SONI Price Control
2010 - 2015

Decision Paper
April 2011
1 Executive Summary

SONI Ltd (SONI) is the Transmission System Operator (TSO) for Northern Ireland and is subject to a regulated price control. SONI’s next price control takes place in the context of government targets for the increased generation of electricity from renewable sources and European legislative developments. The Utility Regulator has taken these into consideration when setting the price control allowance.

The Utility Regulator published a price control consultation paper in January 2011, covering the 5.5 year period from 1 April 2010-30 September 2015. The overall objective of this price control is to ensure that SONI can continue to operate the transmission system in Northern Ireland securely and efficiently, and at a reasonable cost to consumers.

Interested parties were encouraged to respond to questions raised in the paper, and to ideas suggested. Nine responses were received from a range of stakeholders. Individual responses can be viewed on the Utility Regulator website. Some respondents welcomed the increased transparency of the Utility Regulator consultation paper. The Utility Regulator aims to continue that approach with this decision paper.

The most comprehensive response was received from SONI. SONI’s main concerns in the consultation paper were:

- Proposed level of operating expenditure (Opex), particularly payroll, staffing levels and pensions;
- Proposed level of capital expenditure (Capex);
- Proposed capital allowance for the building; and
- Proposed incentives.

The overall focus of responses was on ensuring that adequate resources are in place to deal with SONI’s legislative and licence obligations during the next price control, and reviewing the incentives proposed by the Utility Regulator. The Utility Regulator has addressed respondents’ concerns by further reviewing each of the topics noted above. Since the consultation paper was issued, further discussions have taken place with SONI to ensure understanding and clarification of Capex and Opex requests, external consultancy support (commissioned by the Utility Regulator) to review SONI’s resource requirements has been completed, and a further assessment of SONI’s building/extension proposals has been carried out.

This decision paper sets out SONI’s allowed revenue to recover its own operating costs, depreciation and a reasonable return on investment. Any costs noted in this paper are quoted as 2010 prices.

The key decisions made in this paper are as follows:

- An RPI-X type price control with an X factor of zero.

1 Responses were received from SONI Ltd, AES Kilroot Power Ltd and AES Ballylumford Ltd, The Consumer Council NI, Endesa Ireland Ltd, ESB Wind Development UK Ltd, Mutual Energy Ltd, NIE Energy Ltd Power Procurement Business (PPB), Northern Ireland Renewables Industry Group (NIRIG), Viridian Power & Energy Ltd
- CPI-X will apply to pension costs and deficit recovery. A 15 year deficit recovery period will be applied.
- An allowance for all identified Capex, including an allowance for a building extension.
- An allowance for Opex including additional employees to increase SONI’s total staff to 84.
- A change to the depreciation profile from 10 years to 8 years (and 25 years for the building extension).
- A WACC of 5.78% will be applied.
- Consideration of incentives (to be treated as a separate project)

Table 1: Summary of SONI Allowed Revenue 2010-2015

<table>
<thead>
<tr>
<th>SONI Allowed Revenue</th>
<th>SONI submission</th>
<th>UR Consultation</th>
<th>UR Decision</th>
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<tr>
<td>Payroll</td>
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<td>Depreciation</td>
<td>16.9</td>
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<tr>
<td>Return</td>
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<td><strong>ALLOWED REVENUE</strong></td>
<td><strong>84.6</strong></td>
<td><strong>64.2</strong></td>
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All figures in the table above are quoted at 2010 prices.

2 See Appendix 2 for an annual breakdown
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3 Introduction

SONI Ltd (SONI), the Transmission System Operator (TSO) for Northern Ireland is subject to a regulated price control. This paper details the Utility Regulator’s decision on SONI’s allowed revenue for the price control from 1 March 2010 to 30 September 2015.

SONI’s revenue is determined by the Utility Regulator and is made up of a number of components as detailed in their licence:

\[ M_{TSOI} = A_{TSOI} + B_{TSOI} + D_{TSOI} + K_{TSOI} \]

In year t, \( M_{TSOI} \) is SONI’s annual revenue cap. The use of a revenue cap is common in many price controls applied to regulated businesses. The components of the above formula can be defined as controllable or uncontrollable costs.

\( A_{TSOI} \) is the total cost estimate relating to Ancillary Services (which includes the provision of Moyle frequency response services). These costs are treated as pass-through as they are considered to be outside SONI’s control.

\( B_{TSOI} \) is SONI’s allowed revenue to cover their predictable and controllable costs (as defined in this price control), which includes operating costs (Opex), depreciation on the Regulatory Asset Base (RAB) and an appropriate return for investors on those assets.

\( D_{TSOI} \) encompasses unpredictable costs approved individually by the Utility Regulator. These costs are treated as pass-through as they are considered to be outside of SONI’s control.

\( K_{TSOI} \) is a correction facility whereby under or over-recoveries in the previous year can be collected by the business (under-recovery) or given back to consumers (over-recovery).

The focus of this paper is on the \( B_{TSOI} \) element of the revenue formula. \( B_{TSOI} \) covers SONI’s predictable and controllable costs which includes operating costs (Opex), depreciation on the Regulatory Asset Base (RAB) and an appropriate return for investors on those assets.

The Utility Regulator published a consultation paper in January 2011 which invited interested stakeholders to respond to questions posed and ideas suggested. The Utility Regulator received nine responses to the consultation paper. The parties that responded were:

- SONI Ltd
- AES Kilroot Power Ltd and AES Ballylumford Ltd (AES)
- The Consumer Council NI
- Endesa Ireland Ltd
- ESB Wind Development UK Ltd
- Mutual Energy Ltd
- NIE Energy Ltd Power Procurement Business (PPB)
- Northern Ireland Renewables Industry Group (NIRIG)
- Viridian Power & Energy Ltd

The responses are published along with this decision paper.
The Utility Regulator has considered each of the responses received and has been involved in discussions with SONI to further clarify some figures and the understanding of assumptions used.

This paper addresses all the issues raised in the responses to the consultation and reflects the outcome of further clarification that has been received from SONI on some cost areas.

- Section 4 discusses the Price Control Approach
- Section 5 discusses the Price Control Duration
- Section 6 discusses Opex
- Section 7 discusses Capex
- Section 8 discusses Cost of Capital
- Section 9 discusses RAB and Depreciation
- Section 10 discusses Rate of Return
- Section 11 discusses Incentives
- Section 12 discusses costs outside the price control (Dt)
- Section 13 discusses Allowed Revenue
4 Approach to Price Control

4.1 Price Control Approach in Consultation Paper

The Utility Regulator consultation paper outlined the following approach to SONI’s 2010-2015 price control:

- **Opex**: Use a RPI-X type price control for Opex to incentivise SONI to control its own costs. An Opex allowance was proposed. The Utility Regulator proposed to continue with a revenue cap approach for SONI’s tariffs.

- **Capex**: Use ex ante regulation for all identified Capex, providing strong incentives for cost efficiency, rather than ex-post evaluation which would incur a higher regulatory burden and lower degree of flexibility for SONI. The Utility Regulator proposed an allowance for Capex.

- **D_{TSOI} costs**: Any costs incurred by SONI which are unforeseen or outside of the ‘normal’ course of business would be treated as D_{TSOI} costs. Any submissions will undergo robust analysis before receiving approval. It is the Utility Regulator’s intention to minimise the number of areas considered under D_{TSOI} approvals for the 2010-2015 price control as allowances will be used for Opex and Capex.

4.2 Responses to Consultation

SONI welcomed the continuation of RPI-X treatment for Opex, a capped approach to tariffs and an ex ante approach to Capex. SONI commented that D_{i} requests should be kept to a minimum, but raised concerns that the Opex and Capex allowances proposed in the consultation paper are not sufficient so D_{i} requirements will inevitably increase.

The Consumer Council NI (CCNI) stated that using ex ante regulation for Capex should encourage cost effectiveness within SONI which should aim to lower the costs passed on to consumers.

AES and NIRIG agree with the Utility Regulator’s proposed approach but NIRIG state that there are not enough incentives proposed.

4.3 Utility Regulator Decision on Approach

The Utility Regulator has decided on the following approach for the SONI price control:

- **Opex**: An Opex allowance will be applied for the period April 2010 – September 2015. Pension costs (discussed in sections 6.5 and 6.6) will have CPI indexation applied and all other operating costs will be incentivised by an RPI-X type price control with an X factor of zero.

- **Capex**: The Utility Regulator will provide an allowance for the approved Capex program (discussed in section 7). The Utility Regulator will not allow an element of expenditure for unknown and unidentified capital programmes.
- **DTSOI costs**: Any costs incurred by SONI which are unforeseen or outside of the 'normal' course of business would be treated as DTSOI costs. Any submissions will undergo robust analysis before receiving approval. It is the Utility Regulator's intention to minimise the number of areas considered under DTSOI approvals as part of this price control by using allowances for Opex and Capex.

As the Utility Regulator has decided to approve allowances for both Capex and Opex, the Utility Regulator gives SONI autonomy to allocate the allowances for each category of Opex and Capex in the most efficient manner according to their business requirements. Efficiency gains can be retained by SONI and any over expenditure would conversely have to be absorbed by SONI.

It should be noted that the Utility Regulator intends to introduce a new format of detailed regular cost reporting during the price control and will be assessing the expenditure of both Capex and Opex to ensure that the outputs as defined in the SONI submission are delivered (e.g. new building, website, joint project work etc). If there are areas not delivered that are within allowances provided, the Utility Regulator will assess whether an adjustment is appropriate. This assessment will take place at the end of the price control period.
5 Duration of Price Control

5.1 Duration in Consultation Paper

The 2007 price control ran from 1 November 2007 to 31 March 2010. This shorter duration was to allow for uncertainty regarding change in the Northern Ireland electricity sector.

The Utility Regulator proposed that the duration of the 2010 SONI price control should be five-and-a-half years, from 1 April 2010 to 30 September 2015. This duration would provide the opportunity for incentive regulation to work effectively. The additional half year is to align the price control period to the SONI financial year and the tariff year (October to September).

The Utility Regulator also suggested that a three-and-a-half year duration may be more appropriate given the lack of detail provided in SONI’s submission for Capex requirements for the last two years of the price control.

5.2 Responses to Consultation

SONI highlighted that five-and-a-half years allows the opportunity for business efficiencies to be developed, to deliver the benefits of achieving the government renewables target, to establish organisational capability and counter anticipated key staff requirements, to allow increased tariff predictability, to allow SONI to play a significant role in contributing to government targets and to provide a stable financial base to deliver the corporate objectives for SONI.

Other respondents commented on the practicalities of a five-and-a-half year price control, given that a year of the control period has already passed. AES and NIRIG state respectively that a longer price control period should allow for greater availability of finance and a better opportunity for any new incentives to take effect.

Viridian Power & Energy Ltd and PPB commented that a three-and-a-half year price control period would be appropriate given the scope and potential for uncertain reforms associated with Regional Electricity Markets beyond 2014.

5.3 Utility Regulator Decision on Duration

The Utility Regulator has decided to implement a five-and-a-half year price control, from 1 April 2010 to 30 September 2015. This will allow greater business stability and allow time for incentives to be fully implemented. There will also be less perceived regulatory risk for investors.
6 Opex

6.1 Overview of Opex

The operating costs submitted by SONI were analysed by the Utility Regulator in the following categories:

- Payroll
- Pension costs (ongoing and deficit)
- IT & Communications
- Other Opex

Each of the above categories are discussed in turn below. Since the publication of the consultation paper, the Utility Regulator requested and received further detail on payroll breakdown and an updated actuarial valuation results for pension costs.

The Utility Regulator also received analysis from external consultants on SONI’s proposed additional staffing levels.

Given the concentration of responses on the need for a satisfactory level of resource, a separate section on Staffing levels is included below.

All figures discussed below are in 2010 prices.

6.2 Staffing levels

6.2.1 Staffing levels in Consultation Paper

In the consultation paper it was highlighted that SONI requested 32 additional staff members for the new price control period. The Utility Regulator proposed an allowance for 81 staff (using a baseline 66 staff and 15 additional staff) based on an assessment of SONI’s current organisational structure and individual business cases submitted by SONI.

6.2.2 Responses to Consultation

Respondents to the consultation paper were asked if they agreed with the Utility Regulator’s proposed headcount and payroll allowance. The general focus of responses was concern that adequate resources are required in order to facilitate renewable generation targets.

SONI strongly disagreed with the proposed headcount and corresponding payroll allowance and state that it is already challenged to meet statutory and licence obligations. SONI reasoned that it requires increased resource to operate the power system, to manage an increase in renewables and associated connections, and to cope with significant infrastructure development. Coupled with this is SONI’s statement that it underestimated staffing levels required at the start of the last price control. SONI indicated that a

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3 Other Opex includes costs associated with: facilities, grid code (incl. legal costs), other legal costs, professional services, scheduling and dispatch of wind, other statutory obligations, financing charges for dispatch balancing costs, bank charges, other charges, central costs and insurance.

4 The last price control was agreed prior to SO and MO licenses being granted, the TIA, Market Operator Agreement, System Operator Agreement and the Trading & Settlement Code.
substantial list of work areas are at risk without the additional resources that they request. SONI also indicated that the additional real time resources would result in them managing wind more efficiently and could result in savings in the region of £600K per year.

SONI commented that ‘connections’ is an area which is more resource intensive than anticipated at the start of the 2007 price control. SONI state that an additional 1200-1500MW of renewables will need to be connected to the NI electricity system by 2020 in order to meet DETI’s 40% target.

Responses from ESB Wind Development UK Ltd, NIRIG and AES focussed on the increase in the level of wind generation on the system in Northern Ireland to meet the government’s target of 40% electricity from renewable sources by 2020. ESB stressed that it is imperative that SONI has a sufficient level of resource to ensure that it continues to be well positioned to meet this challenge. However, ESB also recognise that possible synergies could be achieved through further collaboration and knowledge sharing with Eirgrid.

AES state that SONI’s submission of a 50% increase in headcount seems excessive, however SONI should be allowed an appropriate level of resource to continue their high standard of service provision.

### 6.2.3 Utility Regulator Decision on Staffing Levels

The Utility Regulator agrees with respondents that SONI provides a critical role in ensuring the safe, secure, reliable and economic operation of the transmission system in Northern Ireland and that the delivery of the DETI SEF target of 40% of renewable generation by 2020 will lead to a high level of change in the electricity sector. The Utility Regulator also recognises that delivery of this target is not the sole responsibility of SONI.

Since the consultation paper was published, external economic consultants (IPA Energy & Water Economics) commissioned by the Utility Regulator to assess SONI’s proposed headcount, have provided their analysis. As part of the consultants’ review, additional questions were posed to SONI in order to further assess the need for the proposed additional resources and to gain a better understanding of how any additional staff should be phased in, based on developments regarding renewable generation.

Using the recommendations in the consultants’ report and further dialogue with SONI, the Utility Regulator has decided to increase proposed headcount to 84. This allows an additional 19 staff of the 32 requested during the price control period (2 of which are student placements). As well as this, a Connections engineer was approved previously for the 6 month period from 1 April– 30 September 2010. Because approval was given along with a corresponding monetary allowance, the Utility Regulator will not reduce the payroll and associated costs for this position for the first six months of the price control period. However, from 1 October 2010 – 30 September 2015, even though the position is approved, the costs will not be recovered through the price control allowance but will instead be treated as per other Connections staff. This gives an overall headcount of 84.
The Utility Regulator has a duty to ensure that the benefit of an increased cost of staffing is received by customers and believes that the headcount allowed for is adequate for SONI to meet its requirements as TSO.

The Utility Regulator has approved additional staff in the following departments:

- 5 positions in real time operations (to ensure that curtailment strategies are enacted in real time so that customers benefit from optimised wind and the cost of wholesale electricity is not impacted). This includes ongoing staffing requirements for intra-day modifications currently being developed;

- 1 position in near time operations (to ensure that SONI can meet licence and Grid Code requirements and ensure optimal scheduling of generators);

- 2 position in Grid Operations (Planning) (to aid the development of the all island transmission network);

- 9 positions in IT/SCADA/EMS (to reduce the requirement for professional services and to develop IT systems which are currently underused making them a more efficient investment, to deliver benefit to customers and to reduce a requirement for DI allowances);

- 2 positions in Joint projects (to ensure ability to react to increasing rate of change within the industry and to have a core function available for specific projects, and to reduce a requirement for DI allowances.)

Of the 32 staff posts requested, 13 were disallowed by the Utility Regulator. These include:

- 1 real time balancing services engineer,
- 1 EMS dispatch training engineer,
- 2 finance officers,
- 1 regulation analyst,
- 1 HR officer,
- 2 near time engineers,
- 3 grid operations (planning) engineers,
- 1 commercial lawyer,
- 1 joint projects engineer.

The Utility Regulator considered the criticality of all positions. An explanation for disallowing the above positions is as follows:

- Four out of five real time engineers were allowed to enable SONI to employ operatives for a third shift. A fifth engineer was considered excessive by the Utility Regulator.
• The Utility Regulator does not consider an EMS dispatch training engineer to be a full time post for the number of relevant staff in place and believes that synergies exist with Eirgrid. However, the Utility Regulator has incorporated an allowance for a training position within SONI’s professional service costs (included in ‘Other Opex’) to allow SONI to source a training engineer for six months per year of the last four years of the price control. This is to ensure that the certification requirements from ENTSO are covered.

• SONI already has an adequate complement of finance, regulation, legal and HR staff to manage an organisation of its size and synergies should be available with Eirgrid. SONI’s ‘Other Opex’ allowance also includes an amount within professional service fees associated with taxation and audit advice, and also legal fees.

• The full complement of shift staff required for the real time department has been approved but the Utility Regulator feels that the additional balancing services engineers can use their skills and time to assist the near time and planning departments when required.

• For the projects identified, the Utility Regulator does not think that a second Joint Projects engineer within the additional resources is required. A phased approach has been applied to the approved Joint Projects manager and engineer positions.

Although SONI require sufficient resources to ensure adequacy of the system operation of the transmission network, the Utility Regulator believes that additional staff can be phased in. In order to obtain a suitable payroll allowance, the Utility Regulator allowed four of the approved positions to start on 1 April 2010, thirteen on 1 April 2011, and two on 1 April 2012. In its price control submission, SONI indicated that a number of key real time staff would be retiring during the period. It should be noted that the Utility Regulator has allowed a six-month overlap period for new recruits filling in retirees’ roles to ensure adequate time is allowed for knowledge transfer.

The Utility Regulator expects SONI to save in professional services costs due to additional headcount. As a result of additional staffing, SONI should (as a minimum) meet all reporting and licence requirements, and manage extra requirements involved with renewable generation and the Single Electricity Market. The Utility Regulator expects all DI requests to be kept to a minimum given the approval of so many extra staff.

6.3 Payroll

6.3.1 Payroll in Consultation Paper

The Utility Regulator consultation paper proposed a payroll amount of £24.9M which corresponded with the proposed number of staff (15 additional resources). When considering total payroll for the price control period, the Utility Regulator took account of the fact that key staff in real time positions will be retiring and will be replaced at a lower cost.

5 The price control is being implemented one year after its start date. The Utility Regulator took this into consideration when calculation allowed revenue.
In SONI’s price control submission, 4 full-time equivalent Connections staff are proposed. In the consultation paper, the Utility Regulator proposed that these 4 staff should be funded by connectees through the Transmission and Distribution connection charging process.

6.3.2 Responses to Consultation

SONI indicated that the Utility Regulator did not take into account all of the relevant costs associated with payroll. SONI’s response to the consultation paper challenged how the payroll allowance was calculated.

CCNI affirmed that any increase in staff levels should only be accepted if there will be benefits for consumers which will ultimately be realised through lower prices.

6.3.3 Utility Regulator Decision on Payroll

In preparation of the consultation paper, Utility Regulator carried out a bottom-up analysis of payroll and associated HR costs.

A baseline payroll was applied for all existing staff using data provided from SONI in their price control submission. This baseline payroll already incorporated overtime and HR costs but the Utility Regulator made an adjustment to disallow overtime.

The analysis for additional staff used pay band information received from SONI (individual salary information was not provided). An allowance for training and other HR costs was also applied, taking account a balance of the maturity of some staff compared to new recruits. An adjustment was applied for the payroll costs incurred by retirees compared to their replacements and shift allowance was allowed for members of staff who reasonably incur it in the Real Time and IT/SCADA departments.

Since the consultation paper was published, the Utility Regulator has received a more detailed breakdown of HR costs from SONI to include training, recruitment, travel and expenses and welfare costs. The Utility Regulator deems that the total amount proposed by SONI is excessive and have made appropriate adjustments to these costs (see table 2).

Table 2: Utility Regulator decision – Payroll associated costs 2010-2015

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In the consultation, the Utility Regulator did not allow an amount for overtime, commensurate with the addition of extra staff. SONI indicate that overtime is required in the Real time department and IT/SCADA operations to deal with absences and unforeseen events. IT/SCADA is business critical so staff work on a rota basis. The Utility Regulator has decided to allow an overtime allowance, pro-rated in line with increase in headcount in these departments. A 45% reduction to SONI’s proposed overtime costs has been applied for the last five years of the price control.

SONI highlighted that the current pay structure means that it takes a typical engineer 16 years to reach the top of his pay band. SONI sought approval to reduce the time it takes to progress through pay bands by reducing the current structure to 5 years which they state is reflective of good employment practice and avoids unnecessary and costly legal cases. The Utility Regulator has assessed information provided by SONI and decided to allow a reduction in the pay band progression period to eight years instead of fifteen years.

In addition to this, SONI’s submission applied a 2% salary increment to payroll costs. This is on top of any inflationary increases. The Utility Regulator does not feel that assumed salary increments are appropriate in the current economic climate. The price control allows for RPI-X increases with an X of zero applied. Many other firms in the competitive market are experiencing pay freezes or salary reductions.

It was already noted in the consultation paper that Connections staff would not be considered for the price control. The Utility Regulator has not changed its position on this. The Utility Regulator expects SONI to work with NIE T&D and connection applicants to ensure that the cash flow required to fund the necessary resources required by SONI are in place.

The Utility Regulator decision is to set SONI’s payroll (and associated HR) cost to £27.3M for the next price control period.

**Table 3: SONI Payroll: Utility Regulator Decision 2010-2015**

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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SONI Submission</td>
<td>2.4</td>
<td>5.9</td>
<td>6.3</td>
<td>6.5</td>
<td>6.6</td>
<td>6.7</td>
<td><strong>34.4</strong></td>
</tr>
<tr>
<td>Utility Regulator Decision</td>
<td>2.1</td>
<td>4.7</td>
<td>5.1</td>
<td>5.1</td>
<td>5.1</td>
<td>5.2</td>
<td><strong>27.3</strong></td>
</tr>
</tbody>
</table>

---

**Figure 1: SONI Payroll: Utility Regulator Decision 2010-2015**

![Chart showing SONI Allowed Payroll/HR costs 2010-2015](chart.png)

**Table 4: Reconciliation of SONI Payroll/HR submission and Utility Regulator decision 2010-2015**

<table>
<thead>
<tr>
<th>Description</th>
<th>Saving</th>
</tr>
</thead>
<tbody>
<tr>
<td>UB have disallowed 2% salary increments (since pay band adjustment applied to</td>
<td></td>
</tr>
<tr>
<td>allow employees to move up the salary band at a faster rate, and RPI-X with</td>
<td></td>
</tr>
<tr>
<td>X of zero applied to Opex)</td>
<td>1.8</td>
</tr>
<tr>
<td>UB have allowed overtime, but applied a reduction to SONI's request to take</td>
<td></td>
</tr>
<tr>
<td>account of extra staff in Real Time and IT/SCADA dept.</td>
<td>0.5</td>
</tr>
<tr>
<td>UB used the top and bottom of pay band H for retirees/replacements. SONI</td>
<td></td>
</tr>
<tr>
<td>indicated that salaries of replacements would be much closer to retirees'</td>
<td></td>
</tr>
<tr>
<td>salaries but no further evidence provided.</td>
<td>0.3</td>
</tr>
<tr>
<td>UB applied a reduction to training budget. Assumed £1K per employee per year.</td>
<td></td>
</tr>
<tr>
<td>£5K recruitment budget per new recruit allowed. No allowance for churn.</td>
<td>0.6</td>
</tr>
<tr>
<td>UB applied reduction to transport/travel budget. Used 2010 (6 month figure)</td>
<td></td>
</tr>
<tr>
<td>as a baseline. Allowed £18K extra per year for ENTSOE travel but applied</td>
<td></td>
</tr>
<tr>
<td>reduction to Joint projects travel. SONI estimated £40K per year required for</td>
<td></td>
</tr>
<tr>
<td>this. UB reduced to £8K.</td>
<td>0.3</td>
</tr>
<tr>
<td>UB applied significant reduction to welfare costs: Allowed 1 eye test per</td>
<td></td>
</tr>
<tr>
<td>year per employee. Assume medicals included within recruitment costs. No</td>
<td></td>
</tr>
<tr>
<td>allowance for staff surveys or tea/coffee as requested by SONI.</td>
<td>0.4</td>
</tr>
<tr>
<td>SONI wanted to reduce the amount of time it takes an average employee to</td>
<td></td>
</tr>
<tr>
<td>work to top of pay scale from 15 yrs to 5 yrs. UB has allowed 8 yrs.</td>
<td>0.2</td>
</tr>
</tbody>
</table>

---

7 This was an indicative figure provided by SONI between the consultation paper and decision paper being published
6.4 Information Technology (IT) & Communications

6.4.1 IT & Communications in Consultation Paper

In the price control consultation paper the Utility Regulator proposed to allow operating costs associated with IT & Communications as forecasted by SONI until the last two years of the control period. From then, a 15% challenge on projected expenditure was proposed. Stakeholders were asked to respond on this issue.

6.4.2 Responses to Consultation

CCNI claim that an allowance for IT & Communications should take account of future upgrading and capacity requirements.

AES stated that a 15% challenge is reasonable and should be achievable through re-tendering/re-structuring.

6.4.3 Utility Regulator Decision on IT & Communications

The Utility Regulator acknowledges that IT & Communications is an area which is critical to the market. Synergies with Eirgrid should allow better bargaining power and economies of scale. In addition, SONI highlighted that the majority of IT contracts are annual so there is opportunity for savings each year or reduced costs by extending the duration of contracts.

The Utility Regulator has decided to maintain the allowance proposed in the consultation paper. A 15% reduction on SONI’s submitted costs will be applied to the last two years of the price control.

Table 5: SONI IT & Communications costs: Utility Regulator Decision 2010-2015

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SONI Submission</td>
<td>0.7</td>
<td>1.9</td>
<td>1.9</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
<td>10.5</td>
</tr>
<tr>
<td>Utility Regulator Decision</td>
<td>0.7</td>
<td>1.9</td>
<td>1.9</td>
<td>2.0</td>
<td>1.7</td>
<td>1.7</td>
<td>9.9</td>
</tr>
</tbody>
</table>
6.5 Ongoing cost of Pensions

In the consultation paper, the Utility Regulator applied a significant reduction to ongoing pension costs. SONI’s submitted costs of £6.1M; the Utility Regulator proposed £2.4M.

6.5.1 Responses to Consultation Paper

SONI strongly disagreed with the proposed pension allowance and said it is contrary to the application of established regulatory precedent. Personnel in the defined benefit section of the SONI pension scheme have ‘protected persons’ status by virtue of historical legacy industry arrangements. SONI divestment required that the new pension scheme mirrored the previous scheme which SONI employees had membership of.

In CCNI’s response, they stated that given the proposed changes in staff over the price control period it seems possible that pension savings can be made.

AES believes that the contribution rate recommended by the actuarial report should be used.

6.5.2 SONI Re-submission of Pension Costs

Since the original price control submission, SONI have re-submitted pension costs for both ongoing and deficit repair elements. The re-submission uses CPI rather than RPI indexation and also takes account that all new employees will enter the defined contribution section of the scheme.
Table 6: SONI re-submitted ongoing pension costs

<table>
<thead>
<tr>
<th></th>
<th>SONI original submission</th>
<th>SONI re-submission</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension (ongoing costs)</td>
<td>£6.1</td>
<td>£4.7</td>
</tr>
</tbody>
</table>

6.5.3 Utility Regulator Decision on Ongoing costs of Pensions

SONI stated in their response that the Utility Regulator proposed costs in the consultation were largely unexplained. The Utility Regulator has provided additional clarity below.

SONI defined benefit members accrue benefits which require a high employer contribution rate, which is more than double the average contribution rate for a typical defined benefit scheme. The total employer contribution rate required for the defined contribution section of the scheme incurs an administration cost equal to the scheme contribution.

The Utility Regulator took account of publicly available information from Department of Work and Pensions and the Pensions Regulator regarding administration costs and also applied an employer contribution rate in line with industry averages. No adjustment was applied to take account of the relatively small scheme membership. The Utility Regulator assumed that all new recruits would enter the defined contribution section of the pension scheme and also that there were elements of the pension costs which were within SONI’s control such as using CPI instead of RPI indexation. This is what adjusted the proposed pension contributions required in the consultation paper so dramatically.

The Utility Regulator is encouraged that SONI re-submitted pension costs using CPI indexation.

The Utility Regulator has decided to allow 100% of ongoing costs for the defined benefit section of the pension scheme and 75% of ongoing costs of funding the defined contribution pension scheme using CPI indexation. The reduction applied is to encourage SONI to reduce the administration costs of running the defined contribution section. The Utility Regulator is of the view that administration costs should drop over time as additional staff are recruited and enter the defined contribution section of the scheme.

Any ongoing pension costs relating to SONI employees engaged in the Market Operator licensed activity that have membership of the defined contribution section is recovered by the SEMO price control to ensure cost reflectivity.

Taking into account the information above and reflecting the total approved staffing level, the Utility Regulator has decided to reduce SONI’s proposed Pensions allowance (ongoing costs) from £4.7M to £4.1M.
Table 7: SONI Ongoing pension costs: Utility Regulator decision 2010-2015

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SONI (Re-)Submission</td>
<td>0.4</td>
<td>0.9</td>
<td>0.9</td>
<td>0.9</td>
<td>0.9</td>
<td>0.9</td>
<td>4.7</td>
</tr>
<tr>
<td>Utility Regulator Decision</td>
<td>0.3</td>
<td>0.8</td>
<td>0.8</td>
<td>0.7</td>
<td>0.7</td>
<td>0.8</td>
<td>4.1</td>
</tr>
</tbody>
</table>

Figure 3: SONI Ongoing pension costs: Utility Regulator decision 2010-2015

6.6 Pension Deficit and Section 75 costs

In the consultation paper, the Utility Regulator proposed to allow 100% deficit repair over a 15 year period.

6.6.1 Responses to Consultation Paper

SONI asked the Utility Regulator to re-consider the timeframe over which a deficit is recovered. Their reasoning is to take account of the remaining expected service of active members and requirements of the regulatory environment and the Pensions Regulator. SONI also ask the Utility Regulator to reflect a consistent NPV calculation.

The CCNI agree that it is more prudent to use a 15 year deficit recovery period.

AES say that a ten year deficit recovery period is appropriate given that SONI is likely to have made the payments in a period of ten years or less and therefore finance any timing difference.
6.6.2 SONI Re-submission

SONI have indicated that its pension deficit (at October 2010) is c. £0.3M using CPI rather than RPI indexation. The Utility Regulator has not yet received a formal actuarial valuation report for the SONI Ltd Pension Scheme but has used illustrative results confirmed in a letter by the scheme actuary.

As well as a re-submitted pension deficit cost, SONI also presented an associated ‘section 75’ cost. Section 75 of the Pensions Act 1995 (as amended)\(^9\) sets out certain conditions where an employer is required to immediately make good a pension deficit rather than correcting the deficit over a period of time. One of these is where there is a transfer of ownership and the new owner is no longer a contributor to the pension scheme but the employees remain part of the original scheme: this is the case with SONI as a result of divestment. SONI have advised that the cost of this is £1.85M which it has already incurred.

Table 8: SONI re-submitted pension deficit costs

<table>
<thead>
<tr>
<th></th>
<th>SONI original submission</th>
<th>SONI re-submission</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension (deficit repair assuming a 9 year recovery)</td>
<td>£0.8</td>
<td>£0.34</td>
</tr>
<tr>
<td>Pension (section 75 deficit repair)</td>
<td>£1.85M</td>
<td></td>
</tr>
</tbody>
</table>

6.6.3 Utility Regulator Decision on Pension Deficit and Section 75 Costs

The Utility Regulator has decided to apply 100% deficit recovery over a 15 year period for the SONI Ltd Pension Scheme. This aligns with an Ofgem precedent\(^10\). The Pensions Regulator says deficit recovery plans longer than 10 years will come under greater scrutiny. However, the Utility Regulator believes that long-term undertakings and the tough economic climate should be taken into account within this longer-term context. The NPV-neutral allowance for pension deficit recovery during the 2010-2015 price control period will be £0.26m. This figure will be reviewed once the formal actuarial valuation report becomes available.

It should be noted that a small number of SEMO employees are included in the Pension Deficit. This cost is regarded as not material and therefore is to be included in the SONI price control.

Section 75 costs will be dealt with under the divestment costs of the Dt provision in SONI’s licence. These costs are not part of this price control allowance.


Table 9: SONI Deficit pension costs: Utility Regulator decision 2010-2015

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SONI (Re-)Submission [9 year recovery period]</td>
<td>0.13</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
<td>0.04</td>
<td><strong>0.34</strong></td>
</tr>
<tr>
<td>Utility Regulator Decision [15 year recovery period]</td>
<td>0.13</td>
<td>0.03</td>
<td>0.03</td>
<td>0.03</td>
<td>0.03</td>
<td>0.03</td>
<td><strong>0.26</strong></td>
</tr>
</tbody>
</table>

6.7 Other Opex

6.7.1 Other Opex in Consultation Paper

‘Other Opex’ includes the following costs:

- Facilities costs (which covers cleaning services, maintenance, security, mail service, switchboard, and utilities)\(^{11}\),
- Grid code (including legal costs, to cover the cost of four Grid code management meetings per year as required),
- Other legal costs (for legal advice concerning HR issues, credit management, commercial contracts),
- Professional service fees (which cover external professional services in respect of consultancy support, communications and recruitment, taxation and audit),
- Scheduling and dispatch of wind (which includes costs of wind forecasting and the increasing cost of the inclusion of wind farms),
- Financing charges for dispatch balancing costs (this is a bank facility for constraint costs),
- Bank charges/ other charges (which include subscriptions, weather forecast, postage, printing & stationery and miscellaneous),
- Central costs (to cover shared group services such as group treasury, finance, internal audit, purchasing),
- Insurance (for building, employer and public liability)

6.7.2 Responses to Consultation

SONI emphasised that the majority of costs in ‘other Opex’ are fixed. Facilities (to an extent) and insurance should be in line with headcount. SONI estimate that approximately 10% of ‘other Opex’ costs should flex with staff numbers.

\(^{11}\) These also cover NI SEMO employees, as agreed at last SEMO price control.
CCNI state that stability of ‘other Opex’ costs since the previous price control should have occurred by now, so additional costs should be minimal and only allowed if fully justified as being cost effective.

6.7.3 Utility Regulator Decision on Other Opex

The Utility Regulator has decided to increase Facilities and Insurance costs to align with the proposed staffing level. Since the consultation paper was issued, the Utility Regulator has assessed an appropriate allowance for a building extension and refurbishment. The Utility Regulator’s consultation paper based 100% of facilities costs on headcount. 55% of SONI’s facilities cost is fixed. The approach has been amended for the Utility Regulator’s decision. Insurance costs were previously calculated to align with the proposed Capex allowance for a building. However, for the Utility Regulator decision, the figure has been re-calculated to align 100% with headcount. The Utility Regulator also took account of the decision in the most recent SEMO price control that it would be appropriate for SONI/EirGrid to deal with their own facilities costs.

Professional fees have been increased by the Utility Regulator since the consultation paper was published to allow SONI to draw down EMS dispatch training expertise.

The impact of these re-calculations has resulted in an increase of £0.2M in SONI’s allowed ‘Other Opex’ when compared to the consultation paper. The Utility Regulator has decided to allow a total ‘Other Opex’ spend of £7.4M.

Table 10: SONI ‘Other’ operating costs: Utility Regulator decision 2010-2015

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Sep 2010</td>
<td>- Sep 2011</td>
<td>- Sep 2012</td>
<td>- Sep 2013</td>
<td>- Sep 2014</td>
<td>- sep 2015</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SONI Submission</td>
<td>0.6</td>
<td>1.6</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
<td>9.0</td>
<td></td>
</tr>
<tr>
<td>Utility Regulator Decision</td>
<td>0.6</td>
<td>1.3</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>7.4</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4: SONI ‘Other’ operating costs: Utility Regulator decision 2010-2015
### 6.8 Total Opex Decision

The Utility Regulator has carried out a bottom up analysis of all Opex to ensure that past efficiencies are captured within the allowance. The Utility Regulator has decided that an X factor equal to zero is appropriate given the level of rigour applied to the assessment of costs.

The Utility Regulator has decided to give SONI autonomy to allocate the allowance for each category of Opex in the most efficient manner according to their business requirements. Efficiency gains can be retained by SONI and any over expenditure would conversely have to be absorbed by SONI.

The Utility Regulator has decided that Opex allowance under the B_{TSO}t term for SONI during the price control period is £48.9M\textsuperscript{12}. This compares to a SONI submission of £58.9M\textsuperscript{13}.

#### Table 11: Total Opex – Utility Regulator decision 2010-2015

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>SONI Submission</td>
<td>4.2</td>
<td>10.3</td>
<td>10.8</td>
<td>11.0</td>
<td>11.2</td>
<td>11.4</td>
<td>58.9</td>
</tr>
<tr>
<td>Utility Regulator Decision</td>
<td>3.9</td>
<td>8.7</td>
<td>9.1</td>
<td>9.2</td>
<td>9.0</td>
<td>9.0</td>
<td>48.9</td>
</tr>
</tbody>
</table>

#### Table 12: Total Opex breakdown by category– Utility Regulator decision 2010-2015

<table>
<thead>
<tr>
<th></th>
<th>SONI Re-submission £M</th>
<th>UR Decision £M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll</td>
<td>34.4</td>
<td>27.3</td>
</tr>
<tr>
<td>Pension (ongoing)</td>
<td>4.7</td>
<td>4.1</td>
</tr>
<tr>
<td>IT &amp; Communications</td>
<td>10.5</td>
<td>9.9</td>
</tr>
<tr>
<td>Other Opex</td>
<td>9.0</td>
<td>7.4</td>
</tr>
<tr>
<td>TOTAL OPEX</td>
<td>58.6</td>
<td>48.6</td>
</tr>
<tr>
<td>Pension (deficit)</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>TOTAL OPEX INCL DEFICIT</td>
<td>58.9</td>
<td>48.9</td>
</tr>
</tbody>
</table>

\textsuperscript{12} This includes £0.26m during the price control period in respect of pension deficit payments (over 15 years)

\textsuperscript{13} This includes £0.34m during the price control period in respect of pension deficit payments (assumed over 9 years)
Figure 5: Total Opex – Utility Regulator Decision 2010-2015

<table>
<thead>
<tr>
<th>Year</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>SONI Submission</td>
<td>4.2</td>
<td>10.3</td>
<td>10.8</td>
<td>11.0</td>
<td>11.2</td>
<td>11.4</td>
</tr>
<tr>
<td>UR consultation</td>
<td>3.2</td>
<td>8.4</td>
<td>8.5</td>
<td>8.4</td>
<td>8.2</td>
<td>8.2</td>
</tr>
<tr>
<td>UR Decision</td>
<td>3.9</td>
<td>8.7</td>
<td>9.1</td>
<td>9.2</td>
<td>9.0</td>
<td>9.0</td>
</tr>
</tbody>
</table>
7 Capex

7.1 Capex in Consultation Paper

SONI submitted their proposed capital expenditure requirements for the business, emphasising the fact that SONI is a very different business from that envisaged when preparing for the last price control.

The Utility Regulator carried out an assessment of the Capex submission provided by SONI. For each business case provided, the Utility Regulator assessed the requirement, proposed costs and justifications for the costs. In the consultation, the Utility Regulator proposed to reduce costs in a number of areas. Capex requests which were not supported with a statement of need or business case were not allowed.

As detailed in the consultation paper, SONI requested a capex budget of £11.3M. The Utility Regulator proposed an allowance of £4.8M.

7.2 Responses to Consultation

SONI do not agree with the proposed CAPEX allowance for the price control. In particular, SONI is concerned about the long-term effect on consumers as a result of under-investment in the TSO business. SONI state that they need a CAPEX allowance that is sufficient to refresh assets, ensure that it is able to manage and connect renewable generation, manage the impact of European and SEM developments and to respond adequately in emergency situations. SONI claim that the provision of a sustainable level of CAPEX will increase tariff predictability and also provides certainty for SONI to organise and plan the business more efficiently over the price control period.

In addition, SONI note that the stock of physical assets they own, in particular IT assets, need to be constantly refreshed over time. SONI claim that the Utility Regulator’s proposed level of CAPEX will defer significant investment to the start of the next price control period.

SONI stated that the Utility Regulator has taken a particular view that all proposed CAPEX ought to have a fully developed and justifiable business case. However, this approach does not support the principal desire to move away from ‘excluded cost’ approvals under the DTSO price control term as set out by the Utility Regulator in section 4.3 of the consultation paper and is not feasible in the context of ex-ante incentive based regulation.

SONI also suggest that the approach in the consultation contradicts the recent Utility Regulatory precedent in the SEMO price control decision, where the SEM Committee were of the view that the business required an amount of ‘Unpredictable Business CAPEX’ and allowed an amount of €250k/annum.

In relation to the building, SONI wants to ensure that the building and associated grounds are at an acceptable standard to comply with health and safety legislation. It also requires the extension in order to meet increasing resource requirements.

AES say that the Utility Regulator should give consideration to the SONI website. It is critical that it is upgraded as a matter of urgency as it is not fit for purpose.
CCNI state that a justification of costs incurred in the last two years of the price control period must be provided in advance so as to ensure that these are cost effective and will ultimately have benefits for consumers.

CCNI also state that with regard to the building, SONI should consider other options since the extension is based on an increase of staff by 50 people. CCNI encourage the most cost effective option to be chosen.

IWEA urged the Utility Regulator to support SONI’s need for the development of both Satellite Communications to wind farms and the Wind Stability Assessment Tool.

Viridian highlight the need to accommodate renewable Connections and integration ( whilst minimising constraints) in the context of intra-day trading which will require, amongst other things, innovation and development of power system tools and forecasting. Viridian also commented that it is unnecessary for all SONI functions to be located within the same building.

### 7.3 Utility Regulator Decision on Capex

Based on the responses received to the consultation, the Utility Regulator has reassessed the capex requirements in the following areas.

- Building
- EMS (Wind Stability Assessment Tool)
- EDRMS
- Website
- Satellite Communications

These are discussed further below.

#### 7.3.1 Building

SONI are located at Castlereagh House. Due to the proposed increases in staff, additional office accommodation will be required and SONI has indicated that there is no available space in the existing building.

SONI has indicated that there are issues with the building concrete, there is no provision for disabled access, and additionally there are heating and ventilation issues and car parking problems. SONI reviewed a number of options including extending and refurbishing the existing building, constructing a new building within the site and moving to an alternative site.

SONI’s proposal recommends the extension and refurbishment of the existing building at an estimated cost of £3.2M. This amount covers disruption costs associated with re-locating staff while building works are ongoing. In the consultation paper, the Utility Regulator proposed an allowance of £400K for refurbishment and temporary arrangements.

Of the £3.2M total cost of SONI’s proposed extension and refurbishment, £2.0M was for an extension, £0.3M for sustainable design, and £0.9M for refurbishment of the existing building to support the extension structure.

Since the consultation period, SONI also provided the Utility Regulator with costs relating to rental accommodation as an alternative. SONI proposed annual cost of rent of £140-160K.
per annum but highlighted the additional costs associated with the upheaval of essential telecommunications, maintaining Castlereagh House and the costs of inefficiencies of staff travel and one-off costs of re-location.

The Utility Regulator assessed all options proposed by SONI. Rental figures were deemed reasonable.

The Utility Regulator commissioned expert architectural and surveyance advice to assist in assessing SONI’s proposed options for the building. The team visited SONI’s site for an inspection and also reviewed a report prepared by SONI’s architects and architectural drawings. The team assessed the reasonableness of the costs proposed by SONI for the extension with the option of sustainable design. The consultancy team are of the view that the extension which is proposed for 50+ staff rather than the number of staff approved by the Utility Regulator would future proof the building for a period of time. The potential costs savings of building a smaller extension for 30+ staff are not considered large enough to recommend.

The Utility Regulator is satisfied that accommodation for additional employees is not currently available in Castlereagh House. The Utility Regulator has considered the inclusion of 14 SEMO employees on the site, who are involved in Market Operator licensed activities.

The Utility Regulator has also given consideration to the appropriateness and value for money for customers of the inclusion of ‘green’ technologies. Amounts for green elements such as a roof garden, biomass hopper and rainwater harvester have been deducted from SONI’s proposed total expenditure required. The Utility Regulator has replaced the cost of a biomass boiler with a conventional boiler upgrade at a cost of £20K. The Utility Regulator has also reduced the costs involved with exploratory works of the original site and trenching/environmental works by 50%. Whilst the ‘green’ technologies were regarded as reasonable by the consultancy team, the Utility Regulator has decided not to allow such costs since any long-term benefit should be assessed by SONI. If a benefit is identified this should provide savings within the Opex allowance and SONI can decide whether to introduce these elements.

The Utility Regulator approves an extension and refurbishment of Castlereagh House at a cost of £2.53M. It is beneficial that all functions are located at one site. It would be costly to move as the building is designed fit-for-purpose for 24x7 operations. Splitting off any departments would be costly in terms of the provision of a secure IT and telecoms infrastructure commensurate with the requirements of the business as well as the inevitable business inefficiency which would result from operation on dual sites.

The Utility Regulator has decided that the Capex costs for the building will have a separate RAB with a depreciation period of 25 years (straight line). This equates to an annual cost of approximately £217K when the depreciation and rate of return elements are considered. Whilst this is slightly higher than the estimated rental costs, the Utility Regulator believes that this is the best long term solution.

The Utility Regulator has decided that this allowance is conditional on a licence change to ensure that if Castlereagh building and ground are ever sold, customers will benefit from the proceeds of any sale. The wording of the condition will be consulted on as part of the licence changes required as a result of this decision paper.
7.3.2 EMS

The Energy Management System (EMS) was a key investment during the last price control. The Utility Regulator acknowledges the importance and potential of this system and has therefore allowed an appropriate capex element to its continued enhancement.

In the consultation paper, the Utility Regulator proposed that the use of a ‘Wind Stability Assessment Tool’ would not be included in the allowance. However, the Utility Regulator, in line with responses to the consultation has given this further consideration and decided to allow this as part of the capital expenditure. The Wind Stability Assessment Tool is currently being developed and should help to reduce D1 requests going forward. It will highlight the risk of operating the power network in potentially unstable conditions, taking into account both the system state and wind forecasts. As discussed in section 6.2, the Utility Regulator has approved four additional real time engineers to ensure that adequate resource is in place to manage the system.

Apart from the additional cost above, the Utility Regulator has decided to allow the costs proposed in the consultation paper. Therefore an allowance of £1.185M will apply for EMS for this price control period.

7.3.3 IT

In the IT assessment, the Utility Regulator proposed to disallow the expenditure for ‘Training Records Systems’ and ‘Network Modelling’. The Utility Regulator also proposed reduced allowances in relation to ‘Document and Record Management Systems’ (EDRMS), IT Standardisation and ‘Data Exchange’ (SDX).

The most significant reduction was in relation to the SONI website, where a budget of £500K was proposed. In the consultation paper, the Utility Regulator proposed £100K for website re-development. The Utility Regulator considered the responses to the consultation paper and agrees that the SONI Website needs to be improved. The Utility Regulator assessed the benchmarking information provided by SONI which demonstrated costs ranging from £360K to £500K. The Utility Regulator also considered the costs associated with the SEMO Website. Following further analysis, the Utility Regulator has decided on an allowance of £400K for the website development and encourages SONI to have the new functionality available as soon as possible to ensure consumers benefit from this investment. This proposed functionality has been identified by SONI within their submission and the Utility Regulator is satisfied that this will meet the necessary requirements.

The Utility Regulator has also considered SONIs comments relating to the EDRMS and has decided to increase this allowance to £150K from £100K. This is to ensure that the critical information stored by SONI is maintained in an efficient manner and should improve the efficiency of information provided to all stakeholders.

Apart from the additional costs discussed above, the Utility Regulator has decided to allow the costs proposed in the consultation paper. Therefore an allowance of £2.013M will apply for IT Capex in this price control period.
7.3.4 Telecoms

Under the Telecoms category the main area raised by respondents related to the proposal to implement a satellite communication system for wind farms at a cost of £600K. In the consultation paper, the Utility Regulator considered the communication costs for wind farms should be charged to connection generators through the charging mechanism for both distribution and transmission connections. Whilst acknowledging the comments received, the Utility Regulator maintains the view that these costs should not be included in the SONI Capex Allowance.

It should be noted that two areas of costs included in the SONI submission were not addressed in the consultation paper. These were the replacement of the old electrical switchboard (£150k) & another for the refurbishment of the diesel generator (£40k). Upon assessing these, the Utility Regulator has decided to include an amount of £105K for the switchboard replacement (following discussions with M&E engineers) and £40K for the refurbishment of the diesel generator.

In summary the Utility Regulator has decided to allow the costs relating to Telecoms of £0.77M.

7.3.5 Other Capex

In relation to Other Capex costs, two areas of work were identified. As per the consultation paper, the Utility Regulator has decided on an allowance of £0.1M for Other Capex.

7.3.6 Non-identified Capex

In the SONI submission, £1.29M of capex was included but not mapped to any business cases. The Utility Regulator does not find it appropriate to allow this amount without justification. The Utility Regulator indicated in the consultation paper that they will consider any innovative ideas submitted with a full Cost-Benefit Analysis (CBA) during the price control period. It is acknowledged that a small ‘unidentified’ capex budget was included in the SEMO price control, however the structure of that price control differs greatly from SONIs as it is menu based rather than allowance based. Therefore the Utility Regulator does not accept that there is a like for like comparison of the two price controls.

In recent discussions, SONI have raised concerns that the lack of flexibility in the Capex Allowance will result in an increased number of Dt requests and result in additional work for SONI and the Utility Regulator. They also flagged that this additional approval process would result in delays in the delivery of programs of work.

Whilst the Utility Regulator appreciates that there may be occasions where new costs arise during a price control period, the Utility Regulator also highlights that it would not be fulfilling its duty of protecting customers by approving costs that have not been justified in any way.

7.4 Summary of Capex Decision

A summary of the Utility Regulator decision in relation to Capex is shown in Table 13.
As highlighted in Section 4, the Utility Regulator intends to introduce a new format of detailed regular cost reporting during the price control and will be assessing the expenditure of both Capex to ensure that the outputs as defined in the SONI submission are delivered. If there are areas of Capex not delivered that are within allowances provided, the Utility Regulator will assess whether an adjustment is appropriate. This assessment will take place at the end of the price control period.

### Table 13: SONI proposed Capex 2010-2015 compared to Utility Regulator decision

<table>
<thead>
<tr>
<th>TOTAL CAPEX ALLOWANCE (£M)</th>
<th>SONI Submission</th>
<th>UR decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 month submission</td>
<td>0.984</td>
<td>0.913</td>
</tr>
<tr>
<td>Building</td>
<td>3.200</td>
<td>2.533</td>
</tr>
<tr>
<td>EMS</td>
<td>1.385</td>
<td>1.185</td>
</tr>
<tr>
<td>IT</td>
<td>2.548</td>
<td>2.013</td>
</tr>
<tr>
<td>Telecoms</td>
<td>1.415</td>
<td>0.770</td>
</tr>
<tr>
<td>Other</td>
<td>0.500</td>
<td>0.100</td>
</tr>
<tr>
<td>Non-identified Capex</td>
<td>1.290</td>
<td>0.000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11.322</strong></td>
<td><strong>7.514</strong></td>
</tr>
</tbody>
</table>
8 Cost of Capital

8.1 WACC in Consultation Paper

In the consultation paper, the Utility Regulator set out its view on the appropriate WACC for the SONI business.

The Utility Regulator employed First Economics (FE) to undertake an independent estimate of the appropriate values a WACC for SONI. SONI also made a cost of capital submission to the Utility Regulator as part of their submission.

The pre-tax cost of capital proposed by the Utility Regulator for SONI for the period from 1 April 2010 to 30 September 2015 was 5.45% in the consultation paper. A summary of the components of the cost of capital calculation is shown in table 14.

<table>
<thead>
<tr>
<th>Building Block</th>
<th>First Economics</th>
<th>SONI</th>
<th>Utility Regulator Proposal</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Low</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Gearing (g);</td>
<td>0.55</td>
<td>0.55</td>
<td>0.5</td>
</tr>
<tr>
<td>Cost of Debt (Kd);</td>
<td>3.5%</td>
<td>3.5%</td>
<td>4.05%</td>
</tr>
<tr>
<td>Risk Free Rate (Rf);</td>
<td>2.0%</td>
<td>2.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Market Return (Rm);</td>
<td>6.5%</td>
<td>7.0%</td>
<td>7.25%</td>
</tr>
<tr>
<td></td>
<td>0.40</td>
<td>0.50</td>
<td>0.45</td>
</tr>
<tr>
<td>Asset beta</td>
<td>0.77</td>
<td>0.99</td>
<td>0.9</td>
</tr>
<tr>
<td>Equity beta (βe).</td>
<td>5.45%</td>
<td>6.94%</td>
<td>6.725%</td>
</tr>
<tr>
<td>Post tax cost of equity</td>
<td>28%</td>
<td>28%</td>
<td>28%</td>
</tr>
<tr>
<td>Pre-tax cost of equity</td>
<td>7.57%</td>
<td>9.65%</td>
<td>9.34%</td>
</tr>
<tr>
<td>Pre-tax cost of capital</td>
<td>5.33%</td>
<td>6.27%</td>
<td>6.70%</td>
</tr>
</tbody>
</table>

Table 14: Summary of SONI Submissions and Utility Regulator Proposal for WACC
In relation to Tax, the Utility Regulator asked for comments on the option where if the statutory tax rate changes during the price control period that the appropriate change may be made to the WACC.

8.2 Responses to Consultation

SONI disagrees with the pre-tax WACC of 5.45% for the price control. SONI’s view is that the Utility Regulator’s proposal for a WACC of 5.45% is not an appropriate regulatory determination of the cost of capital for SONI over the forthcoming price control period. It fails to incorporate a number of key SONI characteristics and is considerably out of line with recent regulatory precedent.

A number of components that derive this WACC outcome are of particular concern to SONI; in particular the debt premium, market return and equity beta.

The 1.5% debt premium proposed by the Utility Regulator can only be considered appropriate for a large traditional utility and not for SONI which is more characteristic of a service company within the utility sector. SONI faces a higher cost of debt due to the small packages and short term nature of debt it can avail of. SONI used the Competition Commission (CC), Final Determination, Bristol Water, September 2010 and also the Ofwat PR09 determination as examples of regulatory precedent.

Regarding the market return component, SONI’s view is that the Utility Regulator’s proposal of 6.75% is an outlier amongst its regulatory peers. Both the Competition Commission in its Bristol Water determination and the Civil Aviation Authority in its NATS determination provided a market return of 7%. Ofwat in its PR09 determination included a rate of 7.4% in its allowed WACC. SONI considers that a minimum market return of 7%, and more likely 7.25% in the current economic climate, represents an appropriate and efficient level reflecting the return an investor demands today and over the forthcoming period.

The consultation paper refers to a framework, provided by First Economics, to assess an appropriate equity beta. SONI believe that this framework is broadly acceptable but the conclusion drawn by First Economics does not fully appreciate SONI’s characteristics. Moreover, the proposal and justification made by the Utility Regulator using this information fails to reflect the SONI characteristics to any satisfactory degree.

The framework outlines two key criteria; Exposure to Volume Risk and Operational Gearing; SONI has a high exposure to volume risk in the short run and its operational gearing is very high; indeed, effectively, without equal in terms of regulated utilities. This creates considerable business risk as even a small unanticipated change in the operating cost base can have very significant implications for the level of return achievable. Therefore, it is clear that SONI has a high asset beta and subsequently a high equity beta. The SONI asset beta submission of 0.45 (assuming zero debt beta) or 0.505 (assuming 0.1 debt beta) reflects the systematic risk faced by SONI.

Overall, SONI maintain that a real pre tax WACC of 6.7% is required.

AES agreed with the continued use of the Capital Asset Pricing Model in the calculation of WACC as this mechanism is well established and maintains consistency with the existing
price control. They also noted that it is helpful that an independent assessment was obtained.

AES suggested that the values for asset and equity beta may warrant a further review in view of the relatively large ranges provided by First Economics and the fact that the Utility Regulator has selected the low value in each of these cases.

AES would agree that if the tax rate changes during the price control period the impact on the WACC should be reviewed.

8.3 Utility Regulator Decision on WACC

The Utility Regulator addresses the points raised by respondents below.

8.3.1 Cost of Debt

In SONI’s response, it could be suggested that they have been somewhat selective in the examples used for Cost of Debt. The SONI submission highlights ‘the CC’s decision to provide a 2% debt premium for Bristol Water’s forward looking debt. This forward-looking assumption was only a relatively small part of the CC’s calculation; as in other recent decisions, the overall cost of debt was a weighted average of cheaper embedded debt costs and the more expensive forward-looking cost of new debt.

SONI has ignored recent reductions in economy-wide borrowing costs. As evidence of this, Ofgem noted in December 2010 that it could update its DPCR5 cost of debt set in December 2009 from 3.6% to 3.1% on the basis of the latest available data.

Whilst not a deciding factor in the Utility Regulator analysis, it should be noted that most regulators take account of a company’s actual borrowing costs when calculating the cost of embedded debt and/or the overall cost of debt. It is worth noting that SONI finances itself mainly through inter-company or parent company loans.

Following further assessment and discussion with First Economics, the Utility Regulator has decided that the Cost of Debt should remain as proposed in the consultation paper. The Cost of Debt is 3.5%.

8.3.2 Market Return

SONI’s comments on the market return also focus on the Utility Regulator’s supposed departures from regulatory precedent. It quotes, in particular, figures of 7.0%, 7.0% and 7.4% respectively from the CAA’s 2010 NATS price control decision, the CC’s 2010 Bristol Water decision and Ofwat’s PR09 determination in support of its claims for a 7.25% market return.

The Utility Regulator notes that SONI did not mention Ofgem’s ~6.75% market return in DPCR5 or the CC’s use of market returns of 6.6% to 6.8% in its 2008/09 airport inquiries. It is also worth highlighting the CC’s 2010 decision overturned Ofwat’s PR09 decision and so invalidates the 7.4% figure as a robust regulatory precedent.

Therefore the Utility Regulator is content with the range proposed by FE of 6.5% to 7.0% and has decided that a Market Return of 6.75% is appropriate.
8.3.3 Asset Beta

SONI raised a concern about exposure to revenue risk, where the company was arguing that variations in short-term cash flow due to changes in demand make it a risky company in the eyes of investors despite its ability to recover a fixed revenue entitlement in the longer term.

The Utility Regulator does not accept this argument. The return that the shareholder ultimately gets from his or her investment in SONI is not affected by changes in volumes. As such, it would be inappropriate for the Utility Regulator to award any sort of risk premium in respect of volume risk.

The second point relates to SONI’s operational gearing. The Utility Regulator acknowledge that the SONI RAB is reducing over the period of the price control and the RAB:Revenue figure is decreasing. The Utility Regulator has discussed this with FE and has decided that it is appropriate to increase the Beta to reflect this reduced RAB:Revenue ratio.

Therefore the Utility Regulator has decided that the asset beta value will be 0.45.

8.3.4 Tax

In the consultation paper, the Utility Regulator raised the consideration that the WACC should reflect the actual Corporate Tax rate for each year in the price control.

In the June Budget 2010, the government announced a reform of corporation tax, including changes to rates and allowances. The main rate of corporation tax was reduced from 28% to 26% in April 2011. The Government has also indicated that further tax reductions will occur in future years. (26% in 2012-13, 25% in 2013–14, 24% in 2014-15).

The Utility Regulator is also aware of the debate ongoing about Northern Ireland having a specific corporation tax for the region.

Therefore the Utility Regulator has decided that the SONI WACC should reflect the tax rate in each year of the price control. A licence condition will be required to ensure that the WACC figure is adjusted to reflect the specified tax rate.

8.4 Summary of WACC

Based on the decisions above, the WACC for SONI has been set at 5.78% (based on a tax rate of 28%). The table below details the WACC for each year of the price control. It should be noted that the tax rates will be adjusted to reflect the actual tax rate in the year in question.
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<tbody>
<tr>
<td></td>
<td>6 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
</tr>
<tr>
<td>Gearing (g);</td>
<td>0.55</td>
<td>0.55</td>
<td>0.55</td>
<td>0.55</td>
<td>0.55</td>
<td>0.55</td>
</tr>
<tr>
<td>Cost of Debt (Kd);</td>
<td>3.50%</td>
<td>3.50%</td>
<td>3.50%</td>
<td>3.50%</td>
<td>3.50%</td>
<td>3.50%</td>
</tr>
<tr>
<td>Risk Free Rate (Rf);</td>
<td>2.00%</td>
<td>2.00%</td>
<td>2.00%</td>
<td>2.00%</td>
<td>2.00%</td>
<td>2.00%</td>
</tr>
<tr>
<td>Market Return (Rm);</td>
<td>6.75%</td>
<td>6.75%</td>
<td>6.75%</td>
<td>6.75%</td>
<td>6.75%</td>
<td>6.75%</td>
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<tr>
<td>Asset beta</td>
<td>0.45</td>
<td>0.45</td>
<td>0.45</td>
<td>0.45</td>
<td>0.45</td>
<td>0.45</td>
</tr>
<tr>
<td>Equity beta (βe).</td>
<td>0.88</td>
<td>0.88</td>
<td>0.88</td>
<td>0.88</td>
<td>0.88</td>
<td>0.88</td>
</tr>
<tr>
<td>Post tax cost of equity</td>
<td>6.17%</td>
<td>6.17%</td>
<td>6.17%</td>
<td>6.17%</td>
<td>6.17%</td>
<td>6.17%</td>
</tr>
<tr>
<td>Taxation</td>
<td>28%</td>
<td>26%</td>
<td>26%</td>
<td>25%</td>
<td>24%</td>
<td>24%</td>
</tr>
<tr>
<td>Pre-tax cost of equity</td>
<td>8.34%</td>
<td>8.34%</td>
<td>8.34%</td>
<td>8.34%</td>
<td>8.34%</td>
<td>8.34%</td>
</tr>
<tr>
<td>Pre-tax cost of capital</td>
<td>5.78%</td>
<td>5.68%</td>
<td>5.68%</td>
<td>5.63%</td>
<td>5.58%</td>
<td>5.58%</td>
</tr>
</tbody>
</table>
9 RAB & Depreciation

9.1 RAB & Depreciation in Consultation Paper

SONI submitted their RAB with the additions included as per their Capex plan. Under the 2007 to 2010 price control, a depreciation of 10 years (straight line) was used. SONI have continued with this approach for the new price control period. The depreciation in the SONI Submission was £16.9M. The table below shows a summary of the RAB and depreciation as submitted by SONI.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
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<td>£M</td>
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<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td></td>
</tr>
<tr>
<td>Additions</td>
<td>0.984</td>
<td>2.693</td>
<td>3.560</td>
<td>1.140</td>
<td>1.805</td>
<td>1.140</td>
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</tr>
<tr>
<td>Closing Value</td>
<td>18.320</td>
<td>18.325</td>
<td>18.840</td>
<td>16.822</td>
<td>15.288</td>
<td>12.975</td>
<td></td>
</tr>
</tbody>
</table>

Table 16: SONI proposed RAB and depreciation 2010-2015

The Utility Regulator raised a question in the consultation about whether respondents agree that the proposed depreciation period of 10 years (straight line) should be used for the price control period.

9.2 Responses to Consultation

SONI is keen that a 5 year straight line depreciation profile would better reflect the economic life of their assets which are highly dependant on IT. They suggest a 20-25 year depreciation profile for the proposed building extension (note that this suggestion was not part of SONI’s original price control submission).

AES agrees with continued use of a ten year depreciation period on the grounds of consistency.

Viridian says that an increase in staff is likely to be for the longer term so recovery of the cost of a building extension could be over a longer term than ten years.

9.3 Utility Regulator Decision on RAB & Depreciation

The Utility Regulator has carried out more detailed analysis on SONI’s asset base and concluded that a weighted average depreciation profile of 8 years is appropriate. This took into account the historical RAB, the EMS useful life, and other IT & Telecoms useful lives.

Given that the Utility Regulator is now allowing a Capex spend for the building (as discussed in section 7.3.1), it will attract a 25 year depreciation period.

In the decision on depreciation, the Utility Regulator has adjusted the depreciation calculations to reflect a half a year’s depreciation in the initial year that new capex appears
on the RAB\textsuperscript{14}. This is to reflect the view that assets are likely to be commissioned throughout the year, giving an average asset age at the end of the first year of only 6 months to the RAB. This adjustment makes the depreciation calculations more cost reflective.

The depreciation decided by the Utility Regulator is £17.9M. This change from the consultation paper corresponds to the capex proposed in section 7, the change in the depreciation period and the adjustment for depreciation in the first year of new capex being added to the RAB.

Table 17: Utility Regulator decision - RAB and Depreciation 2010-2015 for SONI

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
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<tbody>
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<td>£M</td>
<td>6 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td></td>
</tr>
<tr>
<td>Additions</td>
<td>0.913</td>
<td>0.883</td>
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<td>1.385</td>
<td>0.365</td>
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<tr>
<td>Closing Value</td>
<td>17.981</td>
<td>15.795</td>
<td>13.786</td>
<td>10.743</td>
<td>8.738</td>
<td>5.604</td>
<td></td>
</tr>
</tbody>
</table>

As the building is to have a depreciation period of 25 years, a separate RAB has been set up. This is detailed below

Table 18: Utility Regulator decision - RAB and depreciation for building 2010-2015 for SONI

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>£M</td>
<td>6 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td></td>
</tr>
<tr>
<td>Opening Value</td>
<td>-</td>
<td>-</td>
<td>1.241</td>
<td>2.432</td>
<td>2.330</td>
<td>2.229</td>
<td></td>
</tr>
<tr>
<td>Additions</td>
<td>-</td>
<td>1.267</td>
<td>1.267</td>
<td>-</td>
<td>-</td>
<td>-</td>
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</tr>
<tr>
<td>Depreciation 25 ys S.L.</td>
<td>0.025</td>
<td>0.076</td>
<td>0.101</td>
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<td>0.101</td>
<td>0.405</td>
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<td>2.229</td>
<td>2.128</td>
<td></td>
</tr>
</tbody>
</table>

\textsuperscript{14} The calculations in the consultation assumes a full years depreciation in the initial year that capex appeared on the RAB
10 Rate of Return

10.1 Rate of Return in Consultation Paper

Based on the submitted RAB and Capex Additions from SONI, and their proposed WACC of 6.7%, the Rate of Return requested from SONI is detailed in the table below.

Table 19: SONI proposed rate of return 2010-2015

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>£M</td>
<td>6 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td></td>
</tr>
<tr>
<td>WACC</td>
<td>6.7%</td>
<td>6.7%</td>
<td>6.7%</td>
<td>6.7%</td>
<td>6.7%</td>
<td>6.7%</td>
<td></td>
</tr>
<tr>
<td>Rate of Return</td>
<td>0.618</td>
<td>1.228</td>
<td>1.245</td>
<td>1.195</td>
<td>1.076</td>
<td>0.947</td>
<td>6.307</td>
</tr>
</tbody>
</table>

The Utility Regulator proposed the following Rate of Return in the consultation paper based on the proposed Capex and a WACC of 5.45%

Table 20: Utility Regulator proposed rate of return (in consultation paper) 2010-2015

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>£M</td>
<td>6 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td></td>
</tr>
<tr>
<td>Average RAB</td>
<td>9.200</td>
<td>17.523</td>
<td>15.935</td>
<td>13.860</td>
<td>11.955</td>
<td>10.047</td>
<td></td>
</tr>
<tr>
<td>WACC</td>
<td>5.45%</td>
<td>5.45%</td>
<td>5.45%</td>
<td>5.45%</td>
<td>5.45%</td>
<td>5.45%</td>
<td></td>
</tr>
<tr>
<td>Rate of Return</td>
<td>0.501</td>
<td>0.955</td>
<td>0.869</td>
<td>0.756</td>
<td>0.652</td>
<td>0.548</td>
<td>4.280</td>
</tr>
</tbody>
</table>

Table 20: Utility Regulator proposed rate of return (in consultation paper) 2010-2015

10.2 Responses to Consultation

No responses were received on this section of the consultation paper

10.3 Utility Regulator Decision on Rate of Return

Based on the decision for Capex and Depreciation and the WACC the Rate of Return for SONI is detailed in table 21.

Table 21: Utility Regulator decision rate of return 2010-2015 for SONI

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>£M</td>
<td>6 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td></td>
</tr>
<tr>
<td>WACC</td>
<td>5.78%</td>
<td>5.68%</td>
<td>5.68%</td>
<td>5.63%</td>
<td>5.58%</td>
<td>5.58%</td>
<td></td>
</tr>
<tr>
<td>Rate of Return</td>
<td>0.528</td>
<td>0.959</td>
<td>0.840</td>
<td>0.690</td>
<td>0.543</td>
<td>0.400</td>
<td>3.960</td>
</tr>
</tbody>
</table>

15 The Utility Regulator noticed an error in the Rate of Return tables presented in the consultation paper. A full years return was included for the six month period to 30 September 2010. The figures should have been half the value to reflect a six month period. This error was applied to both the SONI and Utility Regulator proposals and has been rectified in the tables above.
The same WACC is to be applied to the building for the price control duration. Therefore the Rate of Return for the building is detailed below.

Table 22: Utility Regulator decision rate of return for building 2010-2015 for SONI

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>£M</td>
<td>6 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td>12 Mths</td>
<td></td>
</tr>
<tr>
<td>Average RAB</td>
<td>0.000</td>
<td>0.621</td>
<td>1.836</td>
<td>2.381</td>
<td>2.280</td>
<td>2.178</td>
<td></td>
</tr>
<tr>
<td>WACC</td>
<td>5.78%</td>
<td>5.68%</td>
<td>5.68%</td>
<td>5.63%</td>
<td>5.58%</td>
<td>5.58%</td>
<td></td>
</tr>
<tr>
<td>Rate of Return</td>
<td>0.000</td>
<td>0.035</td>
<td>0.104</td>
<td>0.134</td>
<td>0.127</td>
<td>0.122</td>
<td>0.522</td>
</tr>
</tbody>
</table>

10.4 Financeability

The Utility Regulator has given consideration to the financeability of SONI as a result of the decisions taken.

The Utility Regulator believes that the impact of Opex on financing is neutral given the rigorous bottom-up analysis applied to it. The amount spent on Opex should equal the amount allowed for in the price control, so there will be no financing issue.

The rate of return is similar to Opex from a financeability point of view. The Utility Regulator believes that its assessment of the required rate of return is correct so as long as this return is paid to the providers of finance (equity and debt) it will be revenue neutral as it will also be the amount that has been allowed in determining allowed revenues.

Capex can present financeability issues because of the issue that money needs to be found for the initial investment and is only returned to the company (through the depreciation element regulated revenues) over the regulatory life applied to those assets. Reducing the allowed Capex spend actually improves the financeability over the price control period by reducing the amount that SONI invests in new Capex. In addition, the Utility Regulator feels that the application of an eight- rather than ten-year depreciation profile to SONI's core assets will help to improve SONI's position.

Overall, the Utility Regulator does not believe that the decisions made will have a negative effect on SONI's financeability.
11 Incentivisation

11.1 Incentivisation in Consultation Paper

Appropriate incentivisation was considered in the price control consultation paper given the benefit and value for money which incentives could potentially deliver to electricity consumers. SONI submitted performance incentives proposals covering the areas of system operator, network delivery and innovation. This paper was published along with the consultation paper. The Utility Regulator proposed two main areas for SONI to focus on over this five-year period.

- Incentive 1: Delivery of Key Industry Documents
- Incentive 2: World Class Forecasting

11.2 Responses to Consultation

SONI highlighted that meaningful incentives are required to balance the potential benefit to customers and potential reward to the business. However SONI are concerned that the two incentives proposed by the Utility Regulator in the consultation paper are inconsistent with the Utility Regulator’s decision to exclude other obligations that are licence obligations and will not deliver clear benefits without further development.

Endesa Ireland recommend that an incentive scheme should be designed and implemented across the NI and ROI jurisdictions ensuring quality of supply and service for the all island customer.

Viridian supports the inclusion of incentives but strongly suggest that incentives should be harmonised across SONI and Eirgrid where possible.

ESB Wind Development UK Ltd welcomes that incentives were considered but states that incentives proposed in the consultation paper do not capture the opportunity to achieve renewable targets for Northern Ireland. They propose additional incentives including:

- Issuance of connection and use of system offers;
- Minimisation of curtailment;
- Innovation in system operations.

Further to this, NIRIG suggest the following potential additions:

- Minimise level of constraint and curtailment of renewables;
- Delivery of connection offers, modifications and constraint reports on time;
- Specifying appropriate grid code rules and enforcing them;
- Bringing innovation to system operation and design;
- Answering customer queries promptly, accurately and consistently;
- Delivering on the next steps from the facilitation of renewables studies.

### 11.3 Utility Regulator Decision on Incentives

The Utility Regulator wants to ensure that SONI is properly incentivised. Having given due consideration to the responses the Utility Regulator has decided not to include the proposed incentives in this price control. Incentives will be dealt with as a separate project, post-price control implementation. This is to allow time to develop the measurable mechanisms required. Discussions will also be held with the Commission for Energy Regulation (CER) and the Single Electricity Market (SEM) Committee on the options for TSO incentives on an all island basis.
12 Costs outside the Price Control Allowance ($D_{TSO_t}$)

12.1 Background

The last SONI price control was agreed before the System Operator and Market Operator licenses were granted and before SEM arrangements had been finalised. It was recognised that the $D_{TSO_t}$ term would be used to cover unforeseen items including divestment.

In its submission, SONI stated that $D_{TSO_t}$ items were likely to include:

- A decision on the implementation of the 2009 Electricity Directive (2009/72/EC) (IME3)
- Significant changes due to European Regional Integration initiatives
- Significant changes to the Single Electricity Market e.g. Introduction of intra-day trading or use of a Security Constrained Unit Commitment (SCUC) engine
- Significant developments in the area of smart grids and demand side management
- Further NI supplier Transmission Use of System (TUoS) tariff development or the introduction of all-island Supplier TUoS
- Further all-island Generator TUoS development
- Transmission Loss Adjustment Factor (TLAF) development (particularly if real time dispatch is to be considered)
- Changes due to further development of Harmonised Ancillary Services
- Separation (NIE/SONI) updating and development of the NI Planning and Security Standards. (This may contain an all-island element).
- A termination of the leasing arrangement at the SONI Emergency Control Centre.
- Section 75 Pension requirements.

12.2 Utility Regulator Decision

The Utility Regulator accepts that there may be a number of areas going forward which cannot be clearly identified as part of this price control and will consider applications by SONI above a de minimis amount of £20K.

SONI should note that the Utility Regulator has agreed to an increase in professional service fees when compared with the allowance in the last price control as well as a significant addition in staff numbers. For these reasons, the Utility Regulator expects a minimal number of Opex related $D_{t}$ requests during the price control period. The Utility Regulator expects SONI to deal with the majority of issues using the additional resources approved.

The Utility Regulator notes the content of the list provide by SONI but SONI should not assume that the Utility Regulator will allow claims of costs for each of the areas identified above. The Utility Regulator will assess any costs submitted as per the procedure defined in the SONI licence (Annex 1, Paragraph 8.1 (f)). i.e.

… the following costs and revenues of the Licensee (whether a positive or negative amount) shall be treated as excluded system support service costs in relevant year $t$:

(f) any other costs and revenues of the Transmission System Operator Business which:

(i) were not taken into account in setting ATSO$t$ or BTSO$t$;
(ii) in the case of costs, those which cannot reasonably be controlled by the Transmission System Operator Business; and

(iii) the Authority determines, upon an application to it by the Licensee, shall be included for the purposes of this paragraph.
13 Allowed Revenue

13.1 Utility Regulator Decision on Allowed Revenue

This paper presents a Utility Regulator decision to allow revenue for the SONI price control 2010-2015 of £71.7M, compared to SONI’s (re)submission of £82.7M.

Allowances for depreciation and return are based on a Utility Regulator proposed Capex spend of £7.5M. This compares to SONI’s Capex submission of £11.3m.

A summary of the proposed allowed revenue is shown in Table 23 below.

Table 23: Utility Regulator decision - Allowed Revenue for SONI 2010-2015

<table>
<thead>
<tr>
<th>SONI Allowed Revenue</th>
<th>1 April 2010 - 30 September 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SONI submission</td>
</tr>
<tr>
<td>Payroll</td>
<td>34.4</td>
</tr>
<tr>
<td>Pension (ongoing)</td>
<td>6.1</td>
</tr>
<tr>
<td>IT &amp; Communications</td>
<td>10.5</td>
</tr>
<tr>
<td>Other Opex</td>
<td>9.0</td>
</tr>
<tr>
<td>TOTAL OPEX</td>
<td>60.0</td>
</tr>
<tr>
<td>Pension (deficit)</td>
<td>0.8</td>
</tr>
<tr>
<td>TOTAL OPEX INCL DEFICIT</td>
<td>60.8</td>
</tr>
<tr>
<td>Depreciation</td>
<td>16.9</td>
</tr>
<tr>
<td>Return</td>
<td>6.9</td>
</tr>
<tr>
<td>ALLOWED REVENUE</td>
<td>84.6</td>
</tr>
</tbody>
</table>

13.2 Impact of Price Control on Tariffs

In order to show value for money for consumers, the Utility Regulator has estimated\(^\text{16}\) below the impact that the new price control will have on tariffs.

The System Support Service (SSS) element of the tariffs (which covers SONI’s costs) makes up 2.9% of the overall tariffs. The average allowed revenue is increasing by 22% in the new price control period. As the allowed revenue makes up 46% of the SSS element, the overall increase in tariffs is 0.3%:

\(^{16}\) The estimate assumes that all other tariff elements remain constant
Assuming an average domestic bill of £480 per year, the impact on consumers is an additional cost of £1.43 per year. Considering the continued security of supply and support in the delivery of renewable generation, the Utility Regulator believes that the allowed revenue shows value for money and is essential going forward. This evaluation assumes that all other tariff elements remain equal, including the remaining areas covered by SSS. However it should be noted that these are also subject to possible increases going forward.

The Utility Regulator accepts that although this is not a significant increase in customer bills, it is a significant increase in SONI’s allowance. SONI and other respondents have commented that the increase in the level of wind generation on the system in Northern Ireland to meet the government’s target of 40% electricity from renewable sources by 2020 will require additional resources. The Utility Regulator has reflected this in the decision made.

<table>
<thead>
<tr>
<th>% of tariff</th>
<th>*</th>
<th>increase in allowed revenue</th>
<th>*</th>
<th>% of SSS element</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.9%</td>
<td>*</td>
<td>22%</td>
<td>*</td>
<td>46%</td>
</tr>
</tbody>
</table>
14 Licence Changes Required for Price Control

The Utility Regulator has identified 3 key areas where licence changes will be required as a result of this price control:

- Annex 1 Charge Restrictions will need updated to reflect new price control
- A WACC formula need to be included to reflect the corporation tax in each year of the price control
- A new licence condition will be required to ensure that if Castlereagh building and ground are ever sold, customers will benefit from the proceeds of any sale.

The Utility Regulator will draft the appropriate wording needed in the licence and consult on these changes prior to implementation.
## 15 Appendices

### 15.1 Appendix 1: Additional Staffing Levels

<table>
<thead>
<tr>
<th>Dept</th>
<th>Positions requested</th>
<th>SONI Submission (32 staff)</th>
<th>UR consultation (15 staff)</th>
<th>UR decision (19(^{17}) staff)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real</td>
<td>Asst Grid Control Manager</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Real</td>
<td>Balancing services engineer</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Plan</td>
<td>Commercial lawyer</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>IT</td>
<td>Placement student</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Plan</td>
<td>Placement student</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>SCADA</td>
<td>Technician</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>EMS</td>
<td>EMS support engineer</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>EMS</td>
<td>EMS Dispatch training engineer</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Jt Pro</td>
<td>Project manager</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Jt Pro</td>
<td>Project engineer</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Real</td>
<td>Balancing services engineer</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Real</td>
<td>Balancing services engineer</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Real</td>
<td>Balancing services engineer</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Real</td>
<td>Balancing services engineer</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Near</td>
<td>Generation compliance engineer</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Near</td>
<td>Renewables engineer</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Near</td>
<td>Projects/ grid infrastructure</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Plan</td>
<td>Connections engineer</td>
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<td>Plan</td>
<td>Transmission engineer</td>
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<td>ENTSOE engineer</td>
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<tr>
<td>Plan</td>
<td>Policy/ code/ technical manager</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>IT</td>
<td>Service delivery manager</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>IT</td>
<td>Technical analyst</td>
<td>1</td>
<td>1</td>
<td>1</td>
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<tr>
<td>IT</td>
<td>Technical analyst</td>
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<td>0</td>
<td>1</td>
</tr>
<tr>
<td>IT</td>
<td>Oracle DB administrator</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

\(^{17}\) Note that overall, salaries for an additional 18 employees are approved for the price control period as of 1 October 2010. 1 Connections staff was allowed during the 6 month period from 1 March 2010 – 30 September 2010. See section 6.2 for further information.
<table>
<thead>
<tr>
<th>Department</th>
<th>Position</th>
<th>Code</th>
<th>Grade</th>
<th>Lost</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT</td>
<td>Data integrity analyst</td>
<td>1</td>
<td>0</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>IT</td>
<td>Sharepoint developer</td>
<td>1</td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Reg Comm</td>
<td>Sen. Commercial &amp; regulation analyst</td>
<td>1</td>
<td>0</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>HR</td>
<td>HR officer</td>
<td>1</td>
<td>0</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Fin</td>
<td>Finance officer</td>
<td>1</td>
<td>0</td>
<td></td>
<td>0</td>
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<td>Fin</td>
<td>Finance officer</td>
<td>1</td>
<td>0</td>
<td></td>
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<tr>
<td>Jt Pro</td>
<td>Joint projects engineer</td>
<td>1</td>
<td>0</td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>
15.2 Appendix 2: SONI Allowed Opex - breakdown of categories per year

<table>
<thead>
<tr>
<th>Category</th>
<th>Payroll/ HR allowance</th>
<th>Ongoing pension allowance</th>
<th>Pension deficit allowance</th>
<th>IT &amp; Comms allowance</th>
<th>&quot;Other Opex&quot; allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll/ HR allowance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SONI Submission</td>
<td>2.4</td>
<td>5.9</td>
<td>6.3</td>
<td>6.5</td>
<td>6.6</td>
</tr>
<tr>
<td>Utility Regulator Decision</td>
<td>2.1</td>
<td>4.7</td>
<td>5.1</td>
<td>5.1</td>
<td>5.1</td>
</tr>
<tr>
<td>&quot;Other Opex&quot; allowance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SONI Submission</td>
<td>0.6</td>
<td>1.6</td>
<td>1.7</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>------------------</td>
<td>----------</td>
<td>----------</td>
<td>----------</td>
<td>----------</td>
<td>----------</td>
</tr>
<tr>
<td><strong>SONI Submission</strong></td>
<td>4.1</td>
<td>10.3</td>
<td>10.7</td>
<td>11.0</td>
<td>11.2</td>
</tr>
<tr>
<td><strong>Utility Regulator Decision</strong></td>
<td>3.7</td>
<td>8.7</td>
<td>9.1</td>
<td>9.2</td>
<td>8.9</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SONI Submission</strong></td>
<td>4.2</td>
<td>10.3</td>
<td>10.8</td>
<td>11.0</td>
<td>11.2</td>
<td>11.4</td>
<td><strong>58.9</strong></td>
</tr>
<tr>
<td><strong>Utility Regulator Decision</strong></td>
<td>3.9</td>
<td>8.7</td>
<td>9.1</td>
<td>9.2</td>
<td>9.0</td>
<td>9.0</td>
<td><strong>48.9</strong></td>
</tr>
</tbody>
</table>
### 15.3 Appendix 3: Reconciliation of Utility Regulator Consultation Proposal and Decision for Payroll

<table>
<thead>
<tr>
<th>Summary of differences since Consultation was published</th>
<th>Increase since consultation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EXTRA STAFF/ PHASING OF START DATES</strong></td>
<td></td>
</tr>
<tr>
<td>5 Real Time staff allowed as of 1st April 2011 which increases salaries and associated costs.</td>
<td>1.13</td>
</tr>
<tr>
<td><strong>OVERTIME</strong></td>
<td></td>
</tr>
<tr>
<td>Overtime not allowed in consultation; Overtime allowed in decision (extra staff level taken into account) due to evidence provided by SONI</td>
<td>0.70</td>
</tr>
<tr>
<td><strong>ABILITY TO MOVE UP SALARY SCALE</strong></td>
<td></td>
</tr>
<tr>
<td>Adjustment allowed in decision to allow staff to move up the pay band at a faster rate (8 yrs instead of current 15 yrs). SONI requested acceleration in 5 yrs - not allowed.</td>
<td>0.40</td>
</tr>
<tr>
<td><strong>RECRUITMENT</strong></td>
<td></td>
</tr>
<tr>
<td>Increase in recruitment budget of £5K per head, in line with industry data and figures supplied by SONI.</td>
<td>0.04</td>
</tr>
<tr>
<td><strong>TRAVEL/ TRANSPORT</strong></td>
<td></td>
</tr>
<tr>
<td>Increase in ENTSOE travel.</td>
<td>0.09</td>
</tr>
<tr>
<td><strong>WELFARE</strong></td>
<td></td>
</tr>
<tr>
<td>This was not taken into account in the consultation paper (unidentified). Amount allowed for annual eye test.</td>
<td>0.01</td>
</tr>
<tr>
<td><strong>PAYROLL OUTSOURCING</strong></td>
<td></td>
</tr>
<tr>
<td>This was not taken into account in the consultation paper (unidentified).</td>
<td>0.03</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>£M</th>
</tr>
</thead>
<tbody>
<tr>
<td>UR consultation</td>
<td>24.90</td>
</tr>
<tr>
<td>UR decision</td>
<td>27.30</td>
</tr>
<tr>
<td>Difference</td>
<td>2.40</td>
</tr>
</tbody>
</table>