

Further Consultation on  
certain matters relating to  
the Price Control 2015 –  
2020 for the Electricity  
System Operator for  
Northern Ireland (SONI)  
SONI Ltd. Response

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May 22<sup>nd</sup> 2017



# Introduction

SONI welcomes the opportunity to respond to the further consultation on certain matters relating to the Price Control 2015 – 2020 for the Electricity System Operator for Northern Ireland (SONI) published by the Northern Ireland Authority for Utility Regulation (UR).

This consultation followed the publication of the final licence modifications resulting from the SONI Price Control 2015 – 2020 Final Determination, published in February 2016. The UR's final decision was not published until 14 March 2017. That final decision was accompanied by an order stating the new licence was to take effect from 9<sup>th</sup> May 2017.

In paragraph 3 of this consultation, the UR notes that SONI raised concerns in its response to the Final Determination about the consultation process the UR had engaged in with regard to the proposed licence modifications relating to Pensions and Change of Law. In paragraph 5 of this consultation, the UR states its intention that, following the conclusion of this consultation, any decision on Pensions and Change of Law will be for the period of the original Price Control i.e. 2015 – 2020 notwithstanding that that price control itself only came into effect through licence modifications on 9 May 2017. In paragraph 6, the UR notes that licence modifications may be required following a decision on this consultation. SONI would have concerns were any such modifications proposed to be retrospective in nature.

From reading these opening paragraphs, SONI believes it would have been reasonable to have expected the UR to then go on to explain what additional work it had undertaken since February 2016 so as to fully consider the issues; why it was necessary to “sever” these issues from the rest of the Price Control rather than resolve them in the 12 month period following publication of the Final Determination; what consideration it has given to SONI's submissions on these issues during this 12 month period; what its current proposals are on these issues having given them due and proper consideration and what its proposed amendments are to SONI's licence to give effect to its proposals. It does none of this.

In practice, this “consultation” is simply a restatement of the UR's decision in its Final Determination supplemented by a summary of SONI's evidence in response at that time. In respect of Pensions only, this is supplemented by a single brief reference to the fact that SONI has since been in a position to provide an actuarial valuation of the SONI pension scheme as at 31 March 2016 (see paragraph 56). No reference is made as to how the UR proposes to adjust its decision on pensions opex to take this information into account. No explanation is offered as to how the UR has taken into account the specific characteristics of SONI's pension scheme. No assessment is offered as to how the UR proposes to discharge its Financeability Duty towards SONI. Nor are any further licence modifications are proposed.

On Change of Law, while the UR has proposed modifications to the licence these simply replicate the modifications initially proposed – without consultation – following the Final Determination. No further justification has been offered as to why these modifications are appropriate. Nor is there any evidence that the UR has taken SONI's original submissions into account.

The implication is that the UR is simply treating this “re-consultation” as a procedural exercise designed to “tick a box” as opposed to genuinely giving proper consideration to the issues. This impression is further reinforced by the lack of clear proposals and/or questions in the consultation paper and the failure to set out a process and time by which the UR will consider all comments received and reach a decision.

Despite the failings with the consultation, SONI has nevertheless endeavoured to assist the UR by providing comments in respect of each issue. As the UR is aware, SONI has already submitted extensive comments, on a number of occasions, throughout the lengthy process, some of which were included or referred to within the consultation paper. Rather than repeat those same comments, which are still applicable, SONI has limited its comments here to the fundamental key points of what should be considered. Where SONI does not comment on a particular issue, this should not be taken to mean that SONI accepts the UR's position. The UR will also be aware SONI has appealed the decisions on pensions issues – including the cut-off date adopted and the allowance for contribution rates for the defined benefit scheme – that were implemented by the new licence modifications in the 14 March 2017 decision to the Competition and Markets Authority.

In its appeal submission, SONI included an expert report regarding the Price Control review and decisions with regard to pensions. This includes evidence concerning the detrimental impact to SONI should it be required to fund any pension deficits arising post 1 April 2015 and concerning the importance of remunerating SONI for its ongoing pensions costs in accordance with the 2016 actuarial valuation. Because it is also relevant to the issues the Utility Regulator purports to reconsider in this consultation, SONI includes that report here in its entirety as an appendix to this response **on a confidential basis**. SONI confirms that where it has quoted extracts from the report in this response which pertain to the issues at hand, it is content for these to be treated on a non-confidential basis.

In respect of pensions specifically SONI recognises that this is a complex area and as such we would very much welcome an opportunity to meet with the UR and its advisors to discuss. In particular we would urge the UR to examine the financeability impacts on SONI of inadequate employer contribution allowances (a minimum £1.5m over the 2015-2020 period) and scheme deficits post 2015.

SONI is available to meet with UR and engage on any aspect of the consultation paper and our response should UR believe this to be beneficial in reaching its decisions.

# Pensions

The nature of how SONI has inherited its pensions obligations in respect of its Defined Benefit scheme are relatively unique. In 2009 SONI was divested from NIE in order to strengthen the independence of transmission system operations. Many of the staff that transferred to SONI were both TUPE protected and held 'protected persons' status, the latter providing the continuation of the pension benefits that existed prior to privatisation of the electricity sector and the NIE scheme of which was closed in 1998.

In 2014 SONI had to open the scheme to allow a small number of new employees, with 'protected persons' status, to join the scheme. These staff were transferring to SONI, following EC approval of UR's preliminary certification decision which included the proposal to transfer the licence obligation for planning the transmission system to SONI from NIE. It was not considered efficient for a separate DB scheme to be established for these staff. There were many communications and engagements between UR and SONI on this issue at that time.

Thus the entirety of SONI's DB pension liabilities arose as a result of public policy decisions to establish a separate TSO function, fully independent of generation and supply for the benefit of the wider electricity industry. SONI is unique in this regard.

The following two sections deal with the two separate though very much related aspects of the consultation paper i.e. the deficit funding and ongoing employer contribution allowance issues.

## Deficit

1. As referred in the introduction there have been many and various communications between SONI and UR on the treatment of pensions during the entire SONI Price Control. SONI notes that the UR's consultation paper has made selected reference to those communications. At a high level overview SONI has very limited and minimal control over any deficits associated with the DB Pension Scheme (as well as ongoing employer contributions), given that the Scheme members have an entitlement, based in statute, confirming the continuation of pension benefits which applied prior to the privatisation of the Northern Ireland electricity sector. SONI itself was not in existence at that time.
2. SONI understands that Ofgem's pension deficit policy aims to protect the interest of consumers and ensure relevant regulated businesses are subject to the same

incentive pressures as the broader market. SONI is engaged in carrying out operations and activities which are also in the interests of consumers, hence the financeability of SONI, including its ability to honour its legal obligations and commitments, is also in the interests of consumers. In addition, the UR has a separate duty to ensure SONI's financeability. SONI is, and only ever has been, seeking the costs necessary to meet its legal obligations and should the legal liability be reduced, SONI would not seek to retain any such income to the expense of customers.

3. UR has specifically welcomed representations as to the appropriateness of applying its Pensions Deficit Recovery Position Paper of December 2014 to SONI. The consultation states that this policy is consistent with two other regulatory decisions in this regard – the CMA in their Final Determination on the NIE RP5 referral and Ofgem's policy for funding pension deficits<sup>1</sup>. SONI does not believe this to be entirely representative as both of those decisions were subject to extensive consultation and were determined in the context of the relevant regulated entities and consideration of the financeability question.
4. In addition, decisions on the funding pension deficits must be taken in the context of any legal requirements on the company and the ability of it to pay any difference between such requirements and regulated allowances i.e. its financeability. It is not UR's role to make Price Control determinations which are simply consistent with other regulators positions and which do not take cognisance of the ability of the regulated entity to pay.
5. Therefore, the UR policy seeks to implement the policy decisions of other regulators, at highest level of comparison only i.e. the implementation of a cut-off date, and without the considerations taken by those regulators. The documentation produced by Ofgem regarding its policy is complex and it does not apply a one size fits all approach. In addition the 2013 paper has been subject to further more recent consultation and refinement including seeking to protect the regulated entities from the related financeability risk<sup>2</sup>. In addition the CMA determination regarding the NIE RP5 referral examined the specifics of the NIE business and determined a benchmarked overall OpEx allowance appropriate for NIE.
6. UR states that considers its pensions deficit policy (2014) is relevant to SONI as it is analogous with the system operators in GB. Although the justifications for this view

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<sup>1</sup> UR quotes the April 2013 paper in the consultation paper however this policy has been subject to additional consultation in 2015 and 2016 with a final decision published 7<sup>th</sup> April 2017

<sup>2</sup> See 'Second Consultation on Ofgem's policy for funding Network Operators' Pension Scheme Established Deficits Pg.4.

have not been provided for SONI to comment specifically, SONI does not believe this to be the case and has outlined in previous communications, particularly those following our response to the Licence Modifications consultation, a number of important and material differences between it and the other licenced entities referred, including:

- (i) SONI does not own a large utility asset base, earning a regulated return for many years until each asset is fully depreciated. Therefore its regulated returns are substantially less, or even decimals of, such companies.
- (ii) 100% of the members of the SONI DB Pension Scheme are 'Protected Persons' for the purposes of the Electricity (Protected Persons) Pensions Regulations (Northern Ireland) 1992<sup>3</sup>. As per the Punter and Southall expert report SONI is unable to change the level of benefits that the Scheme provides for its current active members who are all protected persons i.e. their benefits must be maintained at the pre-privatisation level for both past and future service<sup>4</sup>. They further note 'It would be possible to control the cost of future benefit accrual and reduce the risk of a deficit emerging in respect of post cut-off date service in the Scheme.....by adopting a very low risk investment strategy and by incorporating additional margins for prudence in the funding assumptions. The result would be to significantly increase the expected cost of future benefit accrual above the current level of 40.3% of pensionable salaries.'<sup>5</sup>
- (iii) The SONI DB Pension Scheme is exceptionally small. From a sample provided in the ONS report (referred to by UR with regard to benchmarking) approximately 1% of schemes had less than 100 members<sup>6</sup>. The key issue with small schemes is the associated administration expenses, which will increase exponentially with additional reporting requirements, as would be required by the implementation of the deficit cut-off date and the requirement to 'illustrate compliance with the RIGS methodology'.

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<sup>3</sup> SONI notes the UR statement that Protected Person status 'does not limit the company from introducing cost saving measures' however its Final Determination accorded strong efficiency targets and challenging output objectives and in any event further efficiencies are to be split 50% hence it is unlikely that SONI could make

<sup>4</sup> Punter Southall Report Para 6.34

<sup>5</sup> Punter Southall Report Para 7.19

<sup>6</sup> See ONS Report 2014, table4

7. In addition, it should be noted that SONI has always made the contributions agreed by the professional actuaries employed to ensure impairments were minimised. Therefore, at no point did SONI make any funding decisions which resulted in the creation of deficits nor did it profit by making contributions lower than the pension contributions allowance approved by the UR in previous price controls.
8. This point above is important in the deliberations both the context of this consultation considering both the allowable deficits as well as the allowable ongoing contributions and to the extent that they are inextricably interlinked. Should the allowable pension contributions be, as it is, substantially less than that required as determined by professional actuaries, all else being equal the deficit will increase. This being the incremental deficit which we understand the UR is proposing to be 100% funded by SONI, a company with regulated equity returns of <£1 million per annum.
9. On this, Punter Southall commented ‘From an actuarial perspective, it is my opinion that it is not reasonable to consider the allowance for future benefit accrual and the funding of any deficit arising in the future (i.e. the implementation of the cut-off date) as two completely separate issues given the inextricable link between the two. If there is inadequate allowance for the cost of future benefit accrual after the cut-off date, this would automatically lead to a deficit in the future in respect of post-cut off date accrual.’ As such, SONI requests that the UR specifically takes into account its considerations regarding the allowable ongoing contribution to the SONI DB Pension Scheme when considering whether it is appropriate to apply the proposed policy to SONI.
10. With regard to the UR’s decision on the allowance for the historic pension deficit recovery Punter Southall notes “The allowance for deficit contributions awarded by NIAUR of £189,000 per annum over a 10 year recovery period is not sufficient to meet the deficit of £1,885,000 calculated as at 31<sup>st</sup> March 2015 on the 2013 valuation basis. NIAUR has simply taken the deficit and divided by the number of years in the recovery period. However, this is incorrect as the deficit is expressed in present value terms. ....Based on a discount rate of 4% per annum, the required contributions to remove a deficit of £1,885,000 over a 10 year recovery period would be £232,000 per annum.”<sup>7</sup>. SONI would request that the UR always consider the net present value basis of deficit allowances going forward as to not do so will clearly result in underfunding.
11. As referred above, the SONI DB Scheme is a small in general terms and in particular when compared to those in the utility sector. Hence, it is not appropriate to oblige it

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<sup>7</sup> Punter Southall Para 7.15

to incur expenditure in additional scheme expenses and administration costs by simply requiring it to comply with reporting timeframes and standards extensively set out by another regulator for other regulated entities. Punter Southall notes this 'would place a significant additional compliance burden upon SONI'<sup>8</sup>. They also note 'If a cut-off date is applied and it is in the past, it would mean that as well as establishing new procedures to operate the Scheme as two separate sub-funds going forward, an exercise would need to be undertaken to "back-fill" records to the cut-off date. The back filling exercise would be a significant undertaking and one which could be avoided by introducing a cut-off date in the future rather than retrospectively. The additional administrative and actuarial costs could be reasonably significant relative to the impact of any potential reduction in cost to consumer'.<sup>9</sup>

12. However, of most importance, it is also not appropriate for UR to apply a policy appropriate for other regulated companies, to SONI's Price Control, without proper consideration of the specific requirements (legal and cost) being made of the company and whether it can reasonably control such requirements (legal and cost). UR states that 'Legally protected pensions does not imply pass through'<sup>10</sup> and that it is up to SONI 'to reduce all costs .....to become an efficient operator' noting that others have implemented measures to address costs and that SONI is 'unfettered in how they manage this aspect of their business'.<sup>11</sup> In this regard Punter Southall comments that "SONI has no ability to change the benefits that it provides to members of the Scheme going forward. It is therefore reasonable in my opinion for SONI to expect to be able to recover the cost of providing those benefits in full"<sup>12</sup>.

13. Against the context of proper consideration of the above, the question of whether or not the company has the financial capability to absorb the resulting, or additional costs, associated with the Regulator's decision, on an enduring basis, has to be carefully considered. From their review of previous UR documents Punter Southall commented "NIAUR appears to have had little regard for the particular circumstances of SONI and the Scheme in setting the pensions element of the 2015-2020 price controls ...."<sup>13</sup>

14. SONI has no data or detail as to the extent of UR's considerations of financeability to date and it is surprising such analysis was not included in this further consultation. In the interests of transparency this, and any further considerations resulting from this consultation, should be set out in the final decision. Having conducted a thorough

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<sup>8</sup> Punter Southall Report Para 7.21

<sup>9</sup> Punter Southall Report Para 7.22 & 7.23

<sup>10</sup> UR Consultation 11<sup>th</sup> April Para 34

<sup>11</sup> UR Consultation 11<sup>th</sup> April Para 35

<sup>12</sup> Punter Southall Para 8.2

<sup>13</sup> Punter Southall Para 8.1



assessment, consideration should also be given as to what is an appropriate cut-off date for the particular regulated entity. In the case of SONI we believe it is not reasonable to apply a retrospective cut-off date and urge the UR to strongly consider this in its final determination.

15. At the end of Section 2.1 'Pension Deficit' of the consultation the UR notes 'The overriding principle is that it is up to the company to reduce all costs (including pensions) in order to become an efficient operator.' SONI is not an inefficient operator and seeks to operate efficiently at all times in the delivery of customer services and benefits. It is up to the Regulator to accord appropriate allowances to SONI in order to fund those activities. SONI believes it is right and appropriate for it to be accorded allowable revenues which allow it to fund the necessary deficit repairs to the DB Pension Scheme; given that SONI has a legal obligation to protect the benefits of the staff accorded 'protected persons' status in Northern Ireland Legislation.

## Ongoing Contributions

1. As the UR states, special arrangements exist in the Electricity Sector and DB Schemes i.e. a number of staff have been accorded and hold 'protected persons' status from when the sector was privatised. As before this obligates their employer to continue to provide the pension benefits that existed prior to privatisation. SONI operates a DB Scheme for staff with protected persons status **only**.
2. The trustees of the DB Scheme are required to approve the level of employer contributions. The trustees are responsible for ensuring that the statutory funding objective is met i.e. that the scheme has sufficient and appropriate assets to cover a prudent measure of the DB Scheme's liabilities.
3. SONI is required by law to perform a full actuarial valuation of the DB Scheme every three years. These have been undertaken in March 2010, 2013 and 2016 respectively.
4. The actuarial valuation is to provide the trustees with the financial advice it requires to enable it to carry out its responsibility prudently and efficiently. Otherwise the scheme risks not having enough assets in place to cover the eventual liabilities hence the scheme will begin to report larger deficits going forward. As before, if actual contribution rates were to match the allowance determined in the SONI Price Control determination then large 'incremental' deficits will emerge.

5. For the SONI Price Control 2010 – 2015 UR allowed the full actuarial valuation of the required contributions as per the March 2010 report i.e. 28%. After the March 2013 report was completed, the Dt process was used to adjust that allowance. Annex 1 of the SONI TSO licence specifically allowed for this Dt cost adjustment.
  
6. As the SONI Price Control 2015 – 2020 submission was made in October 2014 the final actuarial valuation of 40.3%, the prevailing rate at that time, was incorporated. The 2013 valuation 40.3% employer contribution requirement included administration expenses of 4.8%. Punter Southall note this was a reduction on the original valuation of 44.1% as follows: “The initial results of the last formal actuarial valuation of the Scheme as at 31<sup>st</sup> March 2013, calculated on the method and assumptions proposed by the Scheme Actuary, revealed that the cost of future benefit accrual, net of the fixed member contribution and including the allowance for administration expenses and PPF levies, was 44.1% of pensionable salaries. SONI negotiated with the Trustees of the Scheme, pushing for less prudent funding assumptions in a number of areas. The concessions gained from the Trustees reduced the cost of future benefit accrual from 44.1% of pensionable salaries to 40.3% of pensionable salaries.”<sup>14</sup> SONI believes this demonstrates its commitment to ensuring that contributions are genuinely reflective of requirements to maintain a stable asset base which is akin to the Ofgem aim of the encouragement to pursue consumer-focused strategies for managing the commitments. Other actions taken over recent year by SONI include:
  - (i) Closing the scheme so that it was not available to any staff without protected persons status;
  - (ii) Successfully transferring from an RPI-based to a CPI-based pension indexation, reducing the employer contribution rate by 6.5% of pensionable salaries;
  - (iii) Not consenting to the payment of any unreduced early retirement pensions; and
  - (iv) Proactively taking steps to avoid setting up a second DB pensions scheme for the seven staff with protected persons status who transferred into SONI in 2014;
  
7. In its submission, SONI made no provision for any change to the prevailing arrangements with regard to Dt submission for future updates, not because SONI doesn't believe it should be achieve efficient cost levels but because SONI has no control to change a legal obligation it has in this regard and which it has no ability to control or manage to any material extent.

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<sup>14</sup> Punter Southall Para 6.82

8. The UR set out to undertake a benchmarking exercise with regard to the allowable ongoing contribution rate. SONI has no objection to such an exercise however the starting point of such an exercise should be to ensure an appropriate comparator is available and in the absence of same to ensure the analysis is adjusted accordingly. UR provided no justification as to why it was appropriate to compare SONI's contribution rate against an industry average with no regard to the age profile of the scheme's membership or the fact that all members were protected persons. Punter Southall make particular reference to this, as follows:

"Notwithstanding the comments I have made comparing the cost of future benefit accrual in the Scheme to those set out in the GAD report, I would like to point out that under the heading "Limitations", paragraph 2.17 of the GAD report states:

*"Schemes' benefits, investment strategies and funding valuations reflect each scheme's particular circumstances. It is beyond the scope of this report to consider such factors. It is recognised that a 'one-size fits all' approach is not appropriate."*

This is an important consideration which the author had deemed it necessary to alert readers of the report to in the introduction and should not be overlooked. The author expresses the view that it is not appropriate to simply benchmark one DB Scheme against another, highlighting that one must consider the differences between those DB Schemes, the way their assets are invested and the way in which they are funded.

I consider this to be particularly pertinent in this case given SONI has no ability to change the level of benefits that the Scheme provides due to the Protected Persons status of all its active members. The GAD report provides no information about the proportion of each scheme's membership who had Protected Persons status or any other relevant characteristics about the members, such as their age, or their qualifications and experience."<sup>15</sup>

9. Even had the benchmarking basis been comparable, SONI has previously highlighted issues with the benchmarking itself, as follows:
- (i) Although the UR's Draft Determination was published in April 2015, UR benchmarked the SONI DB Scheme contribution requirement to the May 2012 GAD Report, which contained analysis of contributions payable by electricity companies in the GB, as at March 2010. The (adjusted) average contribution rate contained in that report were at 26% much lower than the equivalent 32% rate as per the November 2014 GAD Report, which contained

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<sup>15</sup> Punter Southall Report Paragraphs 6.73, 6.74, 6.75

contributions payable, as at March 2013 i.e. comparable to the actuarial report which formed the basis of the SONI submission.

- (ii) The GAD Report quite clearly states in the first footnote attached to the benchmark table that the contribution rates shown exclude any allowance for administration expenses and PPF levies. As before The SONI submission included its administration expenses.

10. Therefore when considering the benchmark inputs into its decision making the UR should have considered the 2014 Report (instead of the 2012 Report) and should have adjusted the benchmark by the 4.8% administration expenses. As Punter Southall noted “NIAUR is allowing 28% of pensionable salaries which is equivalent to leaving 23.2% of pensionable salaries after deducting expenses for consistency with the figures in the 2014 GAD report. On that basis, the provision in NIAUR’s final determination is below the bottom end of the range of comparable pension costs in Great Britain.”<sup>16</sup>

11. In its Final Determination UR referred to a new benchmark, the ONS Survey, which was a further move away from having a comparable benchmark, given it includes an all sector economy, is based on private schemes only and is unlikely to have included any members with ‘protected persons’ status or a similar age profile to the SONI DB Scheme. In addition Punter Southall note “NIAUR states, in its final determination dated 22<sup>nd</sup> February 2016 (paragraph 136), that consideration was given to the most recent GAD report. However, it is not clear that NIAUR has taken any account of the fact that contribution rates increased for every scheme in the GAD survey...”<sup>17</sup>. UR states that ‘a number of options considered’ however no evidence or detail as to what options were considered, and to what extent, was proffered.

12. UR states it also considered the number of active DB members within the scheme staff to total staff which ‘suggested that SONI had a particularly high level of DB members’. As previously explained, SONI has no control over how many staff are members of the DB scheme – it is entirely made up of the staff with ‘protected persons’ status. It would appear that the allowable contribution should be higher in this case however SONI is unclear in terms of how this was considered by UR.

13. The most recent actuarial report as per March 2016, provided to the UR in December 2016, sets out an employer contribution requirement of 44.4%, including 4.8%

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<sup>16</sup> Punter Southall Report Paragraphs 6.63

<sup>17</sup> Punter Southall Report Paragraphs 6.71

expenses. This would require the previous arrangements with regard to Dt submissions to be retained. For the sake of transparency, it would be beneficial to continue to include the specific Dt reference within section 8 of Annex 1.

14. UR has included in its consultation the question of the treatment of TUPE staff. As the UR has stated it may not be practical to separate out the pension costs of these staff to Dt (or another mechanism) and as such we would concur that it may in fact be appropriate that these costs should be considered as part of the overall allowances.
15. SONI believes it has on a number of occasions outlined why it believes it to be reasonable for UR to accord an allowance for the DB Pension Scheme in particular which aligns to the final Actuary Report every three years. This is on the basis of its legal obligations, the initial historical nature of those obligations, the more recent inclusion of additional members transferred to SONI in accordance with UR approved licence obligations, the Actuaries determination (and not SONI's), the link between contributions and deficits and finally the financeability of SONI. As Punter Southall concludes, "SONI has no ability to change the benefits that it provides to members of the Scheme going forward. It is therefore reasonable in my opinion for SONI to expect to be able to recover the cost of providing those benefits in full."
16. The ability of SONI, as a regulated entity with average expected equity returns of between £0.4 million and £1.0 million per annum over the 2015 – 2020 period, to financially absorb the minimum £1.5 million shortfall between the 40.3% actuarial valuation and the 28% allowance determined when SONI has limited if any ability to manage the costs cannot be considered to secure its financeability , even if it was in isolation to other shortfalls being considered, including but not limited to potential additional scheme deficits.

# Change of Law

In its February 2016 consultation paper on the proposed Licence Modifications the UR originally introduced changes to Annex 1 Section 6, “Change of Law”, which had not prior to that point been subject to, or included in, the Price Control consultation process (i.e. the modification had not been referred to in either the Draft or Final Determinations).

SONI objected to these amendments on the basis that UR was seeking to reserve for itself a new power to determine a Relevant Change of Law event primarily through the removal of paragraph 6.3.

SONI also highlighted issues with other aspects of this section including the UR’s retention of the inexplicable requirement that the UR have regard to condition 60 of the NIE Energy Supply Licence in making a determination regarding a Relevant Change of Law. This is a separate entity’s licence, which has no relevance to SONI.

SONI notes that in this consultation the UR has simply reinstated its original amendments, as proposed in the consultation paper of February 2016, without amendment or further explanation. This demonstrates scant regard for the concerns voiced by SONI in its response to that consultation. The proposals are flawed for 2 reasons:

1. The UR’s reasoning is wrong

UR is proposing to amend Annex 1 so that it can proceed with determining a relevant change of law itself and specifically without requiring a request from the licensee to do so, on the basis that the current provisions “work one way” and there is “no mechanism by which the UR could make a change to the revenue entitlement to reflect a change of law in circumstances where the licensee does not make an application to UR to do so”. This is not the case. UR has a statutory power pursuant to Article 14(1) of the Electricity (Northern Ireland) Order 1992 (the Electricity Order) to propose amendments to SONI’s licence and to make a determination on same following a mandatory consultation process. Such licence modification can only take effect pursuant to a period of 56 days, beginning with the date of publication of the UR’s decision.

2. The proposal denies SONI a right of appeal

Consistent with its February 2016 consultation paper, the UR is again proposing to remove paragraph 6.3 of Annex 1, which provides that the licence shall be modified

to give effect to the UR's determination on Relevant Change of Law. The effect of this paragraph was to provide SONI with a right of appeal under Article 14B of the Electricity Order. As per SONI's original submission in March 2016, it is inappropriate for the UR to limit SONI's established rights of appeal without clear justification. UR states incorrectly that removing the paragraph does not remove any of SONI's current rights, as once a determination is made then "one avenue open to a regulated company is by reference to the CMA with regard to the opening RAB in the next price control". This is not the case. The CMA does not provide for an appeals process which allows a regulated company to submit an appeal on the basis of an unrelated error with no connection to or link with the regulated RAB. No Relevant Change of Law determination to date has had a bearing on SONI's RAB.

Finally, UR states that the reference, in the proposed paragraph 6.3, to NIE Energy Supply Licence is "still sufficient" as the "requisite arrangements" referred may still have an impact on SONI. This does not make sense and is not reasonable. SONI is a totally separate business to that of NIE and all other regulated NI entities. SONI has its own set of requisite arrangements which, for the sake of transparency and clarity should be set out in its own licence, rather than by way of reference to a separate entity and separate licence. Keeping licences up to date and relevant would be beneficial for both the regulated entity itself as well as all other interested parties.

# Conclusion

1. In addition to seeking to continue incentive pressures on regulated entities, Regulators must consider whether the company will be financeable having taken on the additional liabilities resulting from same. This does not preclude a Regulator from seeking to apply incentive pressures however they should only be implemented following a thorough consideration of the element of control the regulated entity has over the particular cost and indeed how they may have contributed to it being an inefficient cost in the first place, if this is the case. The incentive properties of an ex ante framework are lost if regulated entities must forego the benefit of incentives delivered in order to in order to pay for costs which have not been accorded an appropriate allowance.
2. UR's Pension Deficit policy is to adopt its interpretation of the Ofgem policy and CMA determination with regard to the NIE RP5 referral. SONI does not believe either can be directly and exclusively interpreted as being the implementation of a deadline date after which all incremental deficits are to be 100% funded by the regulated entity. In addition, SONI does not believe it is reasonable to transfer a high level interpretation of a policy specifically designed for different regulated entities with very different financial characteristics.
3. In the 2010 – 2015 Price Control UR allowed in full the ongoing contribution requirement as per the Actuarial triannual reports. SONI would urge that UR determine to revert to that policy on the basis that SONI does not act against the consumer interest by ensuring its DB Pension Scheme is properly funded to limit large exposures arising.
4. In any event the question of allowances for deficit and ongoing employer contributions cannot be taken in isolation of one another as they are inextricably linked, specifically deficiencies in the latter will create larger deficiencies in the former all else being equal.
5. Finally, SONI sees no benefit to the UR amending the current licence to reflect its proposed Change of Law condition. In addition it would appear to be a retrograde step by removing SONI's right to appeal any detrimental decisions in this regard.