

SONI Ltd Response

Price Control for Northern Ireland TSO 2020 to 2025, Consultation on Utility Regulator Approach

24 January 2019



Introduction

SONI is the licensed Transmission System Operator (TSO) in Northern Ireland. SONI is responsible for planning and operating the electricity transmission system safely and securely to ensure a reliable supply of electricity for Northern Ireland consumers. SONI also operates the all-island wholesale electricity market with EirGrid plc through the Single Electricity Market Operator which has been in operation since November 2007.

SONI holds two separate licences in respect of its TSO and Market Operator functions; the Utility Regulator's consultation to which this response is directed relates only to SONI's (TSO) Licence to participate in the transmission of electricity.

SONI fully supports and practices a collective and proactive approach, working with stakeholders, to develop solutions which deliver the best outcomes and value across all relevant stakeholder groups. TSO activities are generally complex and multi-faceted, requiring cross-industry buy-in and commitment.

Structure of this Response

This response is set out in two parts. In the main body of the response SONI provides a summary of its key points followed by its comments on:

- An overview & key achievements;
- Roles, Services & Stakeholder Engagement;
- Form, duration and scope, including timelines for the price control;
- Our thoughts on the Reckon Report; and
- Business plan assessment.

The second part of this response, in Section 6, is where we respond to the UR's specific questions.

Key Points

1. SONI welcomes the approach to its price control by set out by Utility Regulator (UR), particularly the focus on unlocking value for customers.
2. The SONI price control will be important for implementation of the UR's Corporate Strategy from 2019 to 2024, with more than half of the 18 objectives set out in UR's strategy linked to actions by SONI.
3. The current price control has seen a number of key achievements delivered to the benefit of customers. These were the result of extensive stakeholder consultation and have delivered significant benefits. These should be reflected in the Approach decision paper, and form a sound basis to build on for the next control period.
4. As part of SONI's day to day activities extensive consultation with stakeholders across the energy industry is carried out, not only for the price control. Our business plan will build on this; we will also proactively engage with stakeholders where we are able to incorporate the outcome. The Stakeholder Expert Challenge Group (SECG) has proved a useful addition to the architecture and we will continue to engage with this group for input into the business plan.
5. SONI agrees that it is vital to set out in its business plan both what we do and why we do it. Yet it is important to be aware that the majority of the roles, services and activities carried out by SONI are mandated through legislation, licences, codes and approved methodologies which would need to be changed to facilitate any change in our scope of work. As these changes take time and many have formal governance processes, SONI must base its business plan on its current set of obligations and its licence as extant.
6. In addition, SONI does not, and cannot, operate in isolation. It must engage extensively with, amongst others, NIE Networks, EirGrid, SEMO, and Mutual Energy. The SONI Price Control approach must be cognisant of and support such interactions.
7. SONI notes the form and duration of the price Control proposed by the UR. SONI agrees with the UR that it is important to retain and build on the framework that has been developed through the CMA process, with evolution based on learning that can be supported by evidence from implementation of those mechanisms.
8. As part of the form of the control SONI believes it is important incentives are balanced between inputs and outputs, between opex and capex, between those items included within the *ex ante* framework and those dealt with through uncertainty mechanisms, and over time. This is an area where the current framework would benefit most from development and where it is possible to easily build on what was done in the past to the benefit of customers.

9. SONI also seeks greater clarity from the UR around any change to the Dt mechanism as it relates to SONI's financeability and was a significant factor in the CMA process. The facts that underpin these concerns have not changed. SONI remains of the opinion that the Dt mechanism should be used as little as possible if UR wishes to leverage the benefits of RPI-X regulation for customers.
10. We welcome the UR's intention to increase the scope of incentive mechanisms. SONI prides itself on delivering consistently high quality service and performance and expects itself to deliver well justified and stretching outcomes. Under the current control SONI has made changes which have:
- Initiated and implemented a comprehensive DS3 programme which required extensive engagement with industry, negotiation with generators etc. in order to increase the maximum SNSP¹ from 50% in 2015 to 65% in 2018, meaning that the maximum instantaneous output from wind generation in Northern Ireland increased from 83% of demand in 2015 to 129% in 2018.
 - Resulted in savings to Northern Ireland customers through lower dispatch balancing costs of £11 million over the final three years of the previous trading arrangements.
 - Increased the volume of renewable generation connected to the system by c.650MW, allowing the percentage of demand supplied by renewables to increase from an annual average of 17.9% in 2014 to 31.6% in 2018.
11. Ultimately, achieving a financeable price control is crucial. It is the sum of the parts of the overall framework and not just the financial remuneration aspects which will require robust assessment to determine if, in the round, the overall price control is indeed financeable. This should be cognisant of the risk profile and high operational gearing asset light nature of SONI TSO.
12. We welcome the introduction of test areas for our business plans; however we note that we are the first company that the UR has applied this approach to and therefore these are relatively generic. It would be helpful if the Approach decision paper included some guidance around how these test areas could be evidenced/ applied in SONI's specific context.
13. Timelines for the completion of this price control are already very tight; in particular we note that the time allowed for the legal drafting of potentially complex algebra does not include any contingency. It will be essential that we have certainty around ongoing revenue before end May 2020 to facilitate timely business planning and to support tariff setting. To that end the Approach decision paper should also set out that which would apply if, for any reason, Licence Modifications are not implemented prior to 1 October 2020.

¹ SNSP is an all-island figure

1. Overview & Key Achievements

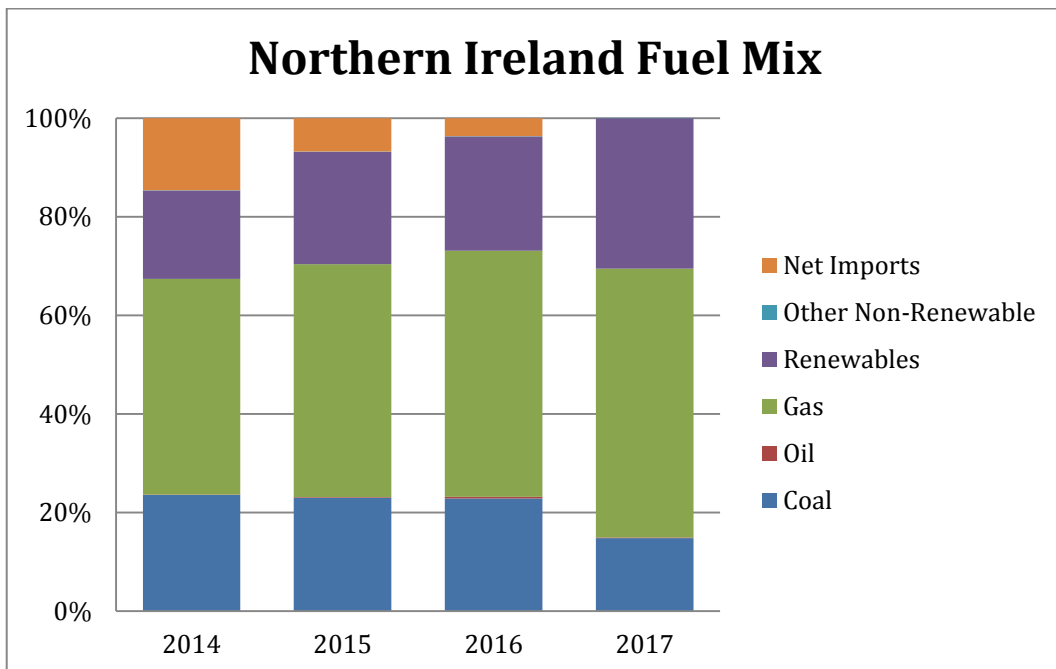
- 1.1 SONI welcomes the UR consultation on the SONI TSO Price Control Approach and is committed to working positively with the UR to develop a Price Control framework which:
- Delivers the range of services and outputs which provide value to consumers and are considered best in class by stakeholders;
 - Adds further motivation, above reputational enhancement, to operate at best in class efficiency noting that SONI has always been motivated to deliver service outcomes which are well-justified, stretching and achievable, as evidenced in the current control; and
 - Maximises the benefits of investment in innovative solutions and practices.
- 1.2 SONI prides itself on delivering a consistently high quality service and performance and expects itself to deliver well justified and stretching outcomes for stakeholders and consumers. In addition, we implicitly involve stakeholders in decision making processes by way of consultation processes and working with UR to implement any additional feedback. We are open and committed to improving the informing and involvement processes on our activities, outcomes and performance and we look forward to working with UR to agree the parameters and potential funding requirements of same. We welcome high expectations that are clearly set out on a tangible measurable basis and with Price Control support for the associated activities.
- 1.3 We have found the Stakeholder Expert Challenge Group (SECG) very useful and welcome the fact that it builds on the extensive engagement we have had with industry over the past few years developing new scheduling and dispatch processes and transitioning to world leading volumes of non-synchronous generation.
- 1.4 We welcome UR acceptance of the continuing transitions in the electricity industry in Northern Ireland and seek to build on the framework that has supported the transition to 40% renewables and compliance with the EU Target Model. SONI is equally committed to delivering a quality business plan that continues to unlock further value for customers.

Key Achievements for 2015-20 Price Control

- 1.5 It is important to SONI that the consideration of a new model does not undermine the framework that has supported its recent achievements. We set out a number of SONI's achievements during the 2015-20 Price Control period to date in paragraphs 1.6 to 1.12 below.
- 1.6 SONI has supported the development and implementation of new trading arrangements, including changes to the key scheduling and dispatch decision

making process. For the revised wholesale market arrangements, SONI is obliged (in conjunction with EirGrid as TSO for Ireland) to schedule SEM generation and ensure that instructions for the dispatch of SEM generation are issued, undertake operational planning and establish and operate a merit order system for the balancing market. Participant balancing quantities and imbalance prices in the balancing market are directly affected by the scheduling and dispatch process. SONI made significant investments in IT infrastructure to implement these new arrangements. SONI is responsible for reviewing the performance of new parameters and reporting annually to the UR. SONI's performance under these new rules is subject to audit.

- 1.7 SONI has facilitated and supported a significant shift in the Northern Ireland fuel mix between 2014 and 2017. This increase in non-synchronous generation has significant implications for how SONI operates and manages the transmission system.



- 1.8 SONI has supported and facilitated the connection of approximately 650MW of renewable generation to the Northern Ireland electricity network during this Price Control period. During this time period the percentage of demand supplied by renewables has almost doubled from 17.9% to 31.6%. The substantial increase in the amount of wind generation connected and utilised in Northern Ireland is shown in the tables below:

Year	Installed Wind Capacity (MW)
2014	729
2015	751
2016	943
2017	1,154
2018	1,276

Year	Total Wind Generation (GWh)
2014	1,343
2015	1,696
2016	1,499
2017	2,034
2018	2,385

- 1.9 Over this current price control period, SONI has delivered initiatives that have resulted in savings of £11M for Northern Ireland customers (£44M all-island) through proactive management of dispatch balancing costs, including through rigorous ongoing challenge of the transmission constraint groups.
- 1.10 By working with the Regulatory Authorities to develop the new capacity market and undertaking its new role of Capacity Market Delivery Body, SONI has ensured security of supply in Northern Ireland at a saving of approximately £50M per year for customers here.
- 1.11 A significant increase in System Non-Synchronous Penetration (SNSP) limit has been achieved. As a result of its world leading DS3 programme, SONI has made changes to system operation that have allowed it to safely increase SNSP limits from 50% in 2015 to 65% in 2018. This means that the maximum instantaneous output from wind generation in Northern Ireland increased from 83% of demand in 2015 to 129% in 2018.
- 1.12 This increase in SNSP on the electricity network is a key component to meeting EU and UK energy targets, and has been enabled through the development of new operational tools and a complete root and branch review of the system services that we procure.
- 1.13 SONI was only able to deliver these benefits by working closely and collaboratively with all relevant stakeholders including NIE Networks, generators, suppliers, the other TSOs on the island and the Regulatory Authorities. We aim to build on these relationships and processes over the next period.
- 1.14 SONI's business plan will build on these achievements. We will submit our plan based on our current set of obligations, with a view to implementing the Clean Energy Package and UK Government commitments such as the Paris Climate Change Accord.

2. Roles, Services & Stakeholder Engagement

- 2.1 SONI welcomes the focus that the UR is placing on understanding the roles and services that we provide to customers in Northern Ireland. SONI provides a critical and complex role, balancing the supply and demand for electricity on a second by second basis at lowest overall cost to consumers. We are happy to ensure that what we do and why we do it are clearly set out in an accessible way within our business plan.
- 2.2 As shown in Figure 1, SONI undertakes a wide range of roles including the connection of customers to the transmission system, planning the transmission network, working with NIE Networks to build network projects, and operating the transmission system on a continual basis.

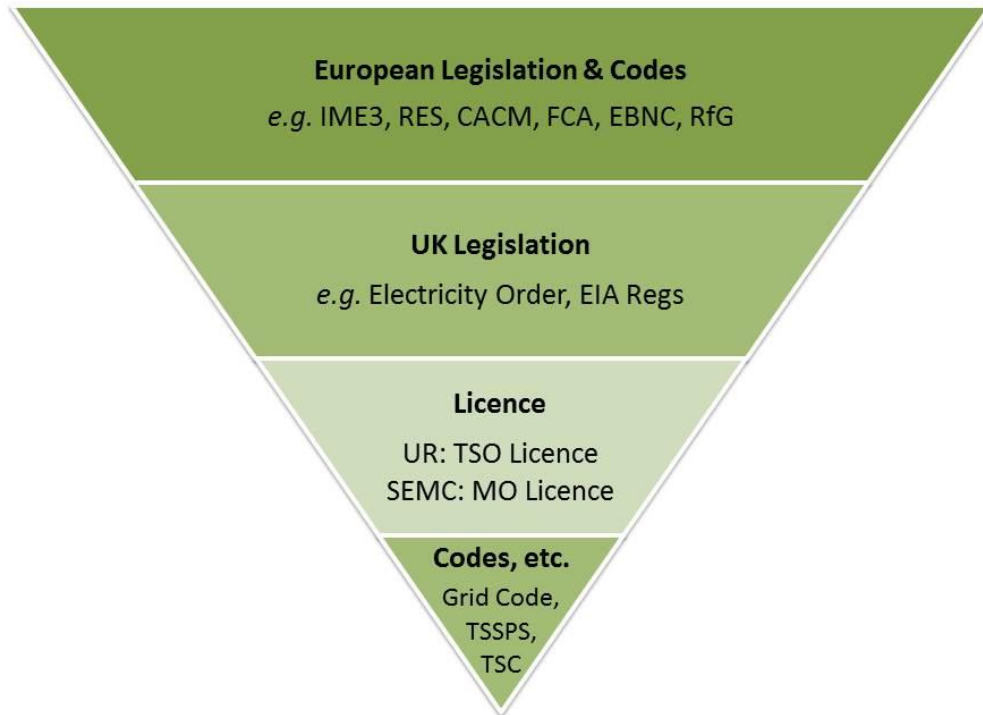
Figure 1. High level diagram of SONI roles



- 2.3 The vast majority of SONI's responsibilities are defined in licence, codes or approved methodologies and standards (Figure 2). All of these have formal governance processes which include significant stakeholder engagement, and as a result these cannot be changed quickly. These strict governance processes provide an important safeguard for customers. For example, the recent update of

our core scheduling and dispatch processes to implement the new trading arrangements was the result of a five year programme of consultation and investment. This change required major revision of the SONI's TSO licence, the Grid Code, the Trading and Settlement Code as well as replacement of major IT systems by both SONI and market participants.

Figure 2. Statutory hierarchy under which SONI operates



2.4 The majority of our responsibilities have been subject to extensive stakeholder consultation during the current Price Control period. This includes the transition to the new I-SEM trading arrangements, the development of the DS3 programme and the review of connection arrangements. A summary of TSO led engagement is set out in the Table 1 below:

Table 1. Statutory hierarchy under which SONI operates

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
Grid Code	2015 to 2018	5	12

- 2.5 In addition to the TSO led engagement on I-SEM and DS3, the Regulatory Authorities also ran a number of engagements. From 2012 through to September 2017, this included 42 consultations and 23 stakeholder events on I-SEM arrangements, and 6 consultations and 3 stakeholder events regarding DS3 system services.
- 2.6 We are committed to following through on the output of these recent consultations and the associated regulatory decisions. Given the magnitude of engagement that has shaped these very recent changes to SONI's ways of working and the short time between the publication of UR's Approach decision paper and submission of SONI's business plan, we do not propose to undertake a wholesale review of our roles and services before July 2019. However, while we are preparing our business plan, we will identify any discretion that we have around the services we provide or the activities that we undertake, which have not been reassessed over the past couple of years.
- 2.7 We will consult with the SECG on the aspects of our business plan which can be flexed to accommodate stakeholder preferences. In particular, we will closely consider the areas highlighted by the SECG, such as transparency, close working with NIE Networks and the development of future energy scenarios to ensure that our business plan reflects these key themes.
- 2.8 The I-SEM trading arrangements and DS3 framework provide a stable platform for the increased participation of small scale generation and demand response into the wholesale market. These have been actively designed to ensure that all forms of generation and demand response are able to compete on a level playing field. SONI is working with NIE Networks to ensure that their initiatives are consistent with the all-island trading rules. We will continue to engage with NIE Networks throughout our business plan preparation to ensure continued alignment.
- 2.9 SONI has noted some minor inaccuracies in the description of its current roles and associated regulatory processes in the draft Approach paper. We welcome an opportunity to discuss these with the UR, to ensure that the Approach decision paper reflects the significant work done by the UR Wholesale Markets Directorate to scrutinise SONI's activities and to promote transparency for customers.

UR Corporate Strategy

- 2.10 The UR's Corporate Strategy for 2019 to 2024 largely aligns with the timeframe for the SONI TSO Price Control and the UR will need to rely on SONI to aid delivery of its objectives (Figure 3). The UR strategy will therefore be an important input into the development of SONI's business plan. SONI will respond separately to the UR's consultation on its Draft Strategy.
- 2.11 SONI would welcome the addition of a statement in the Approach decision paper that highlights the interconnection between the UR corporate strategy and SONI's strategic objectives, together with clarification of how this interaction will be reflected in UR's assessment of SONI's business plan.

Figure 3. SONI input into UR Strategic Objectives in the 2019-24 Forward Plan



3. Form, Duration & Scope

- 3.1 SONI believes that it is important that this Price Control uses the outcome of the CMA process as a foundation for moving forward. In this regard it is essential that, while lessons can be learnt from the implementation of the uncertainty mechanisms, the core principles and the overall financeability assurance should remain.
- 3.2 We agree with the UR's proposed duration of five years for this Price Control. This covers a critical period for Northern Ireland as the electricity industry implements the Clean Energy Package and supports the delivery of UK Government commitments under the Paris Accord. The I-SEM trading arrangements and the DS3 initiatives will provide a strong platform to build on for these legislative developments, as these new ways of working become embedded into the industry.
- 3.3 SONI would strongly encourage the UR to implement a Price Control framework that includes all predictable activities within the revenue allowance. Significant changes to SONI's activities almost always require changes to licence, codes, methodologies and/or standards. These changes can only be made following stakeholder consultation.
- 3.4 SONI will be submitting its business plan based on its full suite of current TSO obligations. We are unsure which activities the UR is proposing to move out of the baseline revenue. As highlighted during the CMA appeal process, SONI has concerns for its overall risk profile, which would impact consumer service and quality output deliverables, if a greater level of revenue recovery becomes 'at risk' due to *ex ante* caps or *ex post* assessment. These concerns remain and would be exacerbated if the scope of the mechanism were expanded beyond those items that cannot be foreseen at this time.
- 3.5 It is important that the regulatory incentive framework protects customers, supports the creation of value and does not result in perverse or unintended outcomes. In particular, SONI would comment that:
- While SONI does not necessarily wish to see a move to a totex based approach, incentives should not fixate solely on whether monies are spent on opex or capex, as this could distract from the overall aims of the Price Control;
 - Any regime proposed should be designed to ensure that the incentive is equally powerful across the regulatory cycle (rolling retention);
 - There should be no boundary or edge effects between Business As Usual activity (under the Revenue cap) and that through Uncertainty Mechanisms (Dt); and

The incentive should be equally powerful in terms of outputs as in respect of inputs; in each instance the sharing factor between the end customers and SONI should be appropriate.

- 3.6 In SONI's view, the focus of any mechanism should be on unlocking and securing the delivery of outputs and outcomes for customers, rather than the inputs.

Timelines

- 3.7 SONI is committed to delivering a high quality submission by the end of July, and will engage with the UR over the coming months to ensure that the submission meets realistic expectations.
- 3.8 We note that the time allowed for the legal drafting of potentially complex algebra does not include any contingency. Therefore, SONI would welcome confirmation in this Approach decision paper of the revenue that SONI will be allowed to collect and retain in the event of a delay. SONI would much prefer certainty being provided in this manner rather than needing to employ the processes set out in paragraph 5 of the Annex to SONI's licence.

4. Reckon Report

- 4.1 The Reckon paper sets out a number of initial proposals concerning the remuneration of the TSO's investors and determination of its financeability. As such, SONI believes it provides a useful starting point.
- 4.2 SONI supports the 4 guiding principles as set out in the Reckon paper:
- Using the outcome of the CMA appeal as a starting point;
 - Recognising the differences between the TSO and infrastructure companies;
 - Employing a targeted and proportionate approach; and
 - The adoption of feedback and iteration.
- 4.3 A financeable Price Control should provide the TSO with the right set of financial tools to achieve the specified, tangible and fair targets set out with the objective of achieving the overall right set of benefits across the stakeholder groups. To that end it supports the UR's principal objective of seeking to protect consumers.
- 4.4 The financeability question is a complex one not limited to wholly financial considerations, as acknowledged by the Reckon paper.
- 4.5 To SONI, a financeable control is one which *overall and in the round*, trades a fair and robust revenue recovery framework providing the financial tools to efficiently deliver activities and outcomes valued by consumers and stakeholders and in their longer-term interests.
- 4.6 While the Reckon paper recognises that SONI should not be simply the product of debt financeability analysis, and this is welcome. Nonetheless, SONI believes that the Reckon paper remains perhaps disproportionately focused on the particulars of an overly narrow interpretation of the financeability question, i.e. remuneration of the TSO's equity capital and debt finance.
- 4.7 In addition to that set out in the Reckon paper SONI would wish to see consideration of the impact of operational expenditure, scenario testing, resilience and incentive frameworks. The application of scenario analysis on RORE as suggested in the paper should play a part; so too however should overall benchmarking of returns as compared to those investors might expect in operating in comparable or similar businesses and business sectors.
- 4.8 Maintaining the framework set out in the 2017 CMA decision and calibrating it so that it is appropriate for the output and service delivery requirements of 2020-2025 will be important. This 'capital layers' framework:
- Cost of capital adjusted for Operational Gearing;
 - Remuneration of contingent debt and equity committed to the business;

- Recognition of collection agent activities; and
- Adjustment in the risk framework for the asymmetric risk of regulatory pass through costs

was developed following a substantial and SONI-specific review and testing of SONI financeability. As such, any adjustments should be limited and properly tested to ensure the risk remuneration equilibrium is maintained.

- 4.9 From a financeability perspective the link between the specificities within the framework and the ability to finance activities efficiently is vital. Increases in regulatory discretion including lack of clarity on cost recovery and increased scope or perception of scope for *ex post* review increases rather than reduces regulatory risk and has the potential to undermine the stability and predictability of the overall framework. To this end uncertainty mechanisms and their management also form a key component of the financeability framework and analysis.
- 4.10 Here, it is proposed to address the question by way of reference to a notional efficient licensee although there are also references to wider reviews including consideration of group implications and assessment of actual debt financeability and financial resilience. It is important to test financeability on actual as well as notional structures. It is the actual licensee which is charged with the provision of the services customers ultimately expect.
- 4.11 Testing debt financeability and equity returns under modelled scenarios and resilience tests (especially to downside shocks) are all important components to TSO remuneration and the overall financeability assessment.
- 4.12 In relation to asymmetric risks and returns to investors, SONI remains firmly of the view that it is important these are recognised. In particular the application of CAPM alone to assess financeability, when CAPM is designed to be capable of being described in terms of a probability distribution of outcomes in terms of simply first and second moments, is in itself deficient in terms of the SONI business.
- 4.13 SONI welcomes the fact that the Reckon paper proposes inclusion of other aspects of the control in terms of the consideration of such asymmetric risk. Up to now, SONI has faced asymmetric risk which has resulted in a higher probability of cost allowance over-runs as compared to underspend, however this has to date not been recognised.
- 4.14 The overall package needs to be financeable against benchmarks which reasonable investors would expect for investing in the TSO business. Margin benchmarks provide a strong cross-check on overall remuneration and one which the CMA incorporated into the overall remuneration package to achieve financeability. Continuous iterative comparison to relevant financeability cross-checks, based on margins, will ensure overall value is preserved for both SONI and consumers. Any concern regarding the robustness of overall benchmarks must be weighed against seeking to make difficult to calibrate adjustments to

existing frameworks – for example the scale of adjustment appropriate to beta in the context of the application of the operating gearing of the SONI business.

5. Business Plan Assessment

- 5.1 We welcome the UR providing us with some clarity around the test areas that it intends to apply to our business plan and setting out its expectations for an excellent submission. However, we note these are relatively generic and may not all be appropriate for SONI's circumstances. For example, unlike a network based utility with a 40 year RAB, because of SONI's high operational gearing, very little of the revenues directly approved as part of this Price Control decision will impact on customer bills beyond 2025².
- 5.2 SONI would therefore encourage engagement before this decision is published to remove ambiguity and ensure that these are focused on matters that are relevant and material to this particular control.
- 5.3 While we agree with the concept of a financial incentive, we would caution against a penalty when only the criteria for a top level submission have been presented and consulted upon in this paper and the framework for the application of such a penalty is not currently set out or prescribed in SONI's licence. Furthermore, this is the first time UR has adopted this approach which means there are no benchmarks or precedent for SONI to consider or rely on. In SONI's opinion, only an asymmetric incentive can be applied in these circumstances because the threshold for consultation relating to a penalty has not been met. Furthermore, the potential downside impacts of this mechanism are being considered outside of the holistic view of SONI's financeability that formed a pillar of the CMA appeal process on our current control.

² Test Area 1 – third row

6. Consultation Questions

Question 1. Do you agree with the proposed form, scope and duration of the control?

- 6.1 In general SONI considers it important that the framework set out in the CMA decision should be maintained and calibrated for the next period.
- 6.2 It is important that SONI can manage its business in a proactive and efficient manner, and it will be essential that all known activities are included within the scope. Consistent with UR policy to date, the use of uncertainty mechanisms would need to be minimised if the Price Control is going to facilitate this.
- 6.3 In this context, SONI objects to the suggested move to increase the proportion of funding that is provided on an “up to a cap” basis³. Conversely, SONI believes that this goes against the interests of customers. We set these reasons out in our submissions to the CMA, including:
- The increase in risk to SONI, which would need to be reflected in the overall Price Control package. This would increase cost to consumers while adding no value;
 - The unnecessary additional overhead that would be incurred by both SONI and UR, again increasing costs to consumers without added value and also removing incentives on SONI to identify efficiency;
 - The difficulty in separating out the costs associated with a change in part of the activities that an individual or team undertake, and the unnecessary risk of arbitrary regulatory decisions as a result.
- 6.4 It is important that the regulatory incentive framework protects customers, supports the creation of value and does not result in perverse or unintended outcomes. In particular, SONI would comment that:
- While SONI does not necessarily wish to see a move to a totex based approach, incentives should not fixate solely on whether monies are spent on opex or capex, as this could distract from the overall aims of the Price Control;
 - Any regime proposed should be designed to ensure that the incentive is equally powerful across the regulatory cycle (rolling retention);

³ As proposed on page 34 of the consultation paper

- There should be no boundary or edge effects between Business As Usual activity (under the Revenue cap) and that through Uncertainty Mechanisms (Dt); and
- The incentive should be equally powerful in terms of outputs as in respect of inputs; in each instance the sharing factor between the end customers and SONI should be appropriate.

Question 2. Do you agree with the way SONI's roles, services and activities have been defined (as set out on page 17 and Appendix C)?

- 6.5 The processes that SONI must follow when undertaking a significant portion of its work are specified in regulatory approved codes, standards and methodologies. This is not immediately obvious from the consultation paper, including the safeguards that these governance processes provide for customers.
- 6.6 Overall, SONI considers the description of its roles and services within the consultation paper to be simplistic and is concerned about misrepresentation of the framework that we operate in. In particular, we are concerned about the complete omission of any reference to the substantial industry wide consultations that both SONI and the UR have undertaken recently to determine the scope of SONI's roles, services and standards. This volume of stakeholder engagement is unprecedented in the electricity industry in Northern Ireland and is set out in Table 1, paragraph 2.4 of this response.
- 6.7 In SONI's opinion, in the absence of a Strategic Energy Framework beyond 2020, the value provided by this stakeholder engagement should underpin the business plan for the next period.
- 6.8 SONI has found the input of the SECG to be beneficial in this regard, given the commonality between it and the stakeholders involved in the engagements set out in Table 1, paragraph 2.4, and reassuringly consistent with the messages we have received elsewhere.
- 6.9 We commit to involving the SECG in the review of our business plan prior to submission and are currently considering the appropriate stage within our internal governance for this to take place.
- 6.10 While SONI's role will be vital in the ongoing decarbonisation of the electricity supply chain, individual initiatives (beyond the current programmes) will be considered as they emerge and will not be included in SONI's business plan⁴. SONI will be preparing its business plan based on its current set of obligations

⁴ Any substantial change to the services that SONI provides would need to be underpinned by changes to the relevant codes, methodologies, standards or licence conditions. These require consultation and UR approval, therefore the outcome cannot be pre-judged.

under statute, licence and codes⁵. We do not consider it appropriate to presume that any of these would (or could) automatically be changed as the result of this Price Control process.

6.11 SONI operates in a different paradigm from asset based utility companies and has little discretion around the timing of its capital investment. For example, while a network utility may be able to adopt a range of strategies for asset replacement, with some assets being run to failure and others proactively replaced over a number of Price Control periods, the majority of SONI's small asset base has an expected life of approximately five years, meaning that it will be replaced or upgraded at least once during each Price Control period. The marginal savings from pushing the asset life by an additional year (20% longer service) would be unlikely to justify the increased industry wide risks from the failure of critical systems. Therefore, while the choices made by asset based companies will impact on both customer bills and levels of service, the majority of the services that SONI provides are considered essential and are therefore governed by industry codes and/or regulatory approvals.

Question 3. Do you agree with our expectations as part of our test area on delivering value for money?

6.12 We note that this is the first time that the UR has consulted upon test areas for a Price Control, and that therefore they are, of necessity, relatively generic. The corollary of this is that they are not all particularly applicable to SONI, and some are more relevant than others. For example, unlike a network based utility with a 40 year RAB, because of SONI's high operational gearing, very little of the revenues directly approved as part of this Price Control decision will impact on customer bills beyond 2025⁶.

6.13 SONI's current set of activities, and the manner in which it is delivering them, is the outcome of a series of consumer engagements and formal consultations. These are also governed by strict regulatory approvals which have considered the wider value to customers provided. SONI will set out the processes that have led to the current obligations and ways of working within its business plan, noting that these have mostly been developed in conjunction with the UR.

6.14 SONI would like to highlight that it is essential that sufficient funding is provided to allow the TSO business to operate in a sustainable manner. It is essential that the shortfall in funding for operating costs over the current five year period is reversed. The UR should provide robust justification for any efficiency savings that it

⁵ For the purpose of the business plan preparation a data freeze is required, which is likely to be January 2019.

⁶ Test Area 1 – third row

introduces and should ensure that they are achievable. This justification will form a core part of the UR's financeability analysis and assessment.

- 6.15 Any assessment of value will need to carefully consider the risks that could be introduced by underfunding SONI and thereby undermining the outcome of the consultation process that has led to SONI's current set of obligations under its licence.
- 6.16 It will be important that the Approach decision paper sets out how these criteria will be applied / weighted in SONI's circumstances.
- 6.17 SONI observes that the draft Approach paper only consults on the "excellent" category, but does not include robust definitions for any of the assessment levels below this (i.e. they are all subjective and open to interpretation). Clearly, SONI strives to meet the highest standards at all times, and it is important that the demarcation between the categories is clear. It could be harmful to all stakeholders if, for example, SONI's reputation was damaged or financial returns were reduced on the basis of distinctions that have not been subject to consultation.

Question 4. Do you agree with our framework approach and expectations as part of our test area on delivering services and outcomes (including our proposed framework for service quality and performance)?

- 6.18 As part of its business plan submission, SONI will set out the evolution of the services that it provides, to assist with understanding of the legal and regulatory framework that have shaped the current services and cost base.
- 6.19 SONI will be preparing its business plan based on its current set of obligations under statute, licence and codes. While we will not presume "that the TSO is automatically best placed to do what it does", equally we cannot presume that any changes to statute, licence or codes that would be necessary to reallocate these activities would be in place before 1 October 2020. For example, any change to SONI's contractual relationship with generators and suppliers that are using the transmission network would require changes to two conditions of SONI's licence (with the associated right of appeal) and would be reviewed in line with Article 10(4) of the 1992 Order.
- 6.20 Many of the roles and responsibilities allocated to SONI have recently been reviewed through a significant workstream led by the SEM Committee. This commenced with a consultation paper in March 2015⁷ and concluded with a suite

⁷ <https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-15-016%20I-SEM%20Roles%20and%20Responsibilities%20Consultation%20Paper.pdf>

of changes to SONI's TSO licence in July 2016⁸ and March 2017⁹. These changes came into effect with the start of the I-SEM less than four months ago and any review will be more beneficial if it is based on experience of operating under these arrangements.

- 6.21 We would appreciate the guidance being clearly tailored to SONI's current circumstances, particularly given the recent and "genuinely fresh perspective" that the I-SEM transition, the world-leading DS3 programme and other initiatives have brought to the way we operate our business. SONI is unsure why a business plan that respects these processes and decisions would be categorised as less than excellent, specifically because these changes have been shaped so recently and by such a considerable volume of stakeholder engagement. Furthermore, customers have made a considerable investment in them. In fact under SONI's current circumstances it might be considered sub-optimal to ignore this unprecedented body of recent work.
- 6.22 SONI has been engaging with NIE Networks with regards to its recent call for evidence on potential changes to the way it manages the distribution system. SONI also works very closely with NIE Networks when choosing solutions for transmission development. We will set these processes out in our business plan; however, our plan will reflect the current framework and will not pre-judge the outcome of the consultation process being held by NIE Networks.
- 6.23 SONI's business plan can only reflect the factors which are currently within its control, and it would be helpful if the guidance clarified that the UR does not expect SONI to extend its system wide view beyond these boundaries.

Question 5. Do you have any initial views on how the service quality and performance framework could be implemented as part of our test area on delivering services and outcomes?

- 6.24 The service quality and performance framework is discussed in various areas of the draft Approach paper, as it touches on a number of services provided by SONI. SONI therefore also responds to this area under the more specific questions elsewhere in this Section 6.
- 6.25 SONI will develop its thinking around the wider service quality and performance incentive framework as part of its business plan development; therefore it would be premature for us to make specific proposals at this time. However, at a generic level we would like to highlight that:

⁸ <https://www.uregni.gov.uk/publications/notices-decision-modifications-soni-tso-and-mo-licences-necessitated-implement-i-sem>

⁹ <https://www.uregni.gov.uk/news-centre/notices-decision-modifications-soni-transmission-system-operator-and-market-operator>

- The overall Price Control package, including any incentives, needs to be financeable against benchmarks which investors might reasonably expect for investing in a business such as SONI's;
- These should be included in any financeability testing and assessment; and
- The financeability assessment must model scenarios and must examine resilience to downside shocks, including downsides from potential incentives.

Question 6. Do you agree with our framework approach and expectations as part of our test area on securing cost efficiency and managing uncertainty?

- 6.26 SONI's positive influence in reducing system wide costs far outweighs its overall cost. This means a refined and targeted cost efficiency and uncertainty approach will capture the maximum benefits for consumers.
- 6.27 In terms of cost recovery, each of the three current cost remuneration structures has a role to play in an efficient cost recovery framework; however consumer benefits are maximised when structures are streamlined and each cost is allocated to the most correct structure.
- 6.28 It is important that there are mechanisms in place to continue to deliver the known output requirements when there are efficient cost increases associated with doing so, in addition to facilitating the delivery any new output requirements mid-way through the full Price Control timeframe. Therefore, the uncertainty mechanisms will need to provide sufficient cost risk protection for the company as part of a balanced risk/remuneration package.
- 6.29 Rather than adding additional cost structures and additional components to the allowable revenue formula, SONI proposes reviewing and collating key cost characteristics i.e. cost certainty, controllability etc. Costs could then be scored for suitability against specific characteristics of each cost structure category so that it becomes apparent which cost category is most appropriate for each cost.
- 6.30 Once a thorough cost allocation process is complete more detailed assessments can be undertaken including setting efficient cost caps and allocating the risk to the right party, in turn dependent on incentive. Strong incentives to deliver efficient, rather than minimal cost, motivates the TSO to review its cost base in line with output requirements.
- 6.31 The setting of cost caps should aim to incentivise the right behaviours. SONI is in favour of appropriate comparator analysis; however our previous experience is that we do not have many meaningful direct comparators for benchmarking purposes because of the extent and set of our obligations. We will endeavour to provide as much relevant comparative assessment as possible. Our business plan should and will reflect a sustainable and achievable cost base.
- 6.32 Any price control should be financeable, and that financeability of the control is dependent on the level of financial risk associated, or perceived to be associated,

with the overall framework inputs and outputs. The CMA 'capital layers' framework was implemented to address an imbalance between overall risk and remuneration having undertaken a comprehensive review of SONI activities, costs and risks. As set out in the main body of our response, SONI supports retaining the CMA framework in so far as this is possible. We would propose more focused early engagement on the subject of cost allocation.

- 6.33 SONI's innovations rarely lead to savings for the company. Rather, innovations in system operation lead to savings for end consumers in other cost areas, for example lower system marginal price or dispatch balancing costs. Because there is one synchronous system on the island of Ireland, most of these innovations can only be delivered in conjunction with the TSO in Ireland. This interdependency should be reflected in the guidance. The guidance should also reflect the fact that SONI (working jointly with EirGrid) is already world leading in some areas due to the nature of the generation that is connecting to our system.
- 6.34 This is a different paradigm to other network companies that the UR regulates, where the ambition is to be a fast follower, making it easier to map out developments up to seven years ahead, therefore the guidance should be either tailored for SONI's circumstances or adapted to ensure it covers the range of companies that this guidance will eventually be applied to (i.e. SONI would expect that the UR would build on the same approach for other upcoming price controls in Northern Ireland).

Question 7. Do you support the overall approach and expectations to financeability set out above, and elaborated on in the Reckon working paper, for the SONI TSO control?

- 6.35 Financeability encompasses consideration of both recovery of reasonable expenditures (Section 3.2) in addition to the financial funding costs (Section 3.3), and tax considerations, etc. However, these must also be considered the wider framework design context, e.g. the treatment of uncertain costs and uncertainty and risk. It is in the detail, collective and interactions of all considerations that will determine if the Price Control is in the round financeable.
- 6.36 SONI agrees the appropriate level of remuneration for TSO equity capital and debt finance depends on the scale of financial risk to which SONI is exposed under the regulatory framework design. The paper asks what risks SONI should bear rather than consider what remuneration its investors require for the risks borne. The answer lies in what risks SONI TSO is obligated to bear, either directly or indirectly, as a result of statute or licence.
- 6.37 The current risk profile underpins the current Price Control framework. Our intention is not to explain these risks in detail as we hope they are adequately understood by all. The SONI TSO business plan submission will include clear justifications for any additional risks.
- 6.38 Both Section 3.3 (Aligning risk and return) of the draft Approach paper and the Reckon working paper set out to discuss the overall approach to financeability and

the related TSO remuneration for debt and equity capital. However both focus on the latter without considering or setting out, even at a high level, the overall context and arrangements of the former. We appreciate this is likely to evolve over time and can only be eventually considered at the later stages however there is merit in identifying at this point the additional steps/inputs to the overall approach.

- 6.39 SONI is of the view that there is no material justification to amend the basics of the current framework which resulted from the final CMA decision including cost of capital adjusted for Operational Gearing, remuneration of contingent debt and equity committed to the business, recognition of collection agent activities and adjustment in the risk framework for the asymmetric risk of regulatory pass through costs. This should be maintained and calibrated for the 2020-2025 period and as such we intend to submit a business plan on this basis.
- 6.40 It is important that at its conclusion the overall Price Control is demonstrably financeable incorporating comprehensive financeability tests - against both debt and equity measures - using comparable investor expectation benchmarks for investing in a SONI TSO. In addition, the financeability assessment must model scenarios in order to stress test resilience. The assessment should be made on both notional and actual bases.

Question 8. Do you support our approach and expectations for remuneration of the SONI's equity capital and debt finance set out above, and elaborated on in the Reckon working paper, for the SONI TSO control (including whether we move to CPI or to CPIH indexation as part for the 2020-25 SONI price control)?

- 6.41 Following on from question 7 we mainly agree with the proposed approach set out on pages 41 - 44 however there are certain areas which we believe would benefit from additional engagement. We concur with Reckon that the development of a transparent definition would provide a valuable conceptual framework to work from and we would welcome additional engagement on this area.
- 6.42 The requirement for SONI to provide an undefined level of confidence that it has sufficient financial resilience over the 2020-2025 period also requires additional engagement. This is very much dependent on SONI's risk profile, dependent on its obligations and can only be based on an assumption of the UR's acceptance of the business plan it submits.
- 6.43 SONI notes the proposal to switch the inflation indexation measure from RPI to CPI/CPIH. We understand this is due to RPI no longer being considered a national statistics measure. Any adjustment must be consistent across all aspects of the control (Real Price Effects, Cost of Capital, RAB indexation, etc.). Ultimately it is about the trajectory of prices and the balance of payments to be made by consumers today and in the future.
- 6.44 We therefore believe it is beneficial to all stakeholders for SONI to consider inflation indexation as part of the entire Price Control framework, for example in conjunction with the Real Price Effects cost allowance, etc. We would be happy to

engage on this specific issue and consider UR proposals for the business plan submission. At this time we have no detailed comment on either index other than to reinforce the importance of consistency and that careful management of cross over effects in terms of investments made historically under an RPI indexed regime will have to be maintained.

Question 9. Do you agree with our expectations as part of our test area for engaging customers, consumers and other stakeholders?

- 6.45 Given the criticality of the service that SONI provides, the majority of our activities are set out in legislation, codes, methodologies or standards that have strict governance processes around any changes, including approval by the UR.
- 6.46 SONI has recently undertaken a significant amount of industry consultation on the I-SEM and DS3 that have shaped the significant changes to our main ways of working. This took a number of years and required substantial changes to licences, codes and other approved documents to facilitate implementation. SONI will be preparing its business plan during its first year of operation under the new framework.
- 6.47 Clearly, it will be neither possible nor appropriate for SONI to repeat this exercise in the time available. SONI will however, set out the consultation and consequential changes to the framework it operates under as part of its business plan and identify areas where it has discretion to alter its ways of working without code changes or a requirement for UR approval. In our business plan, SONI will endeavour to demonstrate the extent of that consultation in our business plan and we will also explain how it has shaped our approach.
- 6.48 In addition, SONI will consult with the SECG on aspects of our business plan that can be flexed to accommodate stakeholder preferences in areas where we have discretion. We will closely consider the areas highlighted as being important in the SECG, such as transparency, close working with NIE Networks and the development of future energy scenarios to ensure that our business plan reflects these themes.
- 6.49 The guidance, as drafted, is appropriate for an asset based utility with discretion around a significant capital investment programme. This approach does not reflect SONI's situation. Therefore, it would be helpful if the Approach decision paper could also contain information that is relevant to SONI's specific circumstances, including for example where the lead time for stakeholder engagement and regulatory approvals necessary for changes to codes, standards or licences is a number of years and therefore cannot be compressed into the time between the publication of this decision and submission of the business plan.

Question 10. Do you agree with our expectations as part of our test area on resilience and governance?

- 6.50 SONI is committed to continuous improvement around the quality of our regulatory submissions, including this business plan.
- 6.51 We would like to highlight that in some cases the current Price Control has not included sufficient funding for the activities that SONI is required to undertake. Therefore, the second test in this category will need to be passed by both SONI and UR. In our business plan, we will endeavour to set out the risks associated with our plan in a clear and consistent manner.
- 6.52 We are unable to comment in any detail around the expected governance arrangements because the paper referred to in this consultation is still to be published. We assume that any implications that exercise would have for the assessment of SONI's business plan will be finalised in parallel with the Approach decision paper and communicated to SONI in time to allow them to be reflected in SONI's approach to developing its business plan. In reality, given the business plan submission is only six months away this may not be possible.

Question 11. Do you agree with our expectations as part of our test area on accounting for past delivery?

- 6.53 SONI is concerned by the tone of this test area, which appears to assume that there is a need "to make a real step forward for the 2020-25 period." SONI has made substantial changes over the current Price Control period, which have delivered tangible benefits for customers. These are set out in Section 2 above.
- 6.54 SONI is committed to continue to move forward, in line with government policy and industry needs, including helping to shape these. We would not expect to submit a business plan that includes developments for their own sake and therefore we will focus on areas where there is value for customers. We therefore request that the wording of the first line is updated to reflect the need for "appropriate steps forward" only.

Question 12. Do you agree with our framework approach proposals and expectation as part of our test area on securing confidence and assurance?

- 6.55 SONI's business plan submission will be subject to its own rigorous corporate governance and risk management processes. Our board will determine its own appropriate quality assurance requirements and in addition, will ensure that it provides the UR with any written assurances that are relevant to the UR assessment of our plan.

Question 13. Do you agree with our framework approach to setting clear regulatory expectations for SONI as part of its business plan and for assessing SONI's business plan, (including test area guidance and questions, categories and incentives to motivate SONI to produce a high quality business plan)?

6.56 SONI welcomes this approach and the step change in clarity it provides. We are, however, concerned that this consultation has only set out expectations related to the "excellent business plan" category.

6.57 While SONI can see the value of a monetary incentive, the process to date would not support a symmetrical approach. This is because:

- No consultation has been undertaken on the other potential categories that our plan will be assessed against, and there is no time available to undertake such a consultation, given that SONI is already developing its plan;
- The UR has not yet used this form of assessment in Northern Ireland, therefore no benchmarks exist;
- The incentive value is being determined outside of any base assessment of SONI's financeability therefore the UR does not have the information necessary to introduce a symmetrical incentive that could result in financial damage to SONI; and
- The framework for the application of such a penalty is not currently set out or prescribed in SONI's licence.

6.58 Therefore, an asymmetric incentive is the only viable option at this point in time.

Question 14. Do you agree that we have identified the right test areas and that these are structured in the right way?

6.59 SONI welcomes the test areas and the step change in approach from our current control, however the test areas appear to have been drafted in a relatively generic manner and may be more suitable for an asset based utility with a substantial capex programme rather than a highly operationally geared company with very tight governance around the tasks that it undertakes.

6.60 We therefore would welcome an opportunity to work with the UR to ensure that the test areas applied to SONI are relevant to our activities and the mandatory processes associated with them.