

NI TSO Price Control

SECG 4: February 2019



Agenda

Topic	Speaker
Introduction/meeting notes/actions 1.35 to 1.45	Tanya Hedley (UR)
Consultation and responses 1.45 to 2.45	Ciaran MacCann (UR)
SECG moving forward 1.45 to 3.30	SONI

Price control objectives: what we
want SONI to deliver

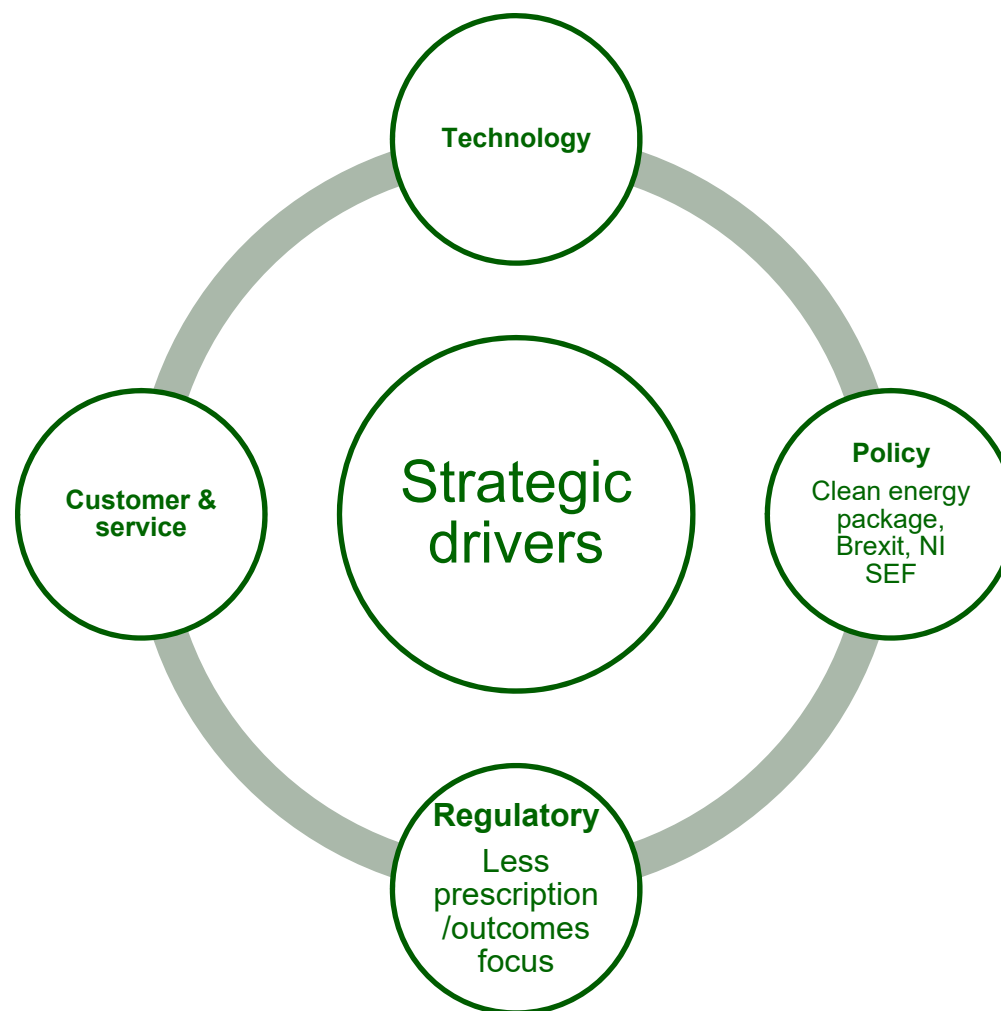
Reminder of our high level expectations

Objectives

1. Confidence that SONI service meets customer expectations and is aligned with system wide interests
2. Confidence that SONI is providing high quality service and performance which improves over time
3. Confidence that costs are reasonable and efficient
4. Better SONI service and cost transparency and clarity
5. Confidence that framework provides SONI's investors with fair package of remuneration

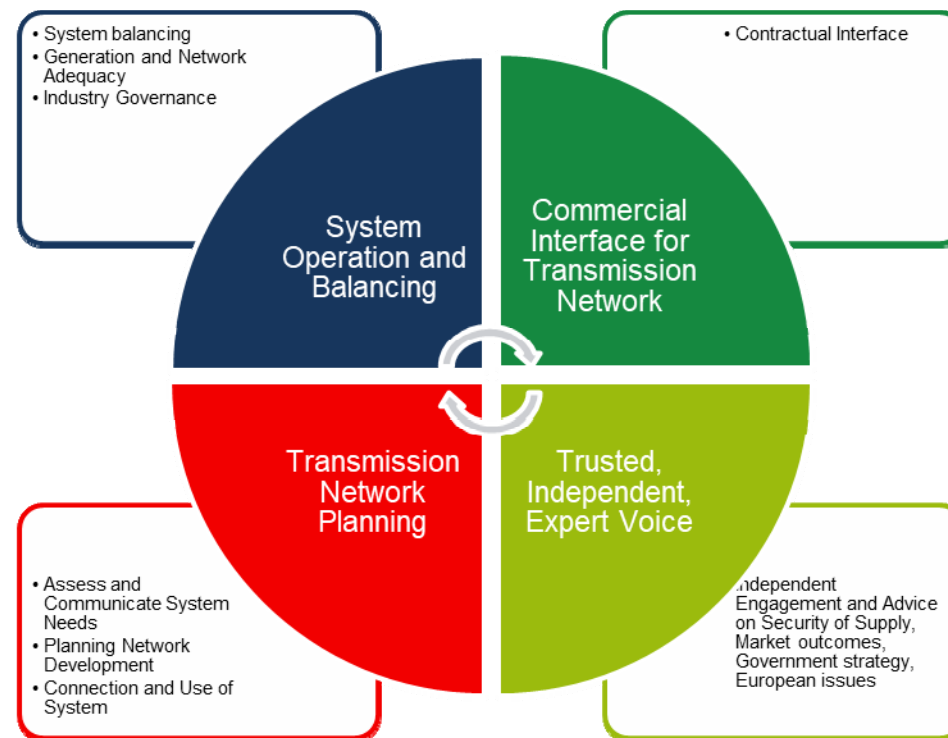
SONIs roles and services and wider context

Complex energy system in transition over our proposed 5 year price control period (2020 to 2025)



SONI's service affects energy system performance

SONI's view below of its complex, interacting set of services affecting a large part of electricity system



SONI spend on services is relatively small compared to potential impact on system and business is asset light in nature

Stakeholder responses

Business plan will largely reflect and build on recent achievements & key engagements **(SONI)**

Absence of SEF means scope needs to be consulted on with stakeholders and DfE **(Stakeholder)**

Description of SONI services and roles is simplistic and missing detail **(SONI and other stakeholder)**

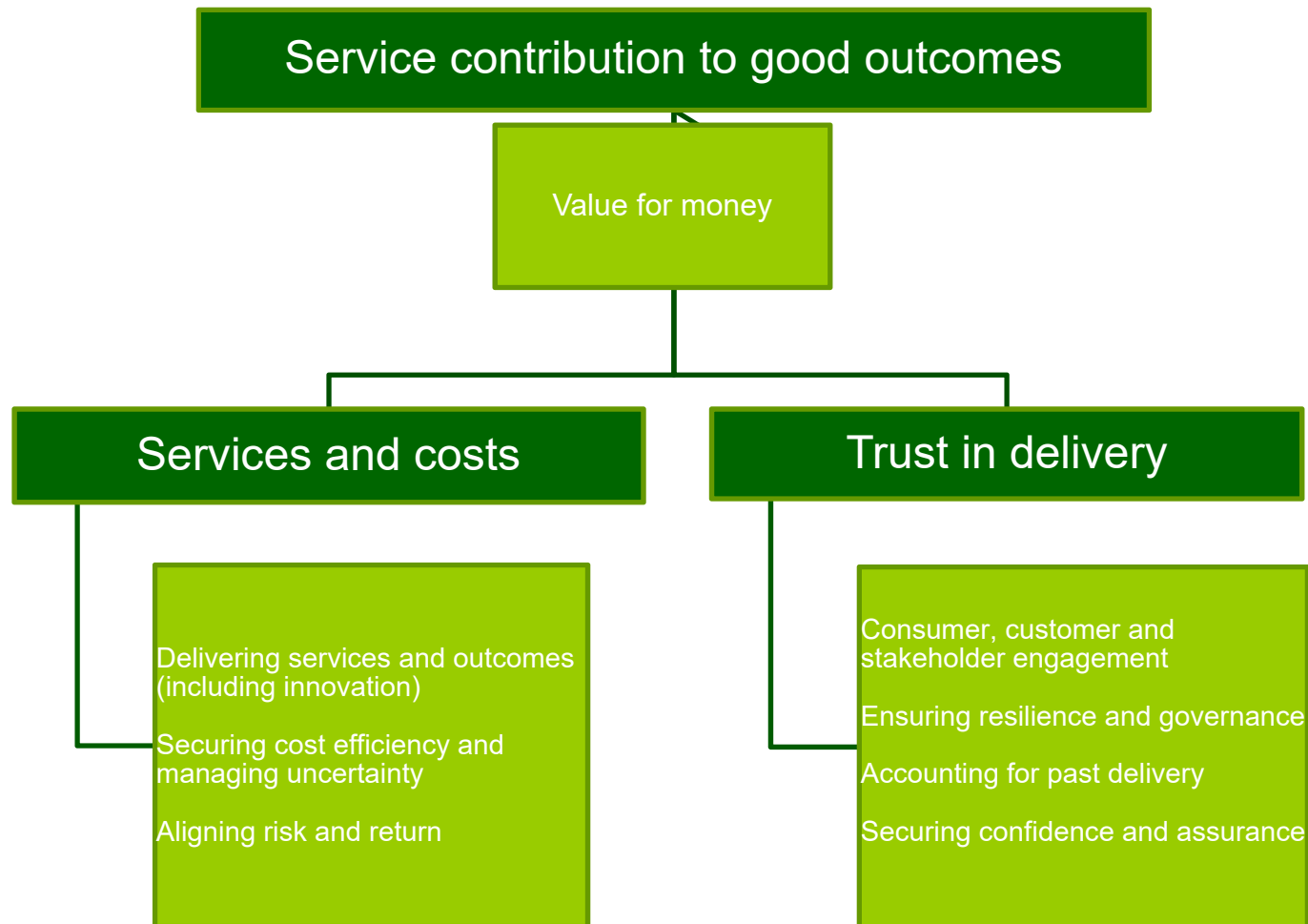
Legislation, codes and licence modifications required before business plan submission to change scope of SONI role **(SONI)**

Overview of key areas of our approach and responses

Overall form and duration of control proposals

- We proposed retaining the existing revenue based price control
- We proposed retaining the 5 year duration
- Stakeholders (including SONI) were supportive of this)

Remainder of approach and proposals split across different test areas



- Demonstration that services and tariffs offer value for money
- Demonstration that business proposals contribute to desired outcomes and affect different parties
- Tariffs represent a fair balance of charges – current and future customers

Stakeholder responses

Step change
envisaged by regulator
means cost justified by
outcome delivery
(stakeholder)

Important area but
difficult to measure -
needs considered by
regulator carefully
(stakeholder)

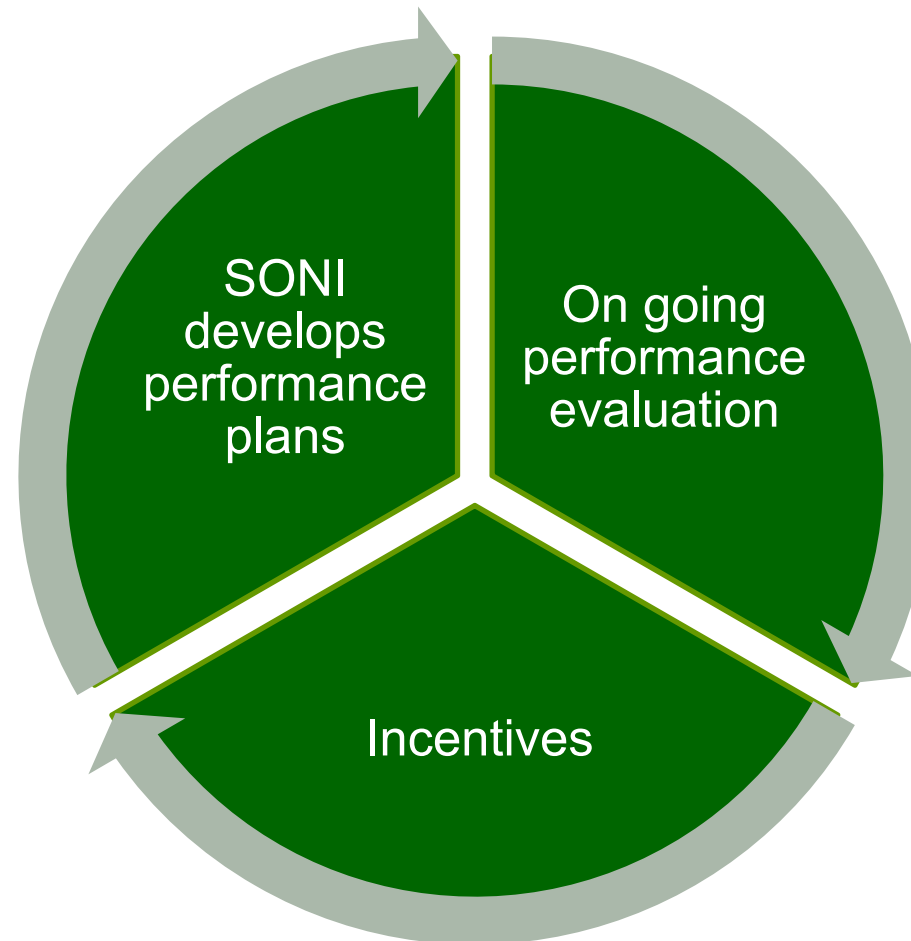
Existing price control
underfunding needs
to be reversed
(SONI)

- Regulatory framework is relatively under-developed
- SONI performance is important: span of system influence and change predicted over 2020 to 2025 period.
- Merit in developing a framework which:
 - a. **Reassures** consumers and customers that high quality service is **delivered as expected**
 - a. Sufficiently **flexible** to deal with a system in transition (including any NI government policy change)
 - a. Reflects the **characteristics of SONI TSO service and business** (complex, interacting, long term impacts)
- Aspects of Ofgem's framework could be tailored to our circumstances

Proposals for a new performance framework

SONI develops
**outcomes and
performance
commitments**

(could include
stakeholder
involvement and
scrutiny)



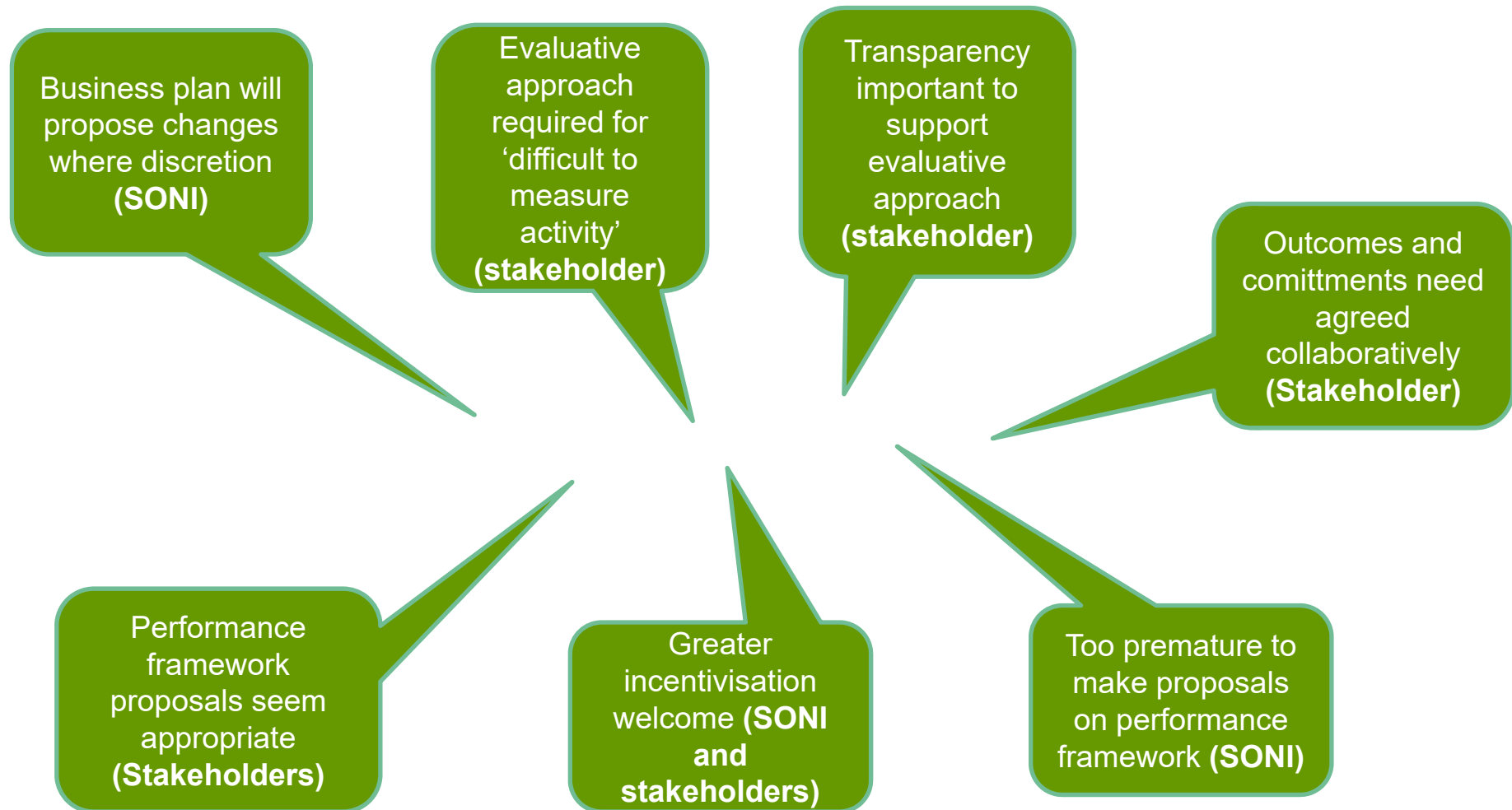
**On-going, ex-post ‘in
the round’ performance
evaluation**

(could include
stakeholder
involvement and
scrutiny)

Setting **financial and non-financial** incentives

- Subject to justification we will provide structure for:
 - Allowance when price control is set
 - Allowances during price control period.

Stakeholder responses



- Existing structure recovers different costs according to:
 - Ex-ante baseline + cost incentive rate of 50%
 - Approval mechanisms: allowance up to approved cap, including contingency
 - Pass-through (actual costs)
- Propose building on existing structures (gone through CMA appeal) to better incentivise SONI to:
 - Invest and spend where it can achieve high quality performance outcomes.
 - Seek efficiencies where achievable
 - Work with rest of regulatory framework (e.g. performance framework proposals)

Proposals for securing cost efficiency and managing uncertainty

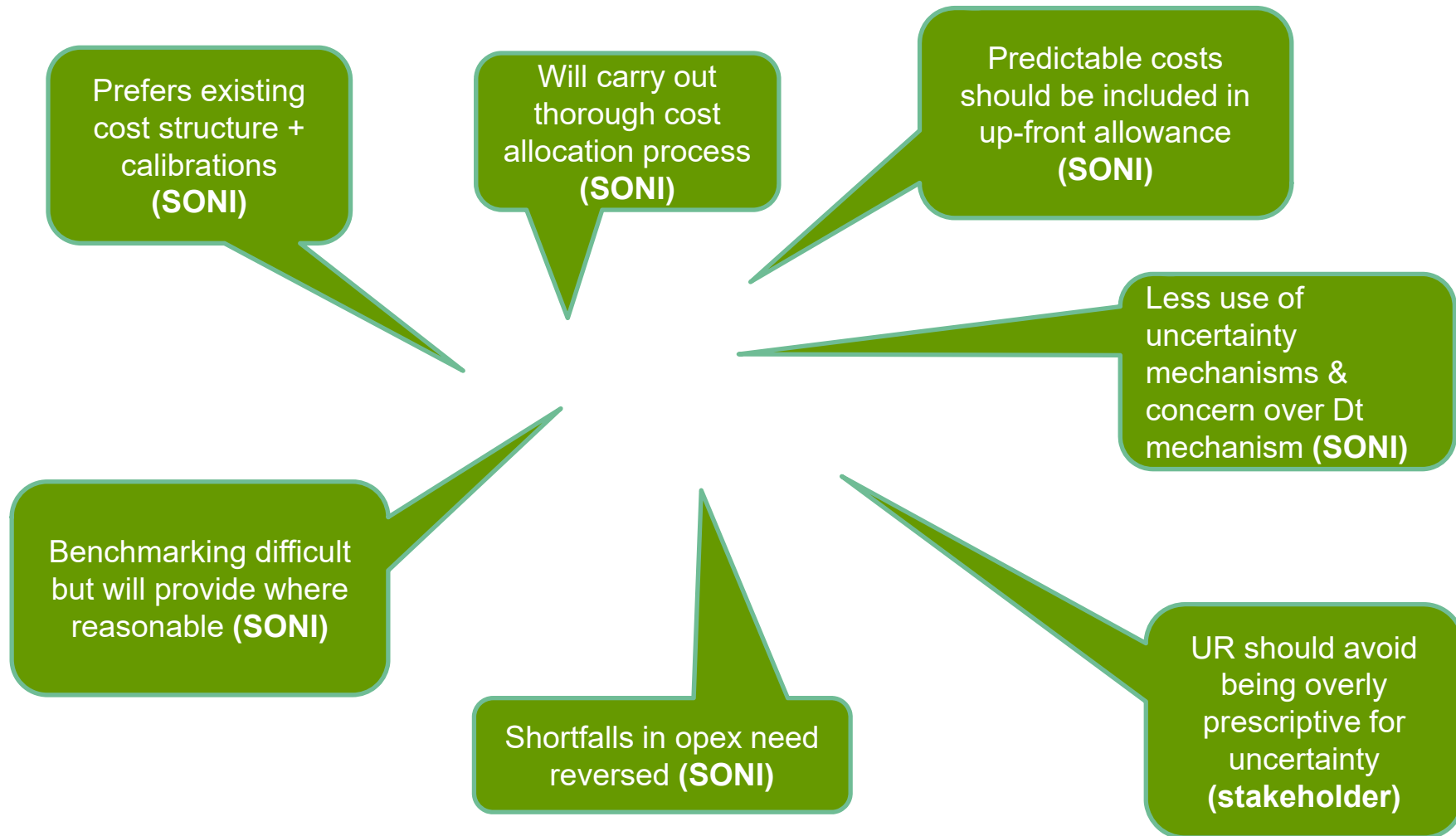
Different service costs would be recovered under cost structures:

At price control	During price control	Where may apply	Commentary
Baseline allowance + lower cost incentive	Approval and/or mechanistic based	e.g. where stronger baseline information & stronger case for stronger efficiency incentives	
Allowance up to approved cap + contingency (against indicative baseline)	Approval based Retain TNPP mechanism	e.g. where weaker baseline information & stronger case for investment & spend.	Cost performance taken account of in evaluative performance framework during price control
Actual costs	Actual costs	e.g. ancillary services reviewed by SEMC	Scope for additional measures to protect against inefficiency

Proposals on cost assessment

- UR to scrutinise business plan under cost assessment
- Benchmarking and bottom up assessment to set allowances
- Expect SONI benchmarking at individual service and aggregate level
- Less regulatory scrutiny for very well evidenced and reliable analysis and vice versa
- Greater analysis and evidence for more significant areas of expenditure

Stakeholder responses



Remuneration

- Propose to reward all layers of capital to support notional efficient TSO licensee
- Understanding risk (including RoRE analysis) and recognising role of equity
- Use of CAPM to provide estimates of cost of equity
- Switching from RPI indexation to CPI indexation
- Remuneration of corporation tax via approximate uplift on cost of capital

Financeability

- Overarching assessment of price control financeability
- Remuneration of equity capital and debt finance
- Analysis of scenarios for RoRE
- Debt financeability analysis
- Assessment of financial resilience of actual licensee

Stakeholder responses

Supports CMA 'layered' approach to remuneration (SONI)

Benchmarking of returns required (SONI)

Increase in regulatory discretion may need remuneration for risk (SONI)

Open to reviewing RPI vs CPI/CPIH indexation (SONI)

Test licensee on actual as well as notional basis (SONI)

Proposals to support trust in delivery

Engaging customers,
consumers and other
stakeholders

- SONI to undertake quality engagement to incorporate in business plan and ongoing activities

Ensuring resilience and
governance

- SONI demonstrate how avoid, cope and recover from business disruption.
- Effective governance structure to deliver plan

Accounting for past
delivery

- Explain performance and how inform future
- Explain and map financial adjustments

Securing confidence and
assurance

- SONI Board and governance assurance
- Strong data quality
- Full publication of well presented and structured business plan

Stakeholder responses

SECG has been a positive initiative
(SONI and stakeholders)

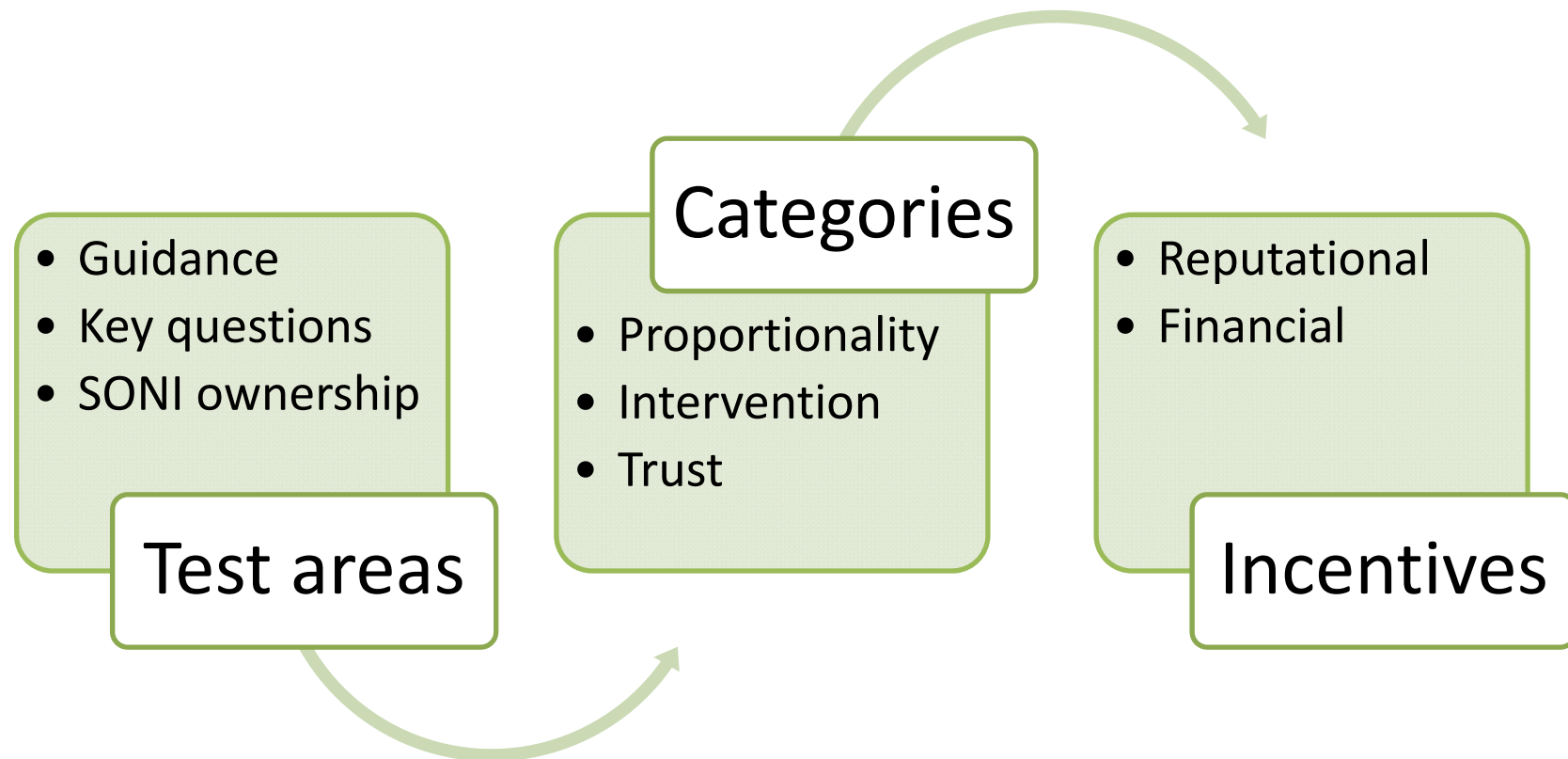
Recent engagement + SECG to largely inform business plan
(SONI)

SONI should evidence consumer views
(stakeholder)

Business plan publication proposal should incentivise functional plan instead of 'polish'
(stakeholder)

UR should be wary of being too prescriptive in certain test areas
(stakeholder)

Overview of proposals for assessing business plan



Categories we propose for business plan

Category	Features
A: Exceptional	<ul style="list-style-type: none">Exceptional and stretching business planExcellent responses across most test areasLimited regulatory intervention to translate to price control packageRelatively high degree of trust in company
B: Good	<ul style="list-style-type: none">Good plan but falling short of being an exceptional and stretching planExcellent responses in some test areasGreater regulatory intervention and less trust than category A
C: Meeting Basic Expectations	<ul style="list-style-type: none">Plan not evidence how best to serve customers and stakeholdersSignificant concerns and lack of excellent responses across test areasGreater regulatory intervention and less trust than category B
D: Poor	<ul style="list-style-type: none">Self-serving business plan with poor responses in multiple test areasExtensive regulatory intervention to translate to price control packageSevere concerns about company's ability to deliver outcomes for stakeholdersRequirement for detailed monitoring of company during the price control period

Case for and against a financial incentive for business plan

Reasons in favour of a financial incentive	Reasons against a financial incentive
Quality of the business plan is important for achieving good outcomes (especially given time constraints)	Complex to make assessment for a single TSO
Strategic fit with expectation of significant change in nature and quality of the business plan	No close yardstick to compare SONI with and given novelty of approach in NI
Time and money required to develop a high quality business plan	Potential distraction from other reasons for the TSO to submit a high-quality plan
Reputational (and other motivational) factors strength is unclear	Little value if already incentivised to produce a good plan

We propose a meaningful but low value financial incentive for business plan

We consulted on the options below

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

Impact of financial incentive on SONI revenue

Revenues	SPC15-20 Total	SPC15-20 Total	SPC15-20 Total
Anticipated SONI Revenues under price control (excl. ancillary services, TUoS, MO overruns) - 2019 prices	£104.84 m	£104.84 m	£104.84 m
Potential Business Plan Incentive Payment - 2019 prices	£0.10m	£0.25m	£0.50m
Incentive Payment as a Proportion of SONI Revenue (%)	0.10%	0.24%	0.48%

Stakeholder responses

Welcome
scorecard
approach and
'step change in
clarity' (SONI)

Regulatory
expectations should
be clear, but UR
should be wary of
over prescription
(stakeholder)

More guidance/
should be tailored
to SONI
circumstances
(SONI)

Step change
justifies a
financial reward/
some in favour
of symmetric
(stakeholder)

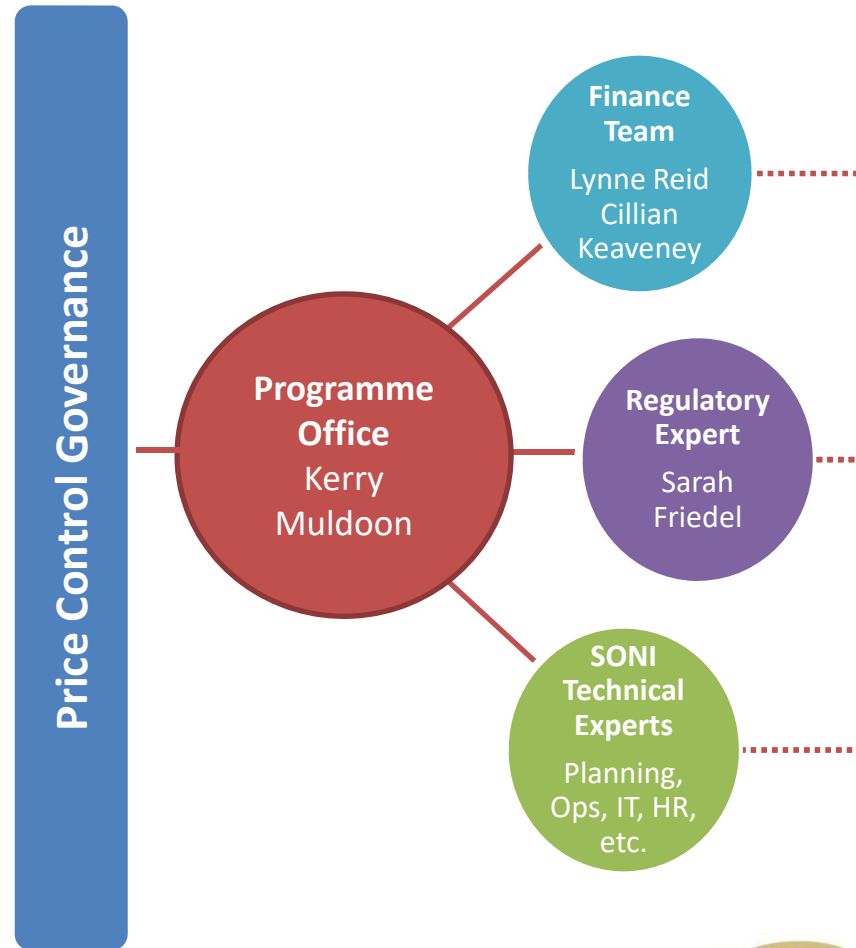
Supports
financial
incentives, but
on asymmetric
basis (upside
reward) (SONI)

SECG Moving Forward



SECG Next Stage

- SONI Price Control Team
- Timelines are challenging
 - Focus on best use of resources and recognise size of the business
 - Need to be realistic, using evolution based learning
- SONI welcomes SECG additional SECG engagement as part of the Business Plan development



SONI Proposal

- Cognisant of the time that SECG members are providing
- 2 meetings and small group input suggested. Thoughts?
- Need to balance all requirements

SECG Meeting – early April

- SONI will update SECG on updates and emerging themes for 2020-25 Business Plan

Focussed Input – mid-April to mid-May

- Identify 2-3 key workstreams (e.g. customer priorities, risk sharing, business plan communication)
- SECG provide feedback via smaller, specialist groups?

SECG Meeting – mid May

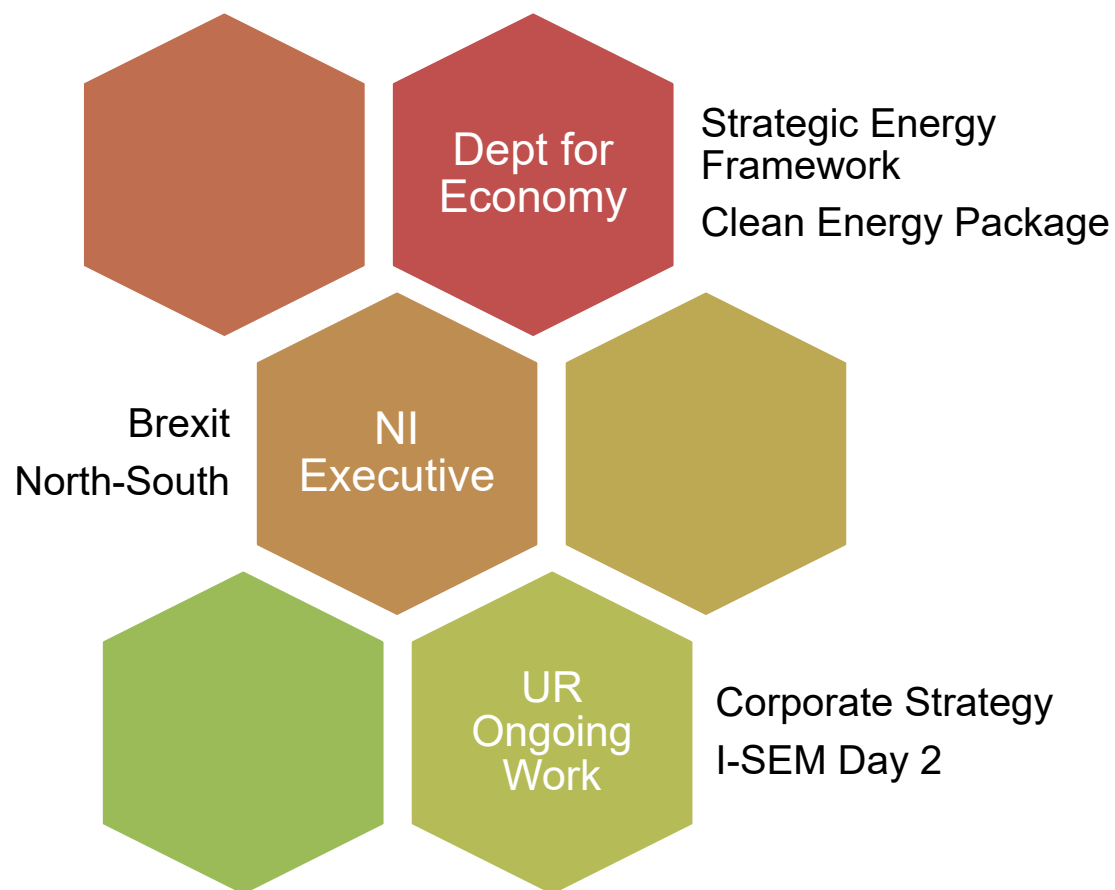
- SONI to report back on how SECG feedback was incorporated into business plan
- Discuss key issues for Price Control with SECG

SECG Insight & Challenge

April SECG

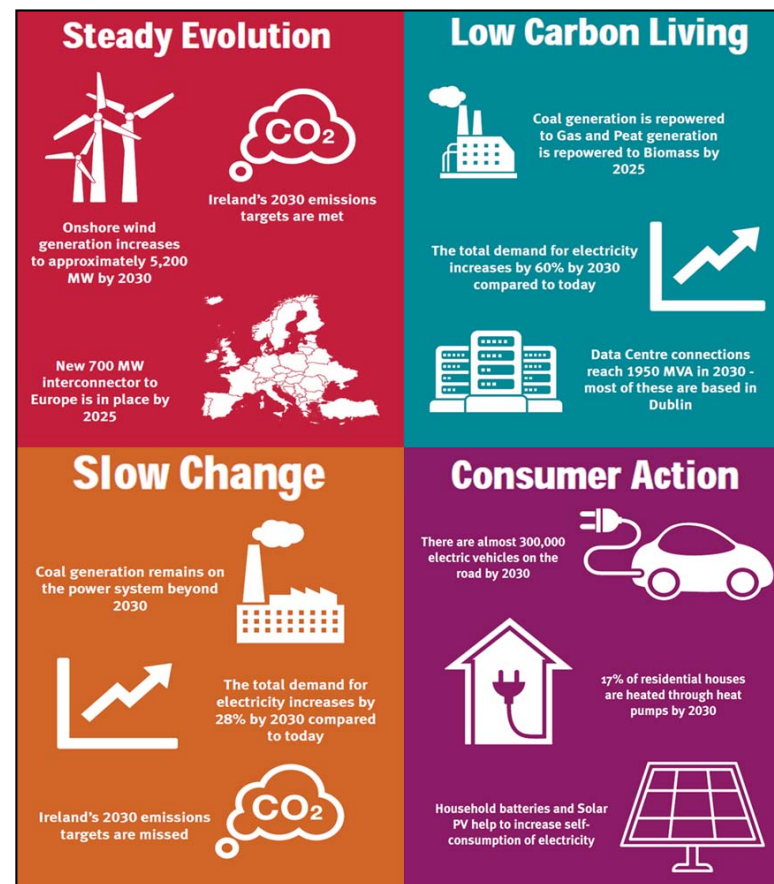
- Proposed outline structure of SONI PC 2020-25 submission
 - SONI views on expected change in energy sector
 - Business plan emerging themes for 2020-25
 - Open discussion of key topics
- Set out how we propose to demonstrate value for money
- Agree roles and timescales for SECG engagement with Business Plan development
- Agree future engagement

Existing Environment of Uncertainty



Tomorrow's Energy Scenarios

- Not directly related to Price Control but...
- NI specific scenarios to be introduced in 2019
- Two scenarios in 2020, increasing to 4 by 2030
- Focus on 2030 in our publications
 - Important year from climate change policy and targets
 - Needs identified in 2030 may require some projects to kick off now
- SECG members input welcome



Annex: SONI key points from consultation

SONI Key Messages on UR Approach Consultation Paper



Alignment with UR's Corporate Strategy

UR Strategic Objective 1.

Promoting markets that deliver effective competition, informed choice & fair outcomes



SONI Inputs to UR Key Success Measures:

4. Enhanced market analysis and monitoring in place facilitating consumer protection, assurance of compliance and enabling enforcement as necessary
5. Increased efficient deployment of interconnector flows evidenced by harmonisation across interconnectors between GB and the SEM
6. Efficient wholesale energy prices that benchmark favourably with comparator markets

UR Strategic Objective 2.

Enabling 21st century networks



SONI Inputs to UR Key Success Measures:

1. All network utilities deliver asset management strategies and long-term network development plans
2. Innovation plans are delivered as part of price control reviews
3. A review of electricity network tariffs is completed
6. Cost and performance reports are published for all network utilities

UR Strategic Objective 3.

Enabling security of supply and a low carbon future



SONI Inputs to UR Key Success Measures:

1. Level of investment in renewable generation to support Govt. targets
2. Increased level of renewable generation, meeting electricity demand
3. Facilitate the delivery of the second north-south interconnector
5. Along with the Dept. for the Economy, Clean Energy package requirements are met by 2024
6. Sufficient generation is secured to meet demand through the SEM Capacity Remuneration Mechanism

SONI Working Environment

- Majority of SONI's roles and services are mandated through legislation, licences, codes and methodologies
 - Changes implemented in line with formal governance processes, and these take time
- SONI operates with a number of organisations, and industry in general, the price control should recognise this:



Parent company and other TSO requiring close alignment as part of the all-island electricity network



Second SONI licence - Joint Venture between SONI & EirGrid, regulated by UR and CRU



Relationship with Transmission Owner and DNO as set out in the Transmission Interface Arrangements



Owner of the Moyle Interconnector with specific SONI licence obligations



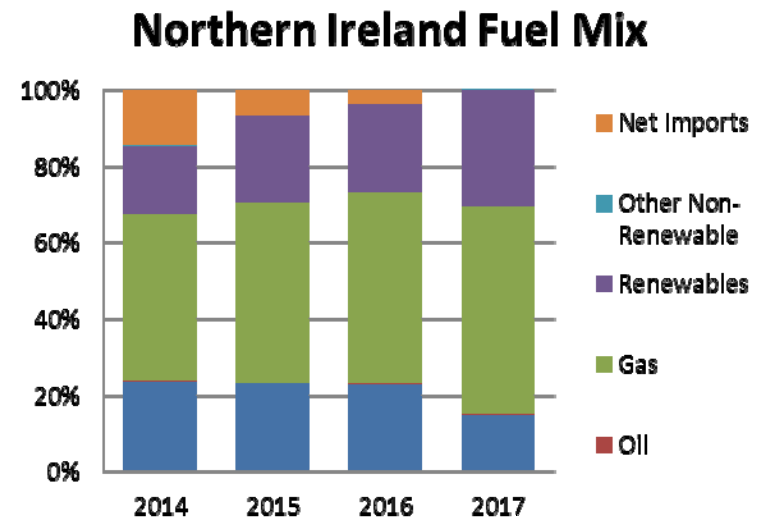
Building on Stakeholder Engagement

- SONI has worked closely with stakeholders and UR on a number of important initiatives
- Important to recognise work achieved during 2015-20 price control period:
 - I-SEM
 - DS3
 - Connections
 - Grid Code
 - Network Codes

Programme	Period	TSO Led Consultations	TSO Led Stakeholder Events
I-SEM	2012 to Sep 2017	40	12
DS3 System Services	2012 to 2018	18	14
Connections & Transmission Network Planning	2015 to 2018	5	2
Network Codes	2015 to 2018	5	10

Delivering Value for Money

- Significant achievements have been made during the current price control period:
 - Level of demand supplied by renewables increased from 17.9% to 31.6%
 - £11million in savings to NI customers through proactive management of dispatch balancing costs
 - Capacity Market delivery body ensured security of supply in Northern Ireland at a saving of £50million to customers
 - SNSP limits increased from 50% in 2015 to 65% in 2018
 - Approximately 650MW of renewable generation connected
 - Maximum instantaneous output of wind energy increased from 83% in 2015 to 129% in 2018



Alignment of Incentives

- UR's intention to consider increasing the scope of incentive mechanisms is welcomed
- SONI will continue to strive to deliver a high quality service, with well justified and stretching outcomes
- Incentives need to be balanced between:
 - Inputs and outputs
 - Opex and capex
 - *Ex ante* frameworks and uncertainty mechanisms
 - Over Time within the Price Control Cycle

Financeability

- CMA determination should be the starting point
 - Adjustments to 'Capital Layers' framework should be limited
 - Needs to be properly tested (scenarios and resilience)
- SONI remains/ increasingly highly operationally geared
- Any assessments need to consider both Notional and Actual licensee – it is the actual licensee providing the service
- SONI view is that the Dt mechanism should be used infrequently