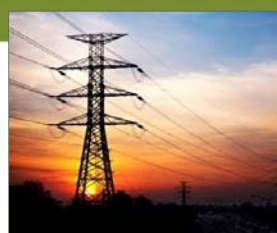


# SONI: TSO Price Control Changes

Conclusions on Pensions  
Allowances and Decision on Change  
of Law provisions

19 October 2017



# 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 and 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 (i) our final conclusions on the pension allowances for SONI's 2015-2020 price control, and (ii) our decision to proceed to make modifications to the change of law provisions in the current price control conditions for the transmission System Operator for Northern Ireland (SONI). While this paper sets out our final conclusions on the pensions allowances, we do not proceed to make the licence modifications that would otherwise implement these conclusions on the basis that the Competition and Markets Authority is currently considering an appeal by SONI against the UR's decision, of 14 March 2017, to modify the price control conditions of SONI's TSO Licence, which includes consideration of matters relating to pensions allowances. The CMA's final determination on the appeal is due in November 2017.

## Audience

Regulated Companies, Consumer Groups, Industry and Statutory Bodies.

## Consumer impact

SONI has a critical role in 'keeping the lights on'. Both the effectiveness and efficiency of SONI is key to industry and consumers. SONI's allowable revenue is passed through to end users as a System Support Services (SSS) tariff. The items contained in this paper form part of this allowable revenue. Any increase in allowable revenue directly results in an increase in tariffs for both Domestic and Large Energy Users.

# Executive Summary

On 11 April 2017, the UR issued a further consultation<sup>1</sup> on certain matters, namely pensions' allowances and the change of law provisions, relating to the 2015-2020 price control for SONI (the Further Consultation).

Having considered the responses to this further consultation and also received updated and verified information from SONI on its March 2016 actuarial valuation for its Defined Benefit pension scheme, on 16 August 2017 the UR published its Draft Decision on the matters in question.

This paper now sets out (i) our final conclusions on pension allowances for the 2015-2020 price control – in respect of which a decision to proceed with licence modification is not being made given that the CMA is currently considering pension allowances as part of SONI's appeal of the UR's licence modification decision of 14 March 2017, and (ii) our decision to proceed to make the licence modifications to the change of law provisions.

## Defined Benefit Scheme – Final Conclusions

### *Deficit cut-off*

The UR's conclusions are –

- that it is appropriate for its pension deficit recovery principles to apply to SONI's Defined Benefit Scheme and therefore that only the pension deficit incurred up to a specific date (a cut-off date) should be recoverable from consumers and any pension deficit incurred after that specific date should be borne by SONI; and
- for the cut-off date to be 31 March 2019.

### *Revised Allowances*

The UR's Draft Decision proposed that –

- The pensions allowance for ongoing contributions (which is subsumed in the payroll allowance) for the 2015-2020 period should be increased from £2 million to £2.906 million.
- However, the Draft Decision did not take into account the full annual expenses of the scheme and therefore the UR now concludes that the allowance for ongoing contributions for the 2015-2020 period should be increased from £2

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<sup>1</sup> <https://www.uregni.gov.uk/news-centre/soni-price-control-2015-2020-further-pensions-consultation>

million to £3.241 million – which takes into account the annual expenses of the scheme.

- The pension deficit allowance for the 2015-2020 period should reflect the updated pension deficit amount of £706k as at March 2016.

The UR's final conclusions are that the pension deficit allowance should be £706k recoverable over a period of 10 years starting from the valuation year of 2016/17 as set out in in the Draft Decision The table below shows the current allowances (implemented through the licence modifications decision of 14 March 2017) and the allowances reflecting the UR's final conclusions.

Existing allowances as compared to Concluded allowances	2015/16	2016/17	2017/18	2018/19	2019/20	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Existing Deficit Repair	189	189	189	189	189	945
Existing Ongoing Contributions	400	400	400	400	400	2,000
<b>Total</b>	<b>589</b>	<b>589</b>	<b>589</b>	<b>589</b>	<b>589</b>	<b>2,945</b>
Concluded Deficit Repair	268	71	71	71	71	550
Concluded Ongoing Contributions	692	763	665	574	546	3,241
<b>Total</b>	<b>960</b>	<b>834</b>	<b>736</b>	<b>645</b>	<b>617</b>	<b>3,791</b>

**Table 1: Concluded pension allowances**

### Defined Contribution Scheme – Final Conclusions

The Draft Decision did not propose any changes to the pension allowances in respect of the SONI Defined Contribution scheme. The UR's final conclusions reflect the Draft Decision.

### Change of Law Provisions – Licence Modification Decision

The UR's Draft Decision proposed certain changes to the 'change of law' provisions in the price control conditions of SONI's TSO Licence.

The UR's decision on the change of law proposals is to proceed to make the proposed licence modifications without any further revision.

The licence modifications being made are shown (in redline text) in Annex 1 of this paper and the Change of Law section states the effect of the modifications and how the UR has taken account of representations made to the Draft Decision. There are no differences between the licence modifications being made and those set out in the Draft Decision.

The licence modifications will take effect from 15 December 2017.

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# 1. Introduction

1. SONI Limited (SONI) is authorised by licence to participate in the transmission of electricity (the TSO Licence) and is the licensed Transmission System Operator (TSO) for Northern Ireland. In this capacity it is subject to a regulated price control as set out in Annex 1 of the TSO Licence. The current price control specifically relates to the period 1 October 2015 – 30 September 2020 (and is referred to in this document as the '2015-2020 price control').
2. On 24 February 2016, the Utility Regulator (UR) issued its Final Determination<sup>2</sup> on the 2015-2020 price control, proposing licence modifications to Annex 1. On 14 March 2017, the UR published its Licence Modification Decision, that is to proceed with the making of relevant licence modifications (namely to modify Annex 1 of the Licence) under and in accordance with Article 14(8) of the Electricity (Northern Ireland) Order 1992 (the Order).<sup>3</sup>
3. In responding to the Final Determination, SONI had raised some concerns about the UR's consultation process on matters relating to (i) the application of the UR's pensions deficit recovery principles and policy to SONI, and (ii) the change of law provisions. In light of the concerns raised by SONI, the UR did not proceed to make the proposed modifications to the change of law provisions in its decision of 14 March 2017 or make a decision on the application of the UR's pension deficit recovery principles and policy to SONI but decided to consult further on these matters and on pension allowances more generally.
4. Accordingly, on 11 April 2017, the UR issued a further consultation<sup>4</sup> on certain matters relating to the 2015-2020 price control for SONI (the Further Consultation).
5. On 12 April 2017, SONI sought permission from the Competition and Markets Authority to appeal the UR's Licence Modification Decision of 14 March 2017, including, among other things, an appeal on matters relating to pensions allowances. The CMA granted permission and is currently considering SONI's appeal.
6. On 16 August 2017 the UR published, under and in accordance with Article 14(2) of the Electricity Order, its Draft Decision on the pension allowances and on the change of law provisions. The Draft Decision took into consideration the responses received to the Further Consultation and also took account of further updated information from SONI on pensions' data.
7. We received one response to the Draft Decision – from SONI. The UR has considered SONI's response and concluded on both matters. Section 2 of this paper sets out the UR's final conclusions on pensions and Section 3 our final

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<sup>2</sup> <https://www.uregni.gov.uk/publications/decision-2015-2020-price-control-soni>

<sup>3</sup> <https://www.uregni.gov.uk/news-centre/soni-price-control-2015-2020-licence-modifications-published>

<sup>4</sup> <https://www.uregni.gov.uk/news-centre/soni-price-control-2015-2020-further-pensions-consultation>



conclusions on the change of law provisions.

8. However, because the CMA is currently considering SONI's appeal, including on matters relating to pensions, the UR has not decided to proceed with the making of licence modifications which would otherwise implement its final conclusions on pensions. The CMA's final determination on the appeal, and therefore its decisions on pension allowances for the 2015-2020 price control, is expected in November 2017.
9. The change of law provisions are not within the scope of SONI's appeal to the CMA and accordingly the UR has decided to proceed with the making of licence modifications to these provisions.

## 2. Pension allowances – final conclusions

10. In this section we first set out the UR's final conclusions in respect of the application of the pension deficit recovery principles to SONI and the associated issue of setting a pension deficit cut-off date.
11. We then outline the UR's final conclusions on the pension allowances for the 2015-2020 price control period in respect of each of the following elements -
  - Defined Benefit (DB) Scheme
    - Deficit repair allowance
    - Ongoing contributions
  - Defined Contribution Scheme

### Pension Deficit Recovery Principles – final conclusions

12. The UR's final conclusions are that it is right and appropriate for the UR's pension deficit recovery policy and principles<sup>5</sup> to apply to SONI in respect of the pension deficit relating to the SONI DB Scheme.
13. In brief, this is that only that pension deficit incurred up to a specified date should effectively be paid for by NI electricity consumers and therefore recoverable through SONI's price control and its SSS tariffs, and that any pension deficit incurred after that specified date should not be paid for by consumers.
14. The UR has also concluded that the specified date in question be 31 March 2019 – which is in line with the end date of the next tri-annual actuarial valuation.
15. The UR's reasons for its final conclusions are those which are set out in the Draft Decision. The UR took account of SONI's specific circumstances when reaching these conclusions, this was not limited to the information provided by SONI and nothing in SONI's response has led the UR to change these conclusions.
16. The UR has also concluded that no additional allowances will be provided for the associated administrative costs of imposing the cut-off. In our Draft Decision we requested representations on the UR's estimates of what it expected these costs to be<sup>6</sup>. We received no representations from SONI on this issue. The UR also considers the administrative expenses of SONI's DB Scheme to be very high when benchmarked - as discussed in the Ongoing contributions section, therefore we expect to see this cost absorbed as a form of efficiency.

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<sup>5</sup> See UR's paper [http://www.uregni.gov.uk/uploads/publications/UR\\_Position\\_Paper\\_-\\_Pension\\_Deficit\\_Recovery\\_v1\\_0.pdf](http://www.uregni.gov.uk/uploads/publications/UR_Position_Paper_-_Pension_Deficit_Recovery_v1_0.pdf)

<sup>6</sup> Para 29 Draft Decision

17. In its response to the Draft Decision, SONI states that because there was no specific licence modification associated with the UR's (then) proposed decision to implement a cut-off date of 31 March 2019 for pension deficit recovery that no decision has been made or is being capable of being made as part of the current process.
18. It is right that there is no licence modification associated with the UR's final conclusion on there being a cut-off date (of 31 March 2019) for the recovery of pension deficit.
19. However, SONI is wrong to state that a decision is not capable of being made as part of the current process.
20. By way of these final conclusions, the UR is providing a very clear advance signal to SONI (and other stakeholders) that the UR has, taking all the circumstances of the case into consideration, determined that NI consumers should not be paying for any pension deficit incurred after 31 March 2019.
21. However, as this particular decision does not impact on or feed through to the current price control i.e. the 2015-2020 price control, there is no licence modification that would otherwise be required to implement the UR's conclusions.
22. Rather this final conclusion will, subject to the outcomes of the CMA appeal, ultimately feed through to subsequent price controls for SONI, i.e. for price controls starting on or after 1 October 2020.
23. The UR's final conclusion is therefore a very clear and unambiguous signal to SONI (and other relevant stakeholders) of the position going forward for future price control, subject only to the CMA's final determination on SONI's appeal and/or to any subsequent decision that may be made by the UR (following due process) which either overrides or overtakes its final conclusions as set out above.

## **Pension Deficit Allowance for 2015-2020 – final conclusions**

24. Our final conclusions on changes to the pension deficit allowance for the 2015-2020 decision remain consistent with the Draft Decision. That is that the pension deficit allowance for the period shall be reduced from £945k to £550k. However full deficit recovery of £706k (the pension deficit amount as at March 2016) is allowed for over 10 years as outlined below
25. This equates to the pension deficit allowance for each relevant year in the 2015-

2020 price control period to be as set out in Table 2: Concluded deficit repair below:

	DB deficit recovery allowance conclusion					
	2015/16	2016/17	2017/18	2018/19	2019/20	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Concluded Deficit Repair</b>	268	71	71	71	71	550

**Table 2: Concluded deficit repair**

26. In its response to the Draft Decision SONI states that we disallowed an amount for 16/17. The UR did not disallow an amount for 16/17. The UR has worked out a deficit recovery plan based on the pension deficit amount of £706k existing at 31 March 2016 as verified by the actuarial valuation.

27. The deficit repair plan we are concluding on is a 10 year recovery plan from the date of the actuarial valuation of 31 March 2016. As at this date the deficit was £706K so our final conclusions are to provide for an allowance of £71k per annum for 10 years beginning in 2016/17 as outlined in our Draft Decision.

28. The actuarial valuation as at 31 March 2016 states that £268k was paid for deficit recovery after 31 March 2016 as part of a recovery plan that would see the deficit fully repaired in 7.5 years. We are concluding on a new recovery plan which would see the deficit repaired in 10 years from the March 2016 actuarial valuation.

29. In their response SONI state that a payment of £148k related to the previous recovery plan and a payment of £120k relates to a planning transfer deficit annual payment. The UR note that SONI have stated a payment relating to planning transfer was made and also note that the UR allowed £500k in 2014 for the full repair of the planning transfer deficit.

30. For clarity please see a comparison of our final conclusions on the recovery of the pension deficit allowance existing at 31 March 2016 compared to SONI's proposed recovery plan for the same deficit:

	Deficit of £706K as at 31 March 2016										
	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
UR Conclusion	71	71	71	71	71	71	71	71	71	71	710
SONI Recovery Plan	268	75	75	75	75	75	75	75	-	-	793

**Table 3: 10 year deficit repair plan**

31. The difference in the total amounts between our conclusion and SONI's recovery plan are due to the fact that our total deficit amount is in real terms and SONI's in nominal. The annual deficit repair amount will be inflated in line with RPI along

with all other opex.

32. In their response to the Draft Decision SONI state that this is in contrast with the NIE RP5 price control. The specific reference SONI make does not comment about the use of RPI but simply determines that the historic deficit repair allowance for RP5 should match the deficit repayment payment profile that NIE has agreed with the trustees of the pension scheme. We acknowledge this may have been appropriate for NIE at the time, especially given that NIE were to be subject to a deficit cut-off from 31 March 2012 however the UR considers its approach to be in line with current regulatory practice as described in the next paragraph.
33. While the UR acknowledges that the concluded deficit repair plan is different than that SONI has agreed with its Trustees, it nevertheless considers that its deficit recovery program is balanced and the most economically efficient for consumers while still providing for the deficit to be recovered in its entirety. The UR believes this to be a generous recovery position for SONI as for similar schemes OFGEM have provided for a 15 year recovery plan<sup>7</sup>.
34. We have also not factored in any investment out-performance in the recovery plan period or deducted the £120k stated by SONI as a 'planning transfer deficit annual payment' which UR could have treated as an unjustified payment at this time due to the allowance provided in 2014.
35. Subject to the CMA's final determination on pension allowances, this deficit recovery plan will be reviewed at the next actuarial valuation and factored into the price control for the period starting on 1 October 2020.

## Ongoing contributions

36. The Draft Decision incorrectly included £8k (rounded up) for expenses per annum in the allowance for ongoing contributions. The correct expense amount is in fact £7.625k per month (£91.5k per annum). An amount of £91.5k per annum has been included in the ongoing contributions. This results in an increase in the allowance

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<sup>7</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/04/decision\\_on\\_policy\\_for\\_funding\\_psedts.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/04/decision_on_policy_for_funding_psedts.pdf)

for ongoing contributions by £335k of £3.791 million as follows:

Existing allowances as compared to Concluded allowances	2015/16	2016/17	2017/18	2018/19	2019/20	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Existing Deficit Repair	189	189	189	189	189	945
Existing Ongoing Contributions	400	400	400	400	400	2,000
<b>Total</b>	<b>589</b>	<b>589</b>	<b>589</b>	<b>589</b>	<b>589</b>	<b>2,945</b>
Concluded Deficit Repair	268	71	71	71	71	550
Concluded Ongoing Contributions	692	763	665	574	546	3,241
<b>Total</b>	<b>960</b>	<b>834</b>	<b>736</b>	<b>645</b>	<b>617</b>	<b>3,791</b>

**Table 4: Concluded pension allowances**

37. The UR considers the current level of expenses to be high when benchmarked using The Pensions Regulator's (TPR) benchmarking tool<sup>8</sup>. When we select schemes with less than 100 members the tool indicates the lowest cost was £264 per member per annum whereas the highest cost was £2,744 per member per annum. The average cost was £1,054 per member per annum. The SONI scheme has around 40 members and so their expenses might be equivalent to around £2,250 per member per annum. This is clearly at the high end of the range.

38. Although the scheme might be considered fairly 'complex' in terms of benefit structure this would not necessarily lead to significantly higher on-going costs. Looking at TPR's survey of expenses, administration costs are only broadly 41% of the total costs for schemes of less than 100 members. Also administration expenses also includes task like general maintenance of records, managing bank accounts, liaising with investment managers and regulatory authorities, administering the pension payroll etc. that are not directly affected by benefit complexity. Therefore we consider that benefit complexity only has a marginal impact on on-going costs and cannot in itself justify the apparently very high expenses.

39. In the Draft Decision we requested representations on UR's estimates of what the administrative costs of the deficit cut-off date may be<sup>9</sup>. We received no representations, justification or new evidence on these costs from SONI. Given that the level of expenses are high when benchmarked as outlined above we expect to see this cost absorbed as a form of efficiency.

## Actuals assessment

40. In the Draft Decision we conducted an assessment of the actual contribution amount that SONI paid in 2016<sup>10</sup>. We calculated an estimate of what the contribution amount should have been using the March 2013 valuation's

<sup>8</sup> <http://www.thepensionsregulator.gov.uk/trustees/your-db-scheme-costs.aspx>

<sup>9</sup> Para 29 Draft Decision

<sup>10</sup> Para 60-67 Draft Decision

contribution rate of 40.3% (the applicable rate at the time) and applying this to the salary roll as at March 2016<sup>11</sup> (recognising that this will be an estimate as it is the year end figure). This showed a large difference of £229k.

41. We noted that it is possible that a number of members aren't paying contributions even though they're still accruing benefits, having completed 40 years' service which may increase the employer contribution proportion.
42. In their response to the Draft Decision SONI stated that a number of senior staff retired in the year 2015/16 all of which had over 40 years' service. SONI did not provide any additional evidence to support this e.g. active members as at March 2015 compared to active members as at March 2016.
43. Extrapolating the previous calculation this means that approximately a quarter of members over the period didn't pay contributions<sup>12</sup>. While this may well be accurate in the absence of any quantitative evidence from SONI we have concluded not to allow this. The UR consider that it would be relatively easy for SONI to provide evidence of the contributions deducted from employees and paid over to the scheme to support the claim for this large amount. The UR considers the decision it makes should be evidence based were evidence is provided. In the absence of this evidence we concluded it not appropriate to allow the amount but the amount as detailed in the Draft Decision.

## Actual Retirees and impact on forecast funding levels

44. In our Draft Decision we outlined why it would be inappropriate to apply the actuarial assumption on retirement as this does not reflect reality<sup>13</sup>.
45. The UR considers the retirement assumption used for the purposes of the actuarial valuation appropriate in order generate a contribution rate (%), however the contribution amount (£) should be the contribution rate applied to the active membership in the scheme.
46. SONI in fact confirmed in their response to the Draft Decision that their contributions are based on actual membership levels<sup>14</sup>. Converse to this in their response to the Draft Decision SONI state that they are 'strongly of the view' that the contribution rate should be applied to the actuarial assumptions... [and] that it is inappropriate for the UR to look beyond the expert work of the actuary.
47. UR can confirm that due consideration was given to the actuary advice received by SONI and they are not looking beyond the work of the actuary. We are using the actuarial valuation to gain the appropriate contribution amount which

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<sup>11</sup> Taken from the March 2016 actuarial valuation

<sup>12</sup> Implied payroll for 2015/16: (£103k + £921k) / 46.3% = £2.2m

Implied employee rate: £103k/£2.2m = 4.7%

Proportion of employees not making contributions: (6%-4.7%)/6% = 22%

<sup>13</sup> Para 68-74 Draft Decision

<sup>14</sup> Page 8 of SONI response in relation to 2015/15 contributions

encompasses the prudent assumptions as a statutory requirement. It is not correct for SONI assert that this contribution amount should then be applied back to the payroll projections contained within the valuation. UR consider that payroll projections for the purposes of forecasting the contribution amount are a business as usual projection and should be conducted in the same way all other opex is projected. SONI have confirmed that actual contributions are based on actual membership. The UR allowance are aimed at also providing allowances based upon actual membership and considering all the evidence provided.

48. The UR's retirement profile is designed to be an (relatively prudent) estimate of what the active membership levels are likely to be, and therefore what the contribution amount will be.
49. We have evidence of actuals up to 30 June 2017 and an estimate up to 31 December 2017. It would be wholly wrong to ignore this reality and apply the valuation retirement profile resulting in an over provision.
50. Contribution amounts for the years 2017/18, 2018/19 and 2019/20 are calculated using the March 2016 actuarial valuation and applying that to the UR's estimated average membership as outlined in Table 6 of the Draft Decision. The UR conclusion is that these contribution amounts are fair and should apply.
51. In SONI's response to the Draft Decision they state that they would have 'no difficulty with an annual 'true up'. The UR considered this, however this 'true-up' would need to be evidenced based, that is SONI would need to provide us with the payroll deductions from employees and the equivalent employer contributions. Our current conclusion is that this 'true-up' would likely be negative (i.e. would involve a reduction in the contribution) if SONI are basing their forecast payroll on the actuarial assumptions. Given our payroll assumption is relatively prudent we don't consider a 'true-up' appropriate at this time.

## Final Conclusions

52. The UR considers the overall pensions allowances to be fair and based on robust analysis.
53. We understand that payments to a DB pension scheme have a timing balance to them. That is to say that not adequately providing for ongoing contributions will lead to an increased deficit. Consumers will continue to pay for any increase in deficit resulting from active members, even after the 31 March 2019 cut-off date.
54. The concluded allowances provide for a full recovery of the current deficit, this will of course be amended in future to reflect subsequent actuarial valuations.



55. We have sought to estimate the ongoing contributions based on sound evidence and the actuarial valuation rate therefore we consider the risk of this increasing the established deficit to be low.
56. We consider the overall package appropriate for SONI, covering all of its ongoing pension costs while being the most economically efficient package for consumers.

## Defined contribution conclusion

57. We have concluded that the allowances for the SONI defined contribution (DC) contributions will remain as follows:

## Existing allowance

SONI Defined benefit ongoing contribution allowance	UR Decision					Total £'000
	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000	
	358	358	358	358	358	1792

**Table 5 Defined contribution conclusion**

## Other relevant pension cost considerations

58. As outlined in the Draft Decision the concluded allowances cover all SONI pension costs<sup>15</sup>.

59. There is an option within Annex 1 of SONI's Licence which allows for "Excluded SSS/TUoS Pension costs" which, as per the Draft Decision, will remain to be invoked in very exceptional circumstances.

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<sup>15</sup> Para 86-88 Draft Decision.

### 3. Change of Law

60. The UR first proposed changes to the change of law provisions in Annex 1 – the price control conditions of the TSO Licence as part of its Final Determination published in February 2016.
61. However, in light of SONI's response that the UR had not fully and properly consulted on its proposed changes to the change of law provisions, while not necessarily agreeing with SONI's arguments, the UR decided not to proceed to make the proposed licence modifications within the licence modifications decision of 14 March 2017. Instead the UR agreed to consult further on its proposed changes.
62. The UR has undertaken that further consultation, namely through the Further Consultation and the Draft Decision, has considered the consultation responses and has concluded on the changes to be made and decided to proceed with the making of licence modifications to the change of law provisions.
63. In responding to the UR's Draft Decision, SONI has essentially re-iterated its response to the Further Consultation as to why the changes should not be made.
64. The UR has given due consideration to SONI's representations to the Draft Decision but does not accept or agree with SONI's views that the changes should not be made. The UR explained its reasons for the proposed changes in its Draft Decision and these reasons continue to be applicable.
65. That is the modifications are right and appropriate in order to (i) provide for asymmetry in respect of changes to the DTSO<sub>t</sub> term to be determined by the UR without the need for SONI to make a request, (ii) provide clarity (through the deletion of provisions which do not add anything and are superfluous) that the determination has effect under the condition, and (iii) continue to provide that the UR will have regard, among other things, to its intentions in relation to the development and implementation of SEM (which are essentially the requisite arrangements provided for in Condition 60 of NIE Energy's supply licence).
66. The effect of the modifications will be (i) that the UR will be able to determine, without having received a request from SONI, that a change of law event has occurred, and (ii) to provide clarification of the current position that where the UR determines a DTSO<sub>t</sub> amount in light of a change of law the determination has effect under the condition.
67. Accordingly, the UR has decided to proceed with the making of licence modifications to the change of law provisions as set out (in redline) in Annex 1 of this paper.

## 4. Next steps

68. While this paper sets out our final conclusions on the pensions allowances, we are not proceeding to make the licence modifications that would be required to implement these conclusions on the basis that the CMA is currently considering an appeal by SONI against the UR's decision, of 14 March 2017, to modify the price control conditions of SONI's TSO Licence, which includes consideration of matters relating to pensions allowances. The CMA's final determination on the appeal is due in November 2017.
69. The change of law provisions are not within the scope of SONI's appeal to the CMA and accordingly the UR has decided to proceed with the making of licence modifications to these provisions.
70. The UR's decision on the change of law proposals is to proceed to make the proposed licence modifications without any further revision.
71. The licence modifications being made are shown (in redline text) in Annex 1 1 of this paper and Section 3 states the effect of the modifications and how the UR has taken account of representations made to the Draft Decision. There are no differences between the licence modifications being made and those set out in the Draft Decision.
72. The licence modifications will take effect from 15 December 2017.

## 5. ANNEX 1 Charge Restrictions

### 1 Definitions

#### 1.1 In this Annex:

<b>Achieved DBC</b>	means, in respect of any Relevant Year, the actual Dispatch Balancing Costs incurred on an all-island basis in that Relevant Year by the Licensee and the Republic of Ireland System Operator and included in the Annual Out-turn Report.
<b>Annual Out-turn Report</b>	has the meaning given to it in paragraph 1 of Condition 39.
<b>Applicable Exchange Rate</b>	means the annual average exchange rate for the conversion of euro into sterling as published by Thomson Reuters.
<b>Average Specified Rate</b>	means one-year LIBOR (or such other bank as the Authority shall specify from time to time) current from time to time during the period in respect of which the calculation falls to be made.
<b>Demonstrably Inefficient or Wasteful Expenditure</b>	means expenditure which the Authority has (giving the reasons for its decision) determined to be demonstrably inefficient and/or wasteful, given the information reasonably available to the Licensee at the time that the Licensee made the relevant decision about that expenditure. For the avoidance of doubt, no expenditure is demonstrably inefficient or wasteful expenditure simply by virtue of a statistical or quantitative analysis that compares aggregated measures of the Licensee's costs with the costs of other companies.
<b>Dispatch Balancing Costs</b>	means costs relating to or incurred in respect of: <ul style="list-style-type: none"> <li>(a) the constraining on or off (as the case may be) generation sets pursuant to the central dispatch and merit order systems and processes established by the Licensee in accordance with Condition 22 or for the purposes;</li> <li>(b) the management of Energy Imbalances;</li> </ul>

	<p>(c) any Uninstructed Imbalance;</p> <p>(d) Testing Charges;</p> <p>(e) Other System Charges; and</p> <p>(f) any SO Interconnector Trade.</p>
<b>Energy Imbalances</b>	means the imbalance(s) between (i) the payments made by the Single Market Operator Business to generators for electricity sold from generation sets scheduled to operate in accordance with the Licensee's instructions pursuant to the processes and procedures for central dispatch and merit order, and (ii) the payments received by the Single Market Operator Business from electricity suppliers in respect of the electricity purchased by such electricity suppliers.
<b>Ex-Ante DBC Target</b>	means, in respect of any Relevant Year, the Dispatch Balancing Costs approved by the Authority and the Commission for Energy Regulation for the purpose of their inclusion as a component in the Imperfection Charge proposed to be levied on suppliers by the Single Market Operator Business for that Relevant Year.
<b>Ex-Post DBC Target</b>	means, in respect of any Relevant Year, either the Ex-Ante DBC Target adjusted in accordance with an Ex-Post Adjustment provided that where no adjustment is to be made it shall be the Ex-Ante DBC Target for that Relevant Year.
<b>Ex-Post Adjustment</b>	means the adjustment (if any) to be made to the Ex-Ante DBC Target applicable in respect of any Relevant Year, as determined by the Authority and the Commission for Energy Regulation in accordance with, and taking account of the factors set out in, the SEM Decision Paper.
<b>Imperfection Charge</b>	has the meaning given to it in the Single Electricity Market Trading and Settlement Code.
<b><u>Legal Requirement</u></b>	<p><u>means, in relation to the Licensee, any of the following:</u></p> <p><u>(a) any enactment to the extent that it applies to the Licensee;</u></p> <p><u>(b) any regulation made by the Council or the Commission of the European Communities to the extent that it applies to the Licensee.</u></p>

	<p><u>and impacts on the Transmission System Operator Business or a decision taken by that Council or Commission which is binding on the Licensee and impacts on the Transmission System Operator Business to the extent that it is so binding;</u></p> <p>(c) <u>any interpretation of law, or finding, contained in any judgment given by a court or tribunal of competent jurisdiction in respect of which the period for making an appeal has expired;</u></p> <p>(d) <u>any direction of a competent authority other than, insofar as it applies to the Licensee, the Authority (except in the exercise of its powers under paragraph 4 of Condition 16) or the Department.</u></p>
<b>Maximum Regulated SSS/TUoS Revenue</b>	means the revenue calculated in accordance with the formula in paragraph 2 of this Annex.
<b>Moyle Interconnector Collection Agency Agreement</b>	has the meaning given to that expression in Condition 37.
<b>Other System Charges</b>	has the meaning given to it in the Single Electricity Market Trading and Settlement Code.
<b>Permitted One-Year Percentage</b>	means 4 per cent of the Maximum Regulated SSS/TUoS Revenue.
<b>Permitted Three-Year Percentage</b>	means 5 per cent of the Maximum Regulated SSS/TUoS Revenue in the second of the Relevant Years.
<b>Price Control Decision Paper</b>	means each of (i) the decision paper issued by the Authority on 19/02/2016 and entitled "Final Determination to the Price Control 2015-2020 for the Electricity System Operator for Northern Ireland (SONI)" (ii) the decision paper issued by the Authority on 10/03/2017 and entitled "Decision on the Licence Modifications for the Price Control 2015-2020 of the Electricity System Operator for Northern Ireland (SONI)" and (iii) as supplemented or amended by any further decision paper on the same subject.

<b>Quantity Entering the Total System</b>	means the aggregate quantity of units metered on entry to the total system in Relevant Year t (minus any units consumed by generation sets and imported from the total system).
<b>Regulated SSS/TUoS Revenue</b>	means the revenue (measured on an accruals basis) derived from SSS/TUoS Charges (including any revenue received from any Separate Business) after deduction of value added tax (if any) and any other taxes based directly on the amounts so derived.
<b><u>Relevant Change of Law</u></b>	<u>means the application to the Licensee of any Legal Requirement which did not previously so apply or the change of any Legal Requirement relating to the Licensee (including any such Legal Requirement ceasing to apply, being withdrawn or not being renewed).</u>
<b>Relevant Year</b>	means a financial year commencing on 1 October and concluding 30 September.
<b>Relevant Year t</b>	means that Relevant Year for the purposes of which any calculation falls to be made; " <b>Relevant Year t - 1</b> " means the Relevant Year preceding Relevant Year t and similar expressions shall be construed accordingly.
<b>SEM Decision Paper</b>	means the decision paper issued jointly by the Authority and the Commission for Energy Regulation dated 5 June 2012 and entitled "Incentivisation of All-Island Dispatch Balancing Costs".
<b>SO Interconnector Trade</b>	has the meaning given to it in the Single Electricity Market Trading and Settlement Code.
<b>SSS/TUoS Charge(s)</b>	means the charges for System Support Services and for use of the All-Island Transmission Networks as provided for under Condition 30.
<b>SSS/TUoS Charge Restriction Condition</b>	means this Annex as from time to time modified or replaced in accordance with its own terms or pursuant to any enactment.
<b>Testing Charges</b>	has the meaning given to it in the Single Electricity Market Trading and Settlement Code.
<b>Transmission Network Pre-construction Project</b>	means a transmission network project (a) identified, by the Licensee or the Transmission Owner, as a project which is



	<p>necessary for the purposes of developing the transmission system;</p> <p>(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</p> <p>(c) approved by the Authority, following a submission by the Licensee for such approval, as a project in respect of which the Licensee may proceed to carry out the activities referred to in paragraph (b) above.</p>
<b>Uncollected SSS/TUoS Revenue</b>	means any amount owed to the Licensee in respect of Regulated SSS/TUoS Revenue, which amount remains unpaid six months after the date it first fell due for payment or which amount the Licensee deems (in accordance with the payment security policy) to be unrecoverable before the expiry of that six month period; plus the reasonable recovery costs incurred by the Licensee in respect of such amount and the reasonable interest attributable to such amount (calculated, in both cases, in accordance with the payment security policy).
<b>Uninstructed Imbalance</b>	has the meaning given to it in the Single Electricity Market Trading and Settlement Code.
<b>Unit</b>	means a kilowatt hour.

1.2 Where any table refers to a numbered Relevant Year t the applicable Relevant Year t is as follows:

<b>Relevant Year t</b>	<b>Relevant Year</b>
1	October 2015 - September 2016
2	October 2016 - September 2017
3	October 2017- September 2018
4	October 2018 - September 2019
5	October 2019 - September 2020

## 2 Restriction of SSS/TUoS Charges

2.1 The Licensee shall, in setting the SSS/TUoS Charges, use its best endeavours to ensure that in each Relevant Year the Regulated SSS/TUoS Revenue shall not exceed the Maximum Regulated SSS/TUoS Revenue which shall be the aggregate of:

- (a) the maximum core SSS/TUoS revenue in Relevant Year  $t$  ( $M_{TSOt}$ ), calculated in accordance with paragraph 2.2 of this Annex;

Plus

- (b) the  $CAIR_t$  amount,

where:

$CAIR_t$  has, in respect of each Relevant Year  $t$ , the same meaning as is given to that expression in the Moyle Interconnector Collection Agency Agreement.

2.2 The maximum core SSS/TUoS revenue shall be calculated as follows:

$$M_{TSOt} = A_{TSOt} + B_{TSOt} - BI_t + D_{TSOt} + Q_t + K_{TSOt} + INCENT_t$$

where:

- (a)  $A_{TSOt}$  means:

- (i) the costs of System Support Services in Relevant Year  $t$  (including amounts payable by the Licensee to any person for the provision or use of any System Support Services provided over any interconnector) in Relevant Year  $t$ ;

plus

- (ii) amounts payable to the Transmission Owner Business for the provision of transmission services in Relevant Year  $t$ ;

plus

- (iii) amounts levied in Relevant Year  $t$  on the Transmission System Operator Business by the Market Operation Activity in accordance with Annex 1 of the Northern Ireland Market Operator Licence to the extent not recovered under any other provision of this Licence or under the Northern Ireland Market Operator Licence;

- (b)  $B_{TSOt}$  means the allowed SSS/TUoS revenue in Relevant Year  $t$ , which for each Relevant Year  $t$  in the period 1 October 2015 to 30 September 2020 is the aggregate of:

- (i) the amount allowed for each cost category listed in Table A in paragraph 2.2(b)(vi); and

- (ii) the rate of return allowance set out in Table B in paragraph 2.2(b)(vii),

which in each case:

- (iii) is indexed by  $RPI_t$  in respect of each Relevant Year  $t$  with respect to  $RPI$  at April 2014 (255.7),

where:

- (iv) the rate of return allowance is calculated in accordance with paragraph 2.3 of this Annex;

(v)  $RPI_t$  means the Retail Price Index (1987 = 100) published or determined with respect to April in Relevant Year t (i.e. RPI in the Relevant Year t = 2 means the value of RPI in April falling within the Relevant Year t=2);

(vi) Table A is as follows:

Relevant Year t	1	2	3	4	5
	£m	£m	£m	£m	£m
Payroll	7.217	7.217	7.217	7.217	7.217
IT & Communications	1.783	1.850	1.924	1.948	1.997
Other OPEX	1.411	1.411	1.783	1.692	1.664
Pension Deficit	0.189	0.189	0.57	0.57	0.57
Depreciation on Non-Building Assets	4.083	1.750	1.344	1.285	1.236
Depreciation on Building Assets	0.116	0.116	0.116	0.116	0.116
Depreciation on CAPEX Overspend for 2010-2015	n/a	n/a	n/a	0.850	0.850
Real Price Effects & Productivity	0.146	0.222	0.299	0.375	0.454

(vii) Table B is as follows:

Relevant Year t	1	2	3	4	5
	£m	£m	£m	£m	£m
rate of return allowance	0.440	0.339	0.305	0.364	0.321

(c)  $BI_t$  means the sum which is designed to share equally, between the Licensee and customers, the value of any outperformance or underperformance of the Licensee against the allowed SSS/TUoS revenue and which shall be calculated as follows:

$$BI_t = (B_{TSO_t} - C_{TSO_t}) * 50\%$$

where:

$C_{TSO_t}$  means:

(i) the aggregate of the actual costs incurred by the Licensee in Relevant Year t in respect of each costs category listed in Table A in paragraph 2.2(b)(vi) of this Annex, minus that part (if any) of such actual costs that the Authority determines to be Demonstrably Inefficient or Wasteful Expenditure;

plus

(ii) the rate of return allowance for Relevant Year t as set out in Table B in paragraph 2.2(b)(vii) of this Annex;

- (d)  $D_{TSO_t}$  means:
- (i) the aggregate of the total amount, allowed by the Authority in accordance with the approval given pursuant to paragraph 8.3(e) of this Annex, in Relevant Year t for excluded SSS/TUoS costs;
  - plus
  - (ii) the total amount, allowed by the Authority in accordance with paragraph 6.1 of this Annex, in Relevant Year t for change of law;
- (e)  $Q_t$  means an adjustment to be applied to the maximum core SSS/TUoS revenue, which:
- (i) in Relevant Year t ending 30 September 2017 shall be the amount which is determined by the Authority and notified to the Licensee in accordance with principles set out in a document provided to the Licensee; and
  - (ii) in each other Relevant Year shall be equal to zero.
- (f)  $K_{TSO_t}$  means the correction factor (whether a positive or negative number) to be applied to the maximum core SSS/TUoS revenue in Relevant Year t derived using the following formula:

$$K_{TSO_t} = (F_{TSO_{t-2}} - R_{TSO_{t-2}}) (1 + I_t)$$

where:

- (i)  $F_{TSO_{t-2}}$  means:
  - (A) the  $M_{TSO_t}$  for Relevant Year t-2;
  - minus
  - (B)  $(D_{TSO_{t-2}} - AD_{TSO_{t-2}})$ ;
  - minus
  - (C) that part (if any) of  $AD_{TSO_{t-2}}$  that the Authority determines to be Demonstrably Inefficient or Wasteful Expenditure,

where:

$AD_{TSO_{t-2}}$  means:

- 1) where actual costs incurred by the licensee in relation to excluded SSS/TUoS costs and change of law in Relevant Year t-2 are less than the costs allowed for  $D_{TSO_t}$ , in Relevant Year t-2, the total of such actual costs;
  - 2) where actual costs incurred by the licensee in relation to excluded SSS/TUoS costs and change of law in Relevant Year t-2 are greater than the costs allowed for  $D_{TSO_t}$  in Relevant Year t-2, the total of the costs allowed for  $D_{TSO_t}$  in Relevant Year t-2,
- (ii)  $R_{TSO_{t-2}}$  means:
    - (A) the Regulated SSS/TUoS Revenue in Relevant Year t-2;
    - minus
    - (B) the  $CAIR_t$  amount in Relevant Year t-2;

- (iii)  $I_t$  means:
  - (A) where the amount derived from the calculations undertaken pursuant to paragraphs 2.2(e)(i) and (ii) is a positive figure, the Average Specified Rate for Relevant Year t-2 plus 2% of that rate (as expressed in decimal figures); and
  - (B) where the amount derived from the calculations undertaken pursuant to paragraphs 2.2(e)(i) and (ii) is a minus figure, the Average Specified Rate for Relevant Year t-2 plus 1% of that rate (as expressed in decimal figures).

(g)  $INCENT_t$  means:

- (i) where the Achieved DBC for Relevant Year t-2 is below the Ex-Post DBC Target for that year, the amount (converted into pounds sterling at the Applicable Exchange Rate for Relevant Year t-2) that is equal to 25% of the DBC Success Amount (represented as a positive figure) for that Relevant Year;
- (ii) where the Achieved DBC for Relevant Year t-2 is above the Ex-Post DBC Target for that year, the amount (converted into pounds sterling at the Applicable Exchange Rate for Relevant Year t-2) that is equal to 25% of the DBC Failure Amount (represented as a negative figure) for that Relevant Year,

where:

- (iii) DBC Success Amount means the amount that is equal to 10% of every whole 2.5% by which the Achieved DBC is below the Ex-Post DBC Target provided that:
  - (A) where the Achieved DBC is less than 10% below the Ex-Post DBC Target, the amount shall be calculated as zero;
  - (B) where the Achieved DBC is more than 20% below the Ex-Post DBC Target, the amount shall be calculated on the basis that Achieved DBC is 20% below the Ex-Post DBC Target.
- (iv) DBC Failure Amount means the amount that is equal to 5% of every whole 2.5% by which the Achieved DBC is above the Ex-Post DBC Target, provided that:
  - (A) where the Achieved DBC is less than 10% above the Ex-Post DBC Target, the amount shall be calculated as zero;
  - (B) where the Achieved DBC is more than 20% above the Ex-Post DBC Target, the amount shall be calculated on the basis that the Achieved DBC is 20% above the Ex-Post DBC Target.

#### Rate of Return

2.3 The rate of return allowance set out in Table B, in paragraph 2.2(b)(vii) of this Annex, for each Relevant Year t is calculated as follows:

$RAB_t \times WACC_t$   
where:

- (a) RAB<sub>t</sub> means the average Regulated Asset Base amount for each Relevant Year t set out in the table below:

Relevant Year t	1	2	3	4	5
	£m	£m	£m	£m	£m
Average Non-Building RAB	5.072	3.470	3.056	2.907	3.142
Average Building RAB	2.385	2.268	2.152	2.036	1.919
Average CAPEX Overspend 2010-2015 RAB	n/a	n/a	n/a	1.275	0.425
<b>Average RAB Total</b>	<b>7.457</b>	<b>5.738</b>	<b>5.208</b>	<b>6.218</b>	<b>5.486</b>

- (b) WACC<sub>t</sub> means:

- (i) the Weighted Average Cost of Capital for Relevant Year t set out in the table below:

Relevant Year t	1	2	3	4	5
WACC	5.9%	5.9%	5.85%	5.85%	5.85%

and:

- (ii) is calculated in accordance with the following formula –

$$WACC = ((r_e/(1-t_x)) \times (1 - g)) + (r_d \times g)$$

where:

- (iii)  $r_e$  = cost of equity

- (iv)  $r_d$  = cost of debt

- (v)  $t_x$  = taxation

- (vi)  $g$  = gearing

where:

- (A) the value of (v) shall be the main rate of corporation tax, applicable to Northern Ireland, in existence at the commencement of the Relevant Year t.

### 3 **Restriction of SSS/TUoS Charges: Adjustments**

- 3.1 If, in respect of any Relevant Year, the Regulated SSS/TUoS Revenue exceeds the Maximum Regulated SSS/TUoS Revenue by more than the Permitted One-Year Percentage, the Licensee shall furnish an explanation to the Authority and in the next following Relevant Year the Licensee shall not effect any increase in the SSS/TUoS Charges unless it has demonstrated to the reasonable satisfaction of the Authority that the Regulated SSS/TUoS Revenue would not be likely to exceed the Maximum Regulated SSS/TUoS Revenue in that next following Relevant Year.

3.2 If, in respect of any three successive Relevant Years, the sum of the amounts by which the Regulated SSS/TUoS Revenue has exceeded the Maximum Regulated SSS/TUoS Revenue is more than the Permitted Three-Year Percentage, then in the next following Relevant Year the Licensee shall, if required by the Authority, adjust the SSS/TUoS Charges such that the Regulated SSS/TUoS Revenue would not be likely, in the judgment of the Authority, to exceed the Maximum Regulated SSS/TUoS Revenue in that next following Relevant Year.

#### 4 **Information to be provided to the Authority**

4.1 Where any change is intended to be made in the SSS/TUoS Charges regulated under paragraph 2 of this Annex, the Licensee shall not later than the time referred to in paragraph 4.2 provide the Authority with:

- (a) a written forecast of the Maximum Regulated SSS/TUoS Revenue, together with its components, in respect of the Relevant Year  $t$  in which such change is to take effect;
- (b) a written estimate of the Maximum Regulated SSS/TUoS Revenue, together with its components, in respect of the Relevant Year  $t-1$  immediately preceding the Relevant Year in which the change is to take effect, unless a statement complying with paragraphs 4.5 and 4.6 in respect of Relevant Year  $t-1$  has been furnished by the Licensee to the Authority before the time referred to in paragraph 4.2.

4.2 The relevant time referred to in paragraph 4.1 shall be 1 month prior to the publication by the Licensee of such charges.

4.3 The Authority may issue directions providing that any forecast or estimate provided in accordance with paragraph 4.1 shall be accompanied by such information as regards the assumptions underlying the forecast or estimate as may be necessary to enable the Authority to be satisfied that the forecast or estimate has been properly prepared on a consistent basis and the Licensee shall comply with any such directions.

4.4 Not later than 6 weeks after the commencement of each Relevant Year  $t$ , the Licensee shall send to the Authority a statement as to:

- (a) whether or not the provisions of paragraph 3 of this Annex are likely to be applicable in consequence of the Regulated SSS/TUoS Revenue in the preceding Relevant Year  $t-1$  or the 3 preceding Relevant Years  $t-1$ ,  $t-2$  and  $t-3$ ; and
- (b) its best estimate (calculated to the extent possible on the basis of the formula set out in paragraph 2.2(e) of this Annex) as to the relevant correction factor  $K_{TSO}$  in respect of Relevant Year  $t-1$ .

4.5 Not later than 3 months after the end of each Relevant Year the Licensee shall send to the Authority a statement, in respect of that Relevant Year, which includes:

- (a) the Maximum Regulated SSS/TUoS Revenue for that Relevant Year  $t$ ; and
- (b) the specified items referred to in paragraph 4.7.

4.6 The statement referred to in paragraph 4.5 shall be:

- (a) accompanied by a report from the Auditors that in their opinion:

- (i) such statement fairly presents each of the specified items referred to in paragraph 4.7 in accordance with the requirements of the SSS/TUoS Charge Restriction Condition; and
  - (ii) the amounts shown in respect of each of those specified items are in accordance with the Licensee's accounting records which have been maintained in respect of each of the relevant Separate Businesses in accordance with Condition 2; and
- (b) certified by a director of the Licensee on behalf of the Licensee that to the best of his knowledge, information and belief having made all reasonable enquiries:
- (i) there is no amount included in its calculations under paragraph 2 which represents other than an amount permitted under the SSS/TUoS Charge Restriction Condition to be so included;
  - (ii) all amounts which should properly be taken into account for the purposes of the SSS/TUoS Charge Restriction Condition have been taken into account.

4.7 The specified items to be contained in the statement referred to in paragraph 4.5 shall be the actual amounts in respect to:

- (a) the Regulated SSS/TUoS Revenue;
- (b) the actual costs of  $A_{TSO_t}$ , (which are to be calculated to the extent possible in accordance with paragraph 2.2(a) of this Annex) and showing separately each component thereof;
- (c) the actual SSS/TUoS revenue (being  $C_{TSO_t}$ , and calculated to the extent possible in accordance with paragraph 2.2(c) of this Annex);
- (d) the actual costs incurred in respect of each category of expenditure for which the Authority determined an allowance with regard to excluded SSS/TUoS and change of law costs; and
- (e) such other items as shall be specified in directions issued by the Authority from time to time for the purposes of this Annex.

4.8 The Licensee shall, for each Relevant Year  $t$  commencing 1 October, submit to the Authority, its best endeavours to by no later than 31 March preceding the start of that Relevant Year  $t$ ,

- (a) the amount of  $D_{TSO_t}$  costs:
  - (i) that the Licensee considers to have previously been allowed by the Authority for that Relevant Year  $t$ ;
  - (ii) that the Licensee is, or will be, requesting a determination in accordance with paragraph 6 or is, or will be, making a claim in accordance with paragraph 8 (but excluding any costs relating to Transmission Network Pre-Construction Project  $D_{TSO_t}$  and PCI  $D_{TSO_t}$ ) for that Relevant Year  $t$ , and
- (b) its calculations in respect of the applicable  $K_{TSO_t}$ , together with its individual components, for the Relevant Year  $t-2$ ,

and requesting approval from the Authority for such costs to be factored into the Licensee's



SSS/TUoS Charges for that Relevant Year  $t$  (which approval may be given with such adjustments to the Licensee's proposed  $D_{TSO_t}$  and  $K_{TSO_t}$  as reasonably determined by the Authority to be appropriate in the circumstances).

5 **Duration of SSS/TUoS Charge Restriction Condition**

5.1 The restrictions on SSS/TUoS Charges outlined in paragraph 2 of this Annex do not apply to tariff years from 1 October 2020 onwards. However, if no modifications to apply any different restrictions with effect from that date are made then, until any such modifications are made, the licensee shall not increase (in nominal terms) any of the tariffs or charges contributing to its Regulated SSS/TUoS Revenue above the levels applicable on 1 October 2019, except where:

- (a) the increase is approved by the Authority and the approval is given in advance of the tariff year in which the increase is to apply;
- (b) the increase is required to ensure that the Licensee is able to collect the Collection Agency Income Requirement required by it to discharge its duties under the Moyle Interconnector Collection Agency Agreement in accordance with Condition 37 of this licence;
- (c) the increase is required to enable the Licensee to collect the TUoS revenue that the Authority has determined is payable to the Transmission Owner Business for the provision of transmission services; or
- (d) the increase is required to enable the Licensee to collect System Support Services, Ancillary Services, Other System Charges and TUoS revenue in respect of generation, as determined by the SEM Committee.

**Disapplication**

5.2 This Annex shall apply so long as the Licence continues in force but shall cease to have effect (in whole or in part, as the case may be) if the Licensee delivers to the Authority a request (a "Disapplication Request") made in accordance with paragraph 5.4 and:

- (a) the Authority agrees in writing to the request; or
- (b) the application of this Annex (or any part of it) is terminated by a notice (a "Disapplication Notice") given by the Licensee in accordance with paragraph 5.5 and not withdrawn.

5.3 Save where the Authority otherwise agrees, no disapplication following delivery of a Disapplication Request pursuant to paragraph 5.4 shall have effect earlier than the date (the "Disapplication Date") which is the later of:

- (a) the date occurring 18 months after delivery of the Disapplication Request; and
- (b) 30 September 2020.

5.4 A Disapplication Request pursuant to this paragraph 5.4 shall:

- (a) be in writing addressed to the Authority;
- (b) specify this Annex or any part of it to which the request relates (excluding in either case this paragraph 5); and

- (c) state the date from which the Licensee wishes the Authority to agree that this Annex or the specified part of it shall cease to have effect.

5.5 A Disapplication Notice pursuant to this paragraph 5.5:

- (a) may be given in the circumstances described in either paragraph 5.6 or paragraph 5.7;
- (b) may be withdrawn by the Licensee at any time prior to the Disapplication Date; and
- (c) where it is given, shall:
  - (i) be in writing addressed to the Authority;
  - (ii) specify this Annex, or any part of it (which shall comprise only such part as was specified in the Disapplication Request) to which the notice relates; and
  - (iii) state the date from which the Licensee wishes the notice to take effect, which shall not be earlier than the Disapplication Date.

5.6 The circumstances described in this paragraph are that, by the beginning of the period of six months which will end with the Disapplication Date, the Authority has not in response to the Disapplication Request published a decision under Article 14(8) of the Order to modify:

- (a) this Annex, or any part of it to which the request relates; or
- (b) this paragraph 5, so as to remove the right of the Licensee to give to the Authority a Disapplication Notice in respect of the relevant Disapplication Request.

5.7 The circumstances described in this paragraph are that:

- (a) by no later than the beginning of the period of six months which will end with the Disapplication Date, the Authority has in response to the Disapplication Request published a decision of a type referred to in paragraph 5.6;
- (b) the Licensee has exercised its right to appeal to the CMA against that decision in accordance with Article 14B of the Order;
- (c) the CMA has, in respect of the provisions to which the Disapplication Request relates:
  - (i) quashed the decision of the Authority under Article 14E(2)(a) of the Order; and
  - (ii) neither remitted the matter back to the Authority under Article 14E(2)(b) of the Order nor substituted its own decision for that of the Authority under Article 14E(2)(c) of the Order; and
  - (iii) no more than 30 days has elapsed since the date on which the CMA quashed the decision of the Authority.

## 6 **Change of Law**

~~6.1 — Where it appears to the Licensee that there has been, or is likely to be, a relevant change of law which has had or is likely to have a material effect on the financial position and performance of the Transmission System Operation Business the Licensee may require the Authority to determine whether the relevant change of law has had or is likely to have such an effect, and if so what amounts, if any, should be treated as allowed change of law revenues in~~

calculating  $D_{TSO,t}$  for relevant year  $t$  and each succeeding relevant year in accordance with paragraph 2 to ensure that the financial position and performance of the Licensee is likely, so far as reasonably practicable, to be the same as if the relevant change of law had not taken place. In determining the matters provided for in the paragraph above, the Authority shall have regard, where relevant, to:

- (a) its intentions in relation to the development and implementation of the “requisite arrangements”, as provided for in condition 60 of the NIE Energy Supply Licence;
- (b) the period over which the Licensee shall incur costs by reason of the relevant change of law;
- (c) the incremental costs (including financing costs) which the Licensee has been or will be required to incur as a consequence of the relevant change of law; and
- (d) the other circumstances of the case.

6.2 A notice given to the Authority by the Licensee pursuant to paragraph 6.1 shall contain or be accompanied by all relevant details of the relevant change of law and such other information as the Authority shall require and, unless the Authority shall otherwise consent, shall be given not later than the first day of April immediately preceding the first of the relevant years in respect of which the Licensee wishes any change in such elements to take effect.

6.3 This Annex shall be modified to give effect to any determination made by the Authority under this paragraph 6. Such modification shall have effect from the later of the date of the determination and the date upon which the relevant change of law comes into force.

6.4 In this paragraph:

**"legal requirement"**

means, in relation to the Licensee, any of the following:

- (a) any enactment to the extent that it applies to the Licensee;
- (b) any regulation made by the Council or the Commission of the European Communities to the extent that it applies to the Licensee or a decision taken by the said Commission which is binding on the Licensee to the extent that it is so binding;
- (c) any interpretation of law, or finding, contained in any judgment given by a court or tribunal of competent jurisdiction in respect of which the period for making an appeal has expired which requires any legal requirement falling within (a) or (b) above to have effect in a way different to that in which it previously had effect;
- (d) any direction of a competent authority other than, insofar as it applies to the Licensee, the Authority (except in the exercise of its powers under paragraph 4 of Condition 16) or the Department;

**"relevant change of law"** means any of the following:

- ~~(a) the application to the Licensee of any legal requirement which did not previously so apply or the change of any legal requirement relating to the Licensee (including any such legal requirement ceasing to apply, being withdrawn or not being renewed);~~
- ~~(b) a change of the United Kingdom Plan, as it applies to Northern Ireland, for the reduction of emissions, made by the Secretary of State on 20 December 1990 pursuant to section 3(5) of the Environmental Protection Act 1990 (as it shall have been amended, supplemented or replaced from time to time).~~

6.1 The Authority may, including following a request made to it by the Licensee asking it to do so, determine that there has been, or is likely to be, a Relevant Change of Law which has had, or is likely to have, a material effect on the financial position and performance of the Transmission System Operation Business.

6.2 Where the Authority makes a determination pursuant to paragraph 6.1, it may, for the purposes of ensuring that the financial position and performance of the Licensee is likely, so far as reasonably practicable, to be the same as if the Relevant Change of Law had not taken place, give effect to that determination by also determining, and notifying the Licensee of, an amount (whether a positive or negative figure) that is an allowed amount for change of law, for the purposes of calculating  $D_{TSO,t}$  in accordance with paragraph 2.2(d) of this Annex, for each Relevant Year  $t$  specified in the Authority's notification.

6.3 In determining the matters provided for in paragraphs 6.1 and 6.2, the Authority shall have regard, where relevant, to:

- (a) its intentions in relation to the development and implementation of the "requisite arrangements", as provided for in condition 60 of the NIE Energy Supply Licence;
- (b) the period over which the Licensee shall incur costs by reason of the Relevant Change of Law;
- (c) the incremental costs (including financing costs) which the Licensee has been or will be required to incur as a consequence of the Relevant Change of Law; and
- (d) any other circumstances relevant to the case.

6.4 Where the Licensee requests the Authority to make a determination pursuant to paragraph 6.1, the request shall:

- (a) unless the Authority otherwise consents, be made no later than the first day in the April immediately preceding the first Relevant Year in respect of which the Licensee would (if the Authority were to make a determination pursuant to paragraph 6.1) want

the Authority to determine an allowed amount for change of law under paragraph 6.2; and

(b) be accompanied by all relevant details (including a breakdown of internal and external incremental costs incurred) of the Relevant Change of Law and such other information as the Authority may request and require to be provided by the Licensee for the purposes of its consideration of the request.

## **7 Unit Coverage**

- 7.1 The component of Maximum Regulated SSS/TUoS Revenue relating to System Support Services (or certain parts of that component) can potentially be recovered from the Quantity Entering the Total System in the authorised transmission area.
- 7.2 The final decision regarding which Units in particular the component of Maximum Regulated SSS/TUoS Revenue relating to System Support Services (or certain parts of that component) will be recovered from in Relevant Year t (“unit coverage”) rests with the Authority.
- 7.3 In each Relevant Year t on the decision of the Authority regarding unit coverage of the System Support Services charge, the Licensee will then draw up for the Relevant Year t the schedule of System Support Services charges in accordance with Condition 30 in a manner which is consistent with the decision of the Authority regarding unit coverage. If the Licensee draws up for Relevant Year t the schedule of System Support Services charges in accordance with Condition 30 in a manner which is not consistent with the decision of the Authority regarding unit coverage then the Authority’s approval under Condition 30 paragraph 6 for the form of this schedule will not be granted.

## **8 Excluded SSS/TUoS Costs**

- 8.1 The Licensee may, subject to paragraphs 8.2 and 8.3, make a claim (to the Authority) that the following costs and revenues of the Licensee (whether a positive or negative amount) shall be treated as excluded TUoS/SSS costs in Relevant Year t:
- (a) any reasonable and efficient costs incurred (or likely to be incurred) by the Transmission System Operator Business (in Relevant Year t) in complying with the requirements imposed on the Licensee under legislation and other legal requirements through which Directive 2009/72/EC is implemented, whether before or after the coming into effect of this Annex, and to the extent not recovered under any other provision of this Licence or under the Northern Ireland Market Operator Licence or under the Transmission Owner Licence;
  - (b) any reasonable and efficient costs incurred (or likely to be incurred) by the Transmission System Operator Business (in Relevant Year t) in complying with the requirements imposed on the Licensee:
    - (i) under the arrangements for the Single Electricity Market (being the project described in the Memorandum of Understanding dated 23 August 2004 and made between the Authority and the Commission for Energy Regulation); and
    - (ii) under the arrangements implementing the Integrated Single Electricity Market (I-SEM) (a joint project developed jointly between the Authority and the Commission for Energy Regulation for the all island electricity market to be

compliant with the EU Target Model of the European Commission to facilitate a pan-European electricity market),

in each case whether before or after the coming into effect of this Annex and to the extent not recovered under any other provision of this Licence or under the Northern Ireland Market Operator Licence or under the Transmission Owner Licence;

- (c) any reasonable and efficient costs incurred (or likely to be incurred) in Relevant Year t associated with any future divestment of the Transmission System Operator Business;
- (d) the pension costs (in Relevant Year t) of the Transmission System Operator Business to the extent not recovered under any other provision of this Licence;
- (e) amounts that become Uncollected SSS/TUoS Revenue in Relevant Year t less any amount or part of an amount treated as Uncollected SSS/TUoS Revenue in respect of a preceding Relevant Year that has been paid to the Licensee in Relevant Year t;
- (f) any reasonable and efficient costs incurred (or likely to be incurred) in Relevant Year t to finance the working capital requirements of SEMO and to the extent not recovered under any provision of this Licence or under the Northern Ireland Market Operator Licence. The financing costs are to be charged at Average Specified Rate plus 2%.
- (g) any reasonable and efficient costs incurred (or likely to be incurred) in Relevant Year t in relation to:
  - (i) the Licensee's membership of the European Network of Transmission System Operators for Electricity (ENTSO-E);
  - (ii) payments made, or required to be made, by the Licensee under and in accordance with the ENTSO-E Inter TSO Compensation Agreement;
  - (iii) the Licensee participating on a mandatory basis in Regional Security Coordination Initiatives (RSCIs) as a member of ENTSO-E.
- (h) any reasonable and efficient costs incurred in Relevant Year t in undertaking electricity transmission network planning activities associated with a Transmission Network Pre-Construction Project; and
- (i) any other reasonable and efficient costs incurred (or likely to be incurred) by the Transmission System Operator Business which:
  - (i) are not taken into account in the setting of  $A_{TSOt}$  or  $B_{TSOt}$ ;
  - (ii) cannot reasonably be controlled by the Licensee; and
  - (iii) the Authority determines, upon an application to it by the Licensee, shall be included for the purposes of this paragraph.

- 8.2 In making any claim pursuant to paragraph 8.1, the Licensee shall ensure that:
- (a) it takes account of, and gives regard to, the Price Control Decision Paper; and
  - (b) the costs or revenues in respect of which the claim is made are not included:
    - (i) in more than one category listed in sub-paragraphs (a) to (i) of paragraph 8.1; and
    - (ii) in more than one claim made pursuant to paragraph 8.1.
- 8.3 Any claim made by the Licensee pursuant to paragraph 8.1 shall:
- (a) be submitted by the Licensee, using its best endeavours, by no later than the first day in April immediately preceding the Relevant Year in respect of which the Licensee wishes the claim to take effect;
  - (b) differentiate between internal and external costs and revenues;
  - (c) relate only to those costs not recovered (or recoverable) under any other provision of this Licence or under the Northern Ireland Market Operator Licence or under the Transmission Owner Licence;
  - (d) contain or be accompanied by all relevant details of the costs claimed and such other information as the Authority shall require in order to determine whether such costs can be recovered by the Licensee; and
  - (e) require to be approved by the Authority as allowed costs for Relevant Year t and shall not become effective as such allowed costs until approved by the Authority.
- 8.4 Any claim for costs made by the Licensee pursuant to paragraph 8.1 received by the Authority after this paragraph 8.4 takes effect, shall be subject to the application of a de minimis threshold, by the Authority, of £40,000 (in nominal terms) in each Relevant Year for each category of costs referred to in paragraphs 8.1(a) to (i) or such other categories of costs as determined by the Authority.

## **9 Reporting**

- 9.1 The Licensee shall, provide to the Authority all information requested in association with this Annex in such format and by such time as may be reasonably directed by the Authority.