost item below £30,000 must be recovered from this allowance. Any individual cost items above £30,000 should be submitted to the UR for approval. For the avoidance of doubt the UR will not necessarily approve the recovery of any or all of these additional cost items.

7. *The aggregate reduction in Working Capital and Profit from the PC12-15 to the PC15-18 price control is £2.2m. PPB voluntarily offered this to be placed at risk through the gain sharing arrangement. Under the gain sharing arrangement, PPB has, on average over the three year period, earned £1.4m, £0.8m less than it had foregone. It is therefore incorrect to intimate that PPB has been over-remunerated by the current price control.*

As shown on page 8 of the consultation paper, PPB has earned up to £2.83m from the gain sharing arrangement, and there is no down-side risk for the company under this mechanism. We consider that the new (compressed) mechanism, coupled with the revisions to profit margin, working capital and new Opex provisions better reflects a reasonable remuneration framework for the company. We note in this regard the endorsement for the new arrangements offered by the Consumer Council in their response to the consultation.

8. *…the fundamental margin requirement to remunerate PPB for its working and risk capital has not changed and the current PC already provides for a low baseline allowance for these elements with PPB bearing the risk that it will not be fully remunerated if it is unable to capture benefits for customers and hence a share of the gains to make up that shortfall*

Noting this argument, it is our decision that PPB has failed to sufficiently demonstrate that in the event that the GUAs are negative and the gain sharing arrangement provides a return of zero, that the company would be underfunded.

9. *determining the margin on the basis of Opex has never been a consideration and there is no precedent for such an approach*

A margin of 10% on Opex would represent an operating margin[1] of 9.1%. The UR considers this to be a reasonable return for an intermediary business such as PPB.

10. *Considering a simple margin of 1% on turn-over would equate to a net margin (profit) of approx. £1.6m*

PPB is a bespoke monopoly intermediary between the power stations and the SEM, and the magnitude of the monies exchanged and handled by PPB is out of scale with the costs of running the business itself. We therefore consider that it would be inappropriate for earnings to be based on turn-over.

11. *…the Working Capital Facility Allowance is currently much less than the underlying cost. The proposal to increase the allowance to £1.0m is arbitrary, and still remains below a minimum estimate of the cost of providing such a facility. PPB estimate that the size of the facility need in I-SEM has increased to £25m. Notwithstanding that PPB could not actually secure such a facility on a standalone basis, the minimum cost of providing this facility is £1.46m*

The UR considers that the £0.62m Working Capital Facility provided for in the current price control was sufficient in the context of SEM. PPB have not provided any

[1] This index considers the comparison of profit to business cost, exclusive of the intermediary energy costs and revenues flowing through the business.

evidence of why a facility of the magnitude of £25m is necessary. Based on PPB's expected revenues, and our knowledge of the GUAs, PPB's hedging strategy and price formation within the I-SEM, the Utility Regulator considers it unlikely that such a deficit should arise. Taken in concert with the prevailing relatively low interest rates available for credit facilities, the Utility Regulator has therefore decided that the proposed Working Capital Facility of £1m is sufficient.

12. *Pensions: any deficit that arises relating to pensions liabilities that were accrued prior to the cut-off date (e.g. as a result of increasing longevity) remaining recoverable from customers over the term of the liability.*

At the point of closure, there remains a risk that the assets will not fund the liabilities. In normal circumstances, where the business continues to operate, then any such variation would be picked up through the ongoing operation of the scheme and the employer would be obliged to make additional contributions to cover any funding gap. However, if the business ceases trading, this cost must be crystallised at closing. This ongoing liability is not attributable to the wider Viridian Group and hence it must be valued at the point of business closure. Pension schemes are increasingly managing this issue through a Buy-in whereby a pensions provider takes on the pension payment obligations.

There is a market for such products and the best terms can be secured from the market at the time. It is not possible to precisely calculate the costs of procuring such products today and hence why we stated that the cost cannot be determined until a Buy-in transaction is contemplated.

The Utility Regulator considers PPB's pension provisions to be *inter-alia*, a balance between assets and liabilities.

- Assets: the pension scheme is currently in deficit, and there is a £116k annual allowance included in opex in order to make up to deficit by 2023 (this is in relation to past pension deficits. Any deficits incurred since 31 March 2015 are recovered from share-holders). If the performance of the financial markets is inadequate, the assets will fall short of expected liabilities.

- Liabilities: the current liabilities are calculated on the expected lifetime of the members of the pension scheme and their dependents. If the expected lifetime increases, the liabilities will increase. This is referred to as “longevity”.

The £116k annual allowance is expected to resolve the current pension deficit. Any decrease in the assets or increase in longevity has the potential to increase the deficit. Other regulated businesses must carry this risk for the remaining lifetime of its pension scheme members, and any increase in deficit can be recovered from consumers. However, cancellation of the contracts would remove this ability to recover from consumers.

On reflection of PPB’s arguments, the Utility Regulator considers it appropriate to retain the £116k top up annual allowance within Opex, and to then consider a specific additional allowance at the time of company wind-up to cater for the forward exposure of pension liability for those liabilities accumulated prior to March 2015, based on an actuarial assessment made at the time. This term will be labelled Y_t within the licence, and will trigger in the same way as Z_t (i.e. once only, the year after the last contract is terminated or expires). Provisions for Y_t are explained further below.

13. *While PPB captured a gain-share averaging £1.4m p.a. over the last 3 years, this was still £0.8m less than the revenues it has foregone (relating to the WCF and profit components, and excluding Opex). PPB therefore rejects the proposal to arbitrarily reduce the gainshare percentage by 70%.*

PPB has earned up to £2.83m per year from the gain sharing arrangement, and there is no down-side risk for the company in the mechanism. We consider that the revised mechanism better aligns the sharing of gains between consumers and the company.

14. The consultation paper states in the third paragraph that "PPB have not included any specific costs within the BEQ" in relation to wind-up costs. This is incorrect as PPB did provide a forecast of such costs where they are possible to forecast.

There are a number of costs items in the BEQ which are significantly higher in the final year. However, it was not explicit in the BEQ that these increases related to wind-up. In any case the new Z_t term is intended to provide the allowance for the tasks which must be completed in the year of final cancellation and as necessary in years that follow.

15. The statement "the Viridian Group is large enough to absorb the employees and the costs associated with re-training" contradicts the Licence requirement for PPB to remain separate from other Associated Businesses and assumes that other Viridian businesses will hold back on recruitment in order to accommodate staff at that time.

The UR expects that some of PPB's staff will take advantage of the Voluntary Selective Severance Scheme. PPB have mentioned within their BEQ submission that for those employees who are too young or do not want to retire, they will seek to re-train and redeploy the staff within the Viridian Group. For those staff that PPB are unable to redeploy, the UR considers that the allowances within the Z_t term will be sufficient to cover any required severance package (noting that, as described below, we have decided to increase this term from £200k to £300k).

16. We stated that the run-off activities and staff redeployment would take 6 months and hence we had simply continued with the ongoing business costs through to the end of March 2024. If the price control were to continue to apply to until 31 March 2024, then that would cover such costs.

While this may be a simplistic and transparent outcome, there is the possibility that the contracts can be cancelled before their expiry. PPB's proposal does not provide clarity or certainty under this scenario. It is more efficient to provide a price control up to a maximum time, and provide an explicit allowance for the costs of winding up the business as we have put forward in the Z_t term. We note also the support offered by the Consumer Council in their response for the proposed arrangements for wind-up, in which they argued that the proposals would provide for "certainty on costs, particularly if the UR decides to cancel the contracts before 2023."

17. We had also highlighted in our BEQ submission that there would be costs in the subsequent 7 years where there are statutory obligations with costs relating to accounts, audit, taxation, data and document storage and corporate costs. The total included for these longer term wind-up costs was £428.6k (this was included in the 2023/24 Opex costs in the BEQ).

The Utility Regulator is unable to identify the £429k referred to in PPB's response within the Business Efficiency Questionnaire. However, we have decided to increase the Z_t term to £300k to allow for these cost items, and also to provide a severance allowance for those staff that do not wish to retire or are unable to be redeployed within the Viridian Group. This will be a guaranteed payment and PPB will retain any surplus if the staff are able to be redeployed.

6. Decisions

PPB's counter proposal to our price control proposals were as follows:

£m	Deprec.	Return	Core Allowance			Pension Deficit	Total
			Opex	Working Capital	Profit		
Current PC	0.313	0.013	2.111	0.664	0.995	0.481	4.577
UR Proposal	0.000	0.000	2.380	1.000	0.238	0.000	3.618
PPB Counter Proposal	0.000	0.000	2.801	0.664	0.995	0.000	4.460

The Utility Regulator details its decisions, in comparison with its original proposal and PPB's counter proposal, in respect to the PPB Price Control 2019-2023 below.

Opex

	UR Proposal	PPB Proposal (Response)	UR Decision
Baseline Opex	1.871	1.871	1.871
Central Trading Team	0.159	0.180	0.159
Consulting Legal, IT and telecoms, and Corporate Charges	0.300	0.650	0.450
Fixed D_t allowance	0.050	0.100	0.060
Total	**2.380**	**2.801**	**2.540**

We have provided an extra £150k above our proposal of £300k to cover I-SEM IT and telecoms costs. We have not increased the allowance for legal costs or corporate charges.

We are increasing the fixed D_t allowance from £50,000 to £60,000. Any individual cost item below £30,000 must be recovered from this allowance. Any individual cost items above £30,000 should be submitted to the UR for approval. For the avoidance of doubt the UR will not necessarily approve the recovery of any or all of these additional cost items.

I-SEM Specific Costs

As described in the consultation paper I-SEM specific costs will be treated as a D_t item so that approval is provided once they are known, Only the actual cost items will be allowable; there will be no return or depreciation allowance included.

Depreciation and Return

As proposed in the in consultation paper, these will be set to zero.

Profit

The Utility Regulator is retaining its profit allowance based on 10% of forecast opex and capex. Because our decision is to increase opex relative to the consultation paper, the profit allowance has been increased to £0.254m.

Working Capital Facility

The Working Capital Facility is being retained at £1.0m.

Pension Deficit Cost

No allowance will be included for pension deficits in the new price control. The Utility

Regulator will consider any potential forward liabilities under the pensions at the time of contract cancellation / expiry, and may provide an appropriate allowance to cover this.

PPB's share of the Gross Surplus

The Utility Regulator is retaining the proposed allowances under the gain sharing mechanism as follows:

(a) where the gross surplus is less than zero: PPB's share = zero;

(b) where the gross surplus is greater than zero and less than or equal to £10m: PPB's share = Gross Surplus * 6%;

(c) where the gross surplus is greater than £10m: PPB's share = £0.6m + ((Gross Surplus - £10m) * 3%)

PPB's maximum share of the gross profit will be retained at £1.8m (as proposed in the consultation paper).

Our final determination is summarised in the following table:

£m	**Deprec.**	**Return**	**Core Allowance**			**Pension Deficit**	**Total**
			Opex	**Working Capital**	**Profit**		
September 2018 Consultation	0.000	0.000	2.380	1.000	0.238	0.000	**3.618**
PPB Counter Proposal	0.000	0.000	2.801	0.664	0.995	0.000	**4.460**
New Price Control Decision	0.000	0.000	2.540	1.000	0.254	0.000	**3.794**

Wind Up Costs

The Utility Regulator is increasing the Z_t term for wind up costs from £200k to £300k. This allowance will cover redundancy costs for those employees which PPB have been unable to redeploy within the Viridian Group, as well as PPB’s statutory obligations with costs relating to accounts, audit, taxation, data and document storage, and corporate costs.

Pension Provisions Beyond Wind-Up

The Utility Regulator is creating the Y_t term to cover the forward economic exposure of the company beyond its wind-up, for the risk associated with movements in future asset and liability values for those pension liabilities accrued prior to 31 March 2015. In similar fashion to $Z_{t,}$

7. Changes Necessary for Licence Modifications

Current Price Control Formula

PPB's revenue allowance is described in Annex 3 of the Power NI Electricity Supply licence. In any relevant year, the maximum regulated PPB PSO revenue is to be calculated in accordance with the following formula:

$$M_{PPBt} = A_t + D_t + E_t + PGS_t - NPR_t + K_{Bt}$$

where:

M_{PPBt}	means the maximum regulated PPB PSO revenue.
A_t	means the actual power purchase costs incurred in the purchase of electricity.
D_t	means:

(a) The allowed charge for excluded power procurement costs and changes in law.

(b) any reasonable costs incurred by PPB in complying with the requirements imposed on the Licensee under legislation and other legal requirements through which Directive 2003/54/EC and/or 2009/72/EC is implemented.

(c) any reasonable costs incurred by PPB in complying with the requirements imposed on the Licensee under the arrangements for the SEM.

(d) any other amounts, not included in the revenues under the Successor Distribution Licence or another Annex of this Licence, requested by the Licensee and approved by the Authority.

E_t	means the allowed PPB entitlement.
PGS_t	means PPB's share of the gross surplus.
NPR_t	means the non PSO revenue in relevant year t.

K_{Bt} means a correction factor.

The PPB price control effectively determines the allowed PPB entitlement (E_t), as well as determining PPB's share of the gross surplus (PGS_t).

The allowed PPB entitlement is derived using the following formula:

$$E_t = DEP_t + RTN_t + IC_t + PD_t$$

where:

DEP_t means the depreciation amount allowed in respect of the PPB Regulatory Asset Base (RAB).

RTN_t means the allowed return on the PPB RAB.

IC_t means the PPB core allowance.

PD_t means the allowed PPB pension deficit cost of:

(i) £0.481m per year; or

(ii) Such other amount as reasonably determined by the Authority.

Summary of Price Control Decision

As described above, the Utility Regulator's decision in relation to PPB's revenues is summarised in the following table. All of these values of are in October 2017 prices.

£m	**Deprec.**	**Return**	**Core Allowance**			**Pension Deficit**	**Total**
			Opex	**Working Capital**	**Profit**		
September 2018 Consultation	0.000	0.000	2.380	1.000	0.238	0.000	**3.618**
PPB Counter Proposal	0.000	0.000	2.801	0.664	0.995	0.000	**4.460**
New Price Control Decision	0.000	0.000	2.540	1.000	0.254	0.000	**3.794**

Changes necessary for Revised Price Control

Depreciation and Return

As described above, the RAB had been fully depreciated. The depreciation and return values within the price control formula can therefore be removed.

Core allowance

The core allowance represents the sum of the operating expenditure, the working capital and the profit allowance. This is therefore set at £3.794m (October 2017 prices), and will be adjusted for RPI in each relevant year.

Pension Deficit Cost

As described above, the allowed pension deficit cost is being removed.

Excluded Costs

A fixed allowance of £60,000 has been included within Opex for costs items which fall under the Excluded Costs part of the licence. However, this allowance only covers cost items under the value of £30,000. An application for cost items above this value may be made, and will be considered on an individual basis by the Utility Regulator.

PPB's share of the gross surplus

PPB's share of the gross surplus is derived from the following formulae:

(a) where the gross surplus is less than zero: PPB's share = zero;

(b) where the gross surplus is greater than zero and less than or equal to £10m: PPB's share = gross surplus * 6%;

(c) where the gross surplus is greater than £10m: PPB's share = £0.6m + ((Gross Surplus - £10m) * 3%)

This will also be subject to a £1.8m cap.

Wind up costs

The Utility Regulator is introducing a Z_t term, equalling £300,000, to cover wind-up costs in the final year of the price control.

Pension provisions beyond wind-up

The Utility Regulator is introducing a Y_t term, the value of which to be determined at its discretion, to apply in the final year of the price control to cover forward exposure and risk in pension liabilities accrued prior to 31 March 2015.

The proposed modifications are contained within the Article 14(2) notice published herewith, and is also dated 14 January 2019.