



www.soni.ltd.uk

Castlereagh House
12 Manse Road, Belfast BT6 9RT
Telephone +44 28 907 94336
Email info@soni.ltd.uk

Jody O'Boyle
The Northern Ireland Authority for Utility Regulation
Queens House
14 Queen Street
Belfast
BT1 6ED

27 April 2018

Response to Consultation on CMA Costs and K term Amendment

Dear Jody,

We are writing in response to your above consultation. This letter sets out SONI's comments on each of the three proposed licence modifications.

1. Exclusion of costs incurred in relation to the CMA appeal from the 50:50 cost risk share mechanism

SONI has reviewed the proposed amendments to the 50:50 risk share mechanism retrospectively and has grave concerns with that proposed by the UR. Given the seriousness and significance of SONI's concerns, a separate letter and paper have been submitted to Dr Bill Emery, in his capacity as chair of the Utility Regulator. For the avoidance of doubt, that submitted at Board level should be considered an additional component of SONI's overall response to the UR consultation.

This paper sets out four main reasons why this proposal should be struck out. These can be summarised as:

- (a) The Utility Regulator's proposal is unjustified, disproportionate and irrational;
- (b) SONI had a legitimate expectation that it could recover its efficiently incurred legal costs and costs of regulatory engagement through the 50:50 risk-sharing mechanism;
- (c) The Utility Regulator's proposals fail to afford equal treatment to SONI;
- (d) The proposals create a perception of bias and improper motive.

SONI has sought legal advice on that proposed and believes it would give rise to grounds for legal challenge, were the Utility Regulator to proceed.

2. Amendment to bridge for the K_t allocation between price control periods

We have noted your proposed change to the K_t algebra. As drafted we would interpret this change in treatment of the K_t in the formula, from $t-1$ in the versions of

*SONI Limited
Castlereagh House
12 Manse Road
Belfast
Northern Ireland
BT6 9RT
Company Registration
No. NI038713*

Annex 1 which would apply for t=1 and t=2, to the current licence which would apply K factors on a t-2 basis from t=3 onwards would give rise to risk of a double count of the K factor. This is set out in the table below.

Relevant Year		Relevant K-Factor	K-Factor Year
1	2016/17	T-1	2015/16
2	2017/18	T-2	2015/16
3	2018/19	T-2	2016/17

SONI would interpret this as implying that SONI would be recovering the 2015/16 K factor in both years t=2 and t=3 of this price control, thus inadvertently and unwillingly recovering additional monies from customers as a result.

SONI would welcome engagement with UR in order to ensure absolute clarity on the drafting of this algebra, in a manner which avoids any risk of double counting of K factors, or any perception that SONI would seek to do so.

3. Provision of costs in respect of fees payable under Condition 8 of the Transmission Licence within Annex 1 Paragraph 8

We note your proposed inclusion of an explicit right for SONI to recover its licence fees through the Dt mechanism. We are not clear why these costs would be passed through to the customers through the SSS tariffs and would welcome further clarification from you in relation to this.

As always we remain available to discuss these matters, and we are keen to work constructively together to address the significant work programme ahead of us.

Yours sincerely

A handwritten signature in blue ink that reads "S Friedel".

Sarah Friedel

Group Regulation

SONI, Ltd



Dr Bill Emery
Chairman
Utility Regulator
Queens House
14 Queen Street
Belfast
BT1 6ED

www.soni.ltd.uk
Castlereagh House
12 Manse Road, Belfast BT6 9RT
Telephone +44 28 907 94336
Email info@soni.ltd.uk

27 April 2018

Re: Utility Regulator's Consultation on Licence Modifications following CMA Appeal

Dear Dr Emery,

We refer to the Utility Regulator's consultation on proposed Licence Modifications published on 28 March 2018. We are writing to you in your position as the Chair of the Utility Regulator's Board to express our grave concerns about the Utility Regulator's motivation for advancing a proposal to retrospectively amend SONI's Licence to Participate in the Transmission of Electricity ("SONI's TSO Licence") to exclude recovery of costs that have been lawfully and efficiently incurred "in connection with" SONI's recently concluded appeal to the CMA regarding the 2015-2020 price control.

Our concerns are explained in detail in the attached document. In short, this proposal has been advanced without a clear policy rationale. It has emerged without notice or any prior indication within the price control consultation that the Utility Regulator intended to make such further licence modification proposals. SONI had a legitimate expectation that it could recover its efficiently incurred costs of regulatory engagement through the 50:50 risk-share arrangements. The proposal advanced fails to afford equal treatment to SONI and its shareholders relative to other regulated utilities in Northern Ireland.

We have taken legal advice on the proposal. As a result we believe there are grounds for a legal challenge if the Utility Regulator were to proceed with these proposed modifications. We wish to avoid this given the "re-set" we had hoped would follow the conclusion of the CMA process.

*SONI Limited
Castlereagh House
12 Manse Road
Belfast
Northern Ireland
BT6 9RT
Company Registration
No. NI038715*



For these reasons we are bringing our concerns to your direct attention. This is separate to our comments on the other proposals included in the consultation document, which are addressed in a separate submission which has been provided to Jody O'Boyle and Natalie Dowey. We would ask that you would share our concerns with your Board.

There is a very significant programme of work between the Utility Regulator and SONI. The CMA Appeal was an unfortunate necessity to enable SONI to have in place a price control which was structured to render it financeable to carry out these activities. The CMA has opined on this matter and such a price control is now in place. It is important that both SONI and the Utility Regulator can move forward and SONI is committed to working collaboratively with the Utility Regulator in doing so. Indeed there have been many recent achievements: SNSP has risen to 65% and the North South Interconnector has achieved planning permission in both Ireland and Northern Ireland. Yet there are still challenges ahead: the operation of I-SEM is now only a few months away and there are continued and ongoing challenges for both organisations in the management of security of supply.

The Utility Regulator Board has extended an invitation to SONI to meet with it in October. SONI welcomes this. We wish to do so in an environment where we are working together to advance these projects to deliver significant benefits to Northern Ireland consumers. Unfortunately we did not have, and were not invited to have, any engagement on the proposal with your office prior to its publication. It is in our view entirely inappropriate for it to be brought forward and it should therefore be struck out.

Yours Sincerely,

A handwritten signature in blue ink, appearing to read "Rosemary Steen", is written over the typed name.

Rosemary Steen
Director
SONI Ltd

Utility Regulator Consultation on proposed Licence Modifications to exclude costs incurred in relation to the CMA appeal from the 50:50 cost risk share mechanism

Response from SONI Ltd

27 April 2018



Utility Regulator proposals regarding the 50:50 risk share mechanism

SONI sets out below its concerns regarding the Utility Regulator's proposal to exclude the costs it legitimately incurred in engaging in the CMA appeal process from recovery under the 50:50 sharing mechanism set out in the TSO licence. In preparing this response SONI has taken advice from its legal advisers, Norton Rose Fulbright LLP.

In short, this proposal has been advanced without a clear policy rationale. It has emerged without notice or any prior indication within the price control consultation that the Utility Regulator intended to make such further licence modification proposals. SONI had a legitimate expectation that it could recover its efficiently incurred costs of regulatory engagement through the 50:50 risk-share arrangements. The proposal advanced fails to afford equal treatment to SONI and its shareholders relative to other regulated utilities in Northern Ireland.

As a result we believe there are grounds for a legal challenge if the Utility Regulator were to proceed with these proposed modifications.

a) The Utility Regulator's proposal is unjustified, disproportionate and irrational

The Utility Regulator proposes to introduce new text in paragraph 2.2(c) of SONI's TSO Licence that would exclude recovery under the 50:50 cost sharing incentive mechanism of costs incurred "in connection with preparing for, bringing, or participating" in the CMA appeal.

The consultation document advances no clear rationale for this proposal. There is reference to a risk of inadvertent over-recovery of SONI's costs, which seems to be linked to the *inter partes* costs awarded by the CMA in SONI's favour. SONI is not seeking and would not seek double-recovery of any costs already awarded by the CMA and the Utility Regulator has failed to explain what grounds there could be to suggest that SONI would seek to recover such costs twice.

The consultation document also states that where costs are not included in a costs order made by the CMA, these costs should fall to be recovered from the regulated company's shareholders, and not costs suitable to be recovered from customers under the price control. It is unclear why the Utility Regulator has sought to apply this interpretation to the costs arrangements set out in Schedule 5A to the Electricity (Northern Ireland) Order 1992, which does not contemplate that the CMA's cost award should reflect only those costs which are suitable to be recovered from customers. Neither did the CMA make any direction in its Costs Order on this point.

A licence amendment that applies a blanket exclusion to all of SONI's costs related to the CMA appeal is disproportionate and unreasonable such that it must be irrational. The irrationality of the Utility Regulator's proposals is evident from three illustrative examples of categories of costs incurred by SONI:

1. Costs incurred prior to publication of the Final Determination on the TSO Price Control

These are generally precluded from recovery under the CMA cost assessment regime. The CMA considered the costs associated with expert reports and included a portion of these in the *inter partes* award made in SONI's favour, but SONI did not submit for assessment any other costs incurred prior to the date of publication. Therefore there is no risk of over-recovery of costs, and no logical basis for precluding such costs from recovery under the 50:50 risk-sharing arrangements. Moreover, had SONI not been required to appeal, such costs would have been recoverable under the 50:50 incentive mechanism – to exclude these costs post-appeal would be irrational.

2. Costs incurred during the CMA appeal process which would have been incurred under "business as usual" conditions

These include costs related to the various decisions and guidance papers the Utility Regulator published during the course of the appeal process, including the DIWE guidance paper, the Pension's Determination, the Q_t guidance and the D/PCNP process. The breadth of the Utility Regulator's proposals appear to capture such costs yet SONI would have had to incur these costs regardless of the appeal as these elements were missing from the TSO Price Control arrangements. The fact that SONI continued to incur costs in relation to these issues during the CMA process was driven by the Utility Regulator's decision to continue publishing guidance papers and decisions throughout the process. These costs were outside of SONI's control and were not solely related to the appeal process meaning there can be no risk of over-recovery of such costs.

3. Costs incurred after the CMA's Final Determination in the appeal arising from continuing engagement with the Utility Regulator on the CMA's remedies

These include costs incurred by SONI after publication of the CMA's Final Determination and Order in engaging with the Utility Regulator's implementation of the remedies. The CMA explicitly excluded such costs from its assessment on the basis that they should not be regarded as being incurred in relation to the appeal, and so there is no risk of over-recovery.

The proposal is in addition so vague that it is difficult to discern the scope of its application but the consultation document suggests a very wide application. It is unclear what could be categorised as a cost associated with "preparing for, bringing, or participating in" an appeal. It is an aspect of good risk management to be prepared for the prospect of appealing any regulatory decision. By the very nature of its regulatory

functions and engagement with the Utility Regulator on proposals SONI is continually engaging in activity which could be perceived as falling under this broad definition. This includes the 2015-2020 Price Control Consultation itself, the engagement that occurred with the Regulator following the Final Determination and the contemplation of the proposals in this consultation.

b) SONI had a legitimate expectation that it could recover its efficiently incurred legal costs and costs of regulatory engagement through the 50:50 risk-sharing mechanism

SONI only became aware of the Utility Regulator's intent to amend paragraph 2.2(c)(i) in the manner now proposed on 9 March 2018 when the Utility Regulator shared with SONI a draft of its licence modification decision seeking to implement the CMA Order. No rationale was given for seeking to retrospectively exclude costs from the risk-sharing arrangements at the time; nor were the arrangements examined by the CMA as part of the appeal process.

Any intention to introduce a proposal that would disallow opex costs, including those concerning regulatory engagement, from the 50:50 risk share should have been subject to the Utility Regulator's consultation on the price control and the mechanism itself. Throughout the CMA appeal process, SONI continued to incur costs on the basis of the price control arrangements and Licence as extant. The 50:50 risk-sharing arrangements are designed to share the value of price control outperformance and underperformance equally between SONI and consumers. This incentivises SONI to achieve efficiencies as it can share with consumers in the benefit of upside performance. It is an important part of the regulatory mechanism.

To introduce retrospectivity to the Licence and TSO Price Control by excluding categories of costs incurred from the 50:50 risk-sharing arrangements risks undermining the incentive properties of the 50:50 risk-share (if the Utility Regulator can retrospectively remove any cost category from the arrangement, SONI in theory would have no prospect of recovering the benefit of any outperformance and therefore would not be incentivised to achieve any). It is also contrary to the principle of legitimate expectation. SONI's expectation was that the mechanism would operate for the duration of the price control. This expectation was unbroken and relied upon in the engagement with the Utility Regulator concerning the price control. SONI's expectation would be breached if the proposal was to take effect.

c) The Utility Regulator's proposal fails to afford equal treatment to SONI

Since introduction of the new energy licence modification appeal regime in 2015, neither the Utility Regulator in relation to other regulated businesses in Northern Ireland nor Ofgem in Great Britain, has proposed to introduce, let alone introduced an explicit term to an appellant's Licence to exclude any recovery of costs related to an appeal.

The Utility Regulator is therefore proposing to treat SONI differently to all other regulated utilities in Northern Ireland and Great Britain, to the detriment of its shareholders and without any objective justification. No equivalent licence modifications were introduced following the appeals brought under the new regime by Firmus, Northern PowerGrid or British Gas Trading.

The Utility Regulator addresses its consultation paper to NIE Networks among others. In NIE's referral to the Competition Commission of the RP5 price control, the CC determined that it was in the public interest for the external inquiry costs claimed by NIE (set at £2.8 million) to be shared equally between NIE's shareholders and its consumers.¹

The Utility Regulator's differential treatment of SONI goes against all existing precedent and, given it has arisen in the context of a contentious appeal process, effectively appears to amount to an abuse of process.

d) The proposal creates a perception of bias and improper motive

SONI and its shareholder are mindful that the contentious nature of the CMA appeal process has put strain on the regulatory relationship between SONI and the Utility Regulator. SONI and EirGrid wish to move forward from the CMA appeal and re-institute a constructive and professional working relationship, to ensure that SONI can continue to deliver on its license obligations in the best interests of Northern Ireland consumers. It is therefore regrettable that the circumstances surrounding this new proposal appear to suggest the possibility of bias being introduced in the aftermath of the CMA appeal.

SONI expects the Utility Regulator to exercise fairness at all times when carrying out its functions. The late advancement of these proposals, aimed solely at SONI, the original failures in the consultation process and the adversarial context in which they have arisen all mean that this proposal fails to reflect the Utility Regulator's values of transparency, consistency and proportionality.

¹ Competition Commission, NIE price determination: Final determination, paragraph 20.15.

Response on other issues in the consultation document

SONI has responded separately on the Utility Regulator's other proposals, namely: (i) provision for SONI to make a claim to the Utility Regulator to recover from consumers any fees payable by it in Relevant Year t under Condition 8 of the TSO Licence (including the Utility Regulator's costs relating to the CMA appeal); and (ii) modification to the K_{TSO} adjustment factor.

Concluding Remarks

There is a very significant programme of work between the Utility Regulator and SONI. The CMA Appeal was an unfortunate necessity to enable SONI to have in place a price control which was structured to enable it to render it financeable to carry out the activities. The CMA has opined on this matter and such a price control is now in place. It is important that both SONI and the Utility Regulator can move forward and SONI is committed to working collaboratively with the Utility Regulator in doing so. Indeed there have been many recent achievements: SNSP has risen to 65% and the North South interconnector has achieved planning permission in both Ireland and Northern Ireland. Yet there are still challenges ahead: the operation of I-SEM is now only a few months away and there are continued and ongoing challenges for both organisations in the management of security of supply.

The Utility Regulator Board has extended an invitation to SONI to meet with it in October. SONI welcomes this. We wish to do so in an environment where we are working together to advance these projects to deliver significant benefits to Northern Ireland consumers. We cannot however do so where the Utility Regulator, as here, continues to pick over the past. We have set out why this proposal is not only illogical and irrational but also unimplementable. Unfortunately we did not have and were not invited to any engagement on it with your office prior to its publication. It is entirely inappropriate it be brought forward and should be struck out.

Should the Utility Regulator have concerns that costs have been or were inefficiently incurred then it in fact has, through DIWE, such a mechanism already at its disposal. It therefore does not need nor benefit from this singular mechanism now proposed. However, SONI must be able to operate on the basis that efficiently incurred costs are recoverable in accordance with the regulatory regime as set out, the stability of which is fundamental to the regulation of the Northern Ireland industry and to the ultimate benefit of customers.