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Dear 

SONI ISEM Opex– Dt Approval

We received a Dt request from SONI, in July 2017, as part of the Northern Ireland 2015 to 2020 TSO Price Control,¹ to recover Opex revenue to deliver ISEM activities.

The Dt mechanism allows SONI to seek additional revenue up to a cap for particular projects or areas of work during the price control period, if and when SONI has sufficient certainty as to the revenue required.

This particular Dt has been requested to cover the ISEM TSO operational costs of delivering the new ISEM Capacity Revenue Market (CRM), balancing services and associated IT support and development. This request does not, therefore, include approval of Capex cost which is subject to a separate approval process.²

This letter sets out our decision to approve a Dt revenue allowance, along with our approach and reasoning. We set out the detail of our approval in the annex.

SONI submission and our approval³

SONI requested approval to spend up to £3.8m to deliver ISEM activity from pre I-SEM go-live (May 2018) to September 2020.

We will allow SONI to recover up to £3.1m in 2018 prices to deliver the additional activity over the period in question.

Our 17% reduction is attributed to the following:

¹ As required by Annex 1 Paragraph 8 of the SONI Transmission licence.

² See appendix 2: <https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-15-004%20Published%20AAD%209%20Jan%202015.pdf>

³ All prices in this approval are in forecast April 2018 prices unless otherwise stated.

- A lower average cost per Full Time Equivalent (FTE) per annum which is more appropriate than that requested by SONI.
- Small adjustments to the number of FTEs and to certain IT support and development costs where these have not been sufficiently justified.

Our approval strikes the right balance between ensuring consumers pay for what is necessary, and ensuring SONI is appropriately funded to carry out the additional ISEM activity over the period.

Further observations

SONI should also be able to make efficiency savings, on top of the above adjustments, during the period. Its submission indicates that operational processes are often new, reasonably repeatable, the ISEM design is specified and SONI has not factored in on-going efficiency assumptions during the period of its request. Savings could typically be expected, often in the earlier years of such activity.

We are, however, conscious of choosing a target which risks being unachievable for ISEM activity which is of high consumer interest. We have, therefore, not set an efficiency challenge on top of our adjustments, in this instance.

But we would expect lower allowances for the next price control based on more efficient costs revealed in the current period.

Next steps

Since SONI submitted this D_t , we have published our D_t guidance.⁴ We request that SONI takes account of those aspects of our final D_t guidance where appropriate. We also remind SONI of how this D_t fits with other mechanisms within the price control (see assumptions section in the annex, along with guidance).

In particular, under paragraph 9 of Annex 1 to its transmission licence, SONI must report on progress at least annually, using the template proposed by the UR following consultation with SONI. We also note that SONI is aware of policy relating to underspending of this D_t allowance, should such reason arise where this should become relevant.

Yours sincerely



Jenny Pyper
Chief Executive

⁴<https://www.uregni.gov.uk/sites/uregni/files/media-files/2018-03-09%20%20TNPP%20and%20Dt%20Guidance%20-%20Decision%20Paper.pdf>

Annex A – Detailed analysis of SONI’s submission

This D_t concerns operational costs associated with pre and post ISEM go-live⁵, to deliver the following new TSO related ISEM functions.

- **Capacity market services:** staff to deliver the new capacity remuneration mechanism (CRM). Competitive auctions under the CRM are a new activity as part of the new capacity market compared to the SEM.
- **Balancing market services:** staff to deliver scheduling and dispatch services. SONI has said that the dispatch and scheduling will require more data inputs in process, entail a greater level of complexity in more compressed timelines (continuous real time scheduling), with more competing priorities compared to the existing SEM.
- **IT support and development:** staff and support costs to manage and maintain a new IT system which supports the balancing and capacity market service.

Our approach

The level of analysis we have taken to scrutinise the costs is proportionate to the level of revenue sought by SONI. We have undertaken the following steps:

- Formal requests to SONI requiring supplementary information.
- Meetings with SONI staff, who will undertake the work, to understand their roles and allow them to justify resources in light of our initial recommendations.
- Discussions with wholesale market colleagues to understand justification for activities and consistency with SEMO price control February 2018 decision. We are satisfied the costs being requested are over and above those required under the SEMO price control.
- We have made a simple update to the existing information we used in the price control to benchmark SONI's proposed salary levels.
- We have gained our Board's approval for the level of allowance and reasoning.

Our overall observations and allowance

Our overall observations on the submission are as follows:

⁵ May 2018

- The link between ISEM regulatory requirements and many functions has been mostly clearly described.
- But it is difficult to comprehensively understand justification for FTE level for many items. We would expect better justification for how the complexity and newness of ISEM differs from SEM in certain instances.⁶
- The cost and resource profile is, generally, quite flat for the period and seems quite high for certain areas.⁷ SONI has not assumed any notable efficiency gains during the period itself (e.g. from experience/‘learning through doing’).⁸
- We would expect better proactive justification that certain costs are not duplicative. For example, with respect to double counting or relationship between opex and capex (not part of the D_t) under IT spend.

SONI’s request is set out below along with our allowance. SONI has requested £3.8m over the period. We consider that a capped approval of £3.1m is sufficient.

SONI Request					
	Pre Go Live	4M	12M	12M	
£	Up to May-18	TY 17/18	TY 18/19	TY 19/20	Total
Total headcount related Opex	270,865	342,217	970,212	951,526	2,534,820
IT Support and Maintenance costs	72,012	129,093	380,070	346,720	927,895
Professional Fees	-	46,870	140,611	140,611	328,093
Total OPEX [£ - April 2018 prices]	342,877	518,181	1,490,894	1,438,857	3,790,808

UR Allowance					
	Pre Go Live	4M	12M	12M	
£	Up to May-18	TY 17/18	TY 18/19	TY 19/20	Total
Total headcount related Opex	214,257	262,468	739,651	709,179	1,925,555
IT Support and Maintenance costs	71,201	123,709	357,946	339,153	892,009
Professional Fees	-	46,870	140,611	140,611	328,093
Total OPEX [£ - April 2018 prices]	285,458	433,048	1,238,208	1,188,943	3,145,657

The figures in the tables above are in forecast 2018 prices which will change as actuals materialise. For the avoidance of doubt, allowances are given below in April 2014 prices for consistency with the existing price control.

Request vs Allowance					
Total OPEX [£ - April 2014 prices]	Pre Go Live	4M	12M	12M	
£	Up to May-18	TY 17/18	TY 18/19	TY 19/20	Total
SONI Request [£ - April 2014 prices]	313,338	473,540	1,362,453	1,314,900	3,464,230
UR Allowance [£ - April 2014 prices]	260,866	395,741	1,131,536	1,086,516	2,874,659

⁶ At a minimum, we would expect some qualitative comprehensive comparative analysis of functions to justify differences between ISEM and SEM for certain functions along with complete comparison of FTE levels and grade structure for each comparative function. While many of the activities are new to SONI, we would expect better quantitative evidence/reporting linking activities to cost, particularly where there is actual experience to date (December 2017 T-1 capacity auction).

⁷ SONI has provided evidence of some existing SEM control centre roles being absorbed into requirement but not for other resource.

⁸ Though it has noted that pooling resources with the RoI TSO from the outset will introduce synergies from the outset.

Our reductions and rationale

We set out below the detailed reasoning for the difference in ours and SONI's views.

Average cost per FTE per annum

SONI has requested an average cost per FTE per annum of £94k. This relates to directly employed staff.

This is based on an average cost per FTE per annum of £86k (2014 prices) which has then been uplifted to 2018 prices.

We have instead decided that an average cost per FTE per annum of £69k in 2018 prices is sufficient. In doing so we have given weight to the following evidence:

- SONI's figure includes overhead costs (facilities, other opex and re-charge), yet these should be largely unaffected by employing new staff in this Dt.
- Our benchmarking from the TSO 2015 to 2020 Price Control Final Determination (FD) updated for latest information and 2018 prices.

Deducting SONI's overheads costs allows a cost per annum per FTE of £77k, which is what we allowed in our final determination adjusted for 2018 inflation.⁹

The updated 2017 ASHE benchmarking indicates that the average UK pay for these types of jobs would be around £68k and Northern Ireland pay around £58k (including employers NIC¹⁰ and pension contributions) adjusted for 2018 prices.

	UK ASHE	NI ASHE
Gross Annual Pay (Mean)	£48,776	£41,768
<i>Plus Employers NIC (13.8%)</i>	£6,731	£5,764
<i>Plus Employers Pension Contributions (20%)</i>	£9,755	£8,354
Total (2017 prices)	£65,262	£55,886
RPI adjustment	3.6%	3.6%
Total (2018 prices)	£67,611	£57,898

⁹ This includes an allocation of overheads set at time we decided the SONI price control (FD).

¹⁰ National Insurance Contributions.

Therefore, our allowance of £69k per FTE is positioned below the £77k per FTE but just above the £68k per FTE UK benchmarking data point.¹¹

We now explain in more detail how we get from SONI's proposed allowance of £94k per FTE to our allowance of £69k per FTE, whilst responding to SONI's considerations.

SONI believes there is no basis for removing the overheads costs from its £94k per FTE assumption. It also says that because full overheads were allowed in the February 2018 SEMO price control decision we must take a similar position in this D_t.

We strongly disagree. Retaining the overheads risks consumers paying twice for overhead costs (once when we set the price control and again under this D_t). As these costs are fixed in nature (e.g. rates, maintenance, insurance, bank facility etc.), it is clear that staff numbers could change (either up or down) and these cost lines would be unaffected. Their materiality is largely unrelated to staffing levels. The SEMO price control allowance considered the overheads were justified and so, essentially, assumes no double counting. So the D_t and SEMO positions are entirely consistent.

In summary, we do not have justification for the allowance being higher than £77k per FTE.

SONI has also claimed that we have not justified why the allowance is then lower than the £77k per FTE determined in the final determination, and gave reasons why it should be higher than £69k per FTE.¹² It believes that our decision departs from established precedent¹³, gives rise to inconsistency, and would render invalid decisions already made in the price control.

We have been consistent in use of the methodology and approach taken in the FD, whilst taking account of the particular circumstances of this D_t to ensure consumers are protected and SONI is appropriately funded.

¹¹ As in the FD, we have put less weight on the NI benchmark compared to UK, even though it would be legitimate to do so, as the latter is likely to be more statistically representative.

¹² It also said that the nature of the ISEM roles, in terms of seniority and skillset, means that the costs should be considerably higher, and additional payments are required for anti-social working (e.g. 24/7).

¹³ SONI particularly mentioned decisions made outside of the SONI 2015 to 2020 TSO price control such as the *Intra-day trading introduced mid 2011 – SEMO resources - Approved by SEMC (29-06-12)*, and *I-SEM Implementation Project - Internal Staff Costs*. We do not consider those decisions establish any useful or binding precedent that should be followed in this case.

Our starting point in this D_t , as in the FD, is the ASHE benchmarking data. In the FD, we considered that it was justifiable to set a higher allowance than the benchmarking in light of evidence regarding transfer of TUPE network planning staff.

The existing FD allowance was set generously to account for the transfer of expensive TUPE network planning staff costs. However, these TUPE network planning staff costs are not the subject of this D_t as SONI has not asked for more planning staff. This makes the allowance in the price control FD less appropriate in terms of its application to new staff in this D_t .

But, in a similar vein to the FD, we have also considered whether there are sound reasons which justify a deviation from the benchmarking data in this D_t .

It is possible to deviate (upwardly) from the UK benchmarked point for this D_t . But in order to deviate to the extent which SONI suggests, we would have to be confident that the increase in staff (8%) should command significantly higher average rates than those afforded to existing staff in similar type roles (e.g. capacity and balancing) in our FD.

We are not sufficiently confident that the deviation which SONI suggests would be in consumers' interest. In fact it would risk over-compensating SONI.

SONI's case is that a further allowance is warranted for anti-social working and the nature of the roles in ISEM (seniority and skillset). While our benchmark assumption already accounts for these factors,¹⁴ we have also considered whether there are bespoke reasons to suggest that the allowance should be significantly higher than the UK benchmark.

We have neither found nor been offered any such justifiable reason by SONI. It is improbable that such a large tranche (approx. 8% increase in staff numbers from the price control allowance of 98) of new staff would command the average rates of existing staff. In particular, we are unpersuaded that higher levels of management are required for the increase in capacity, balancing and IT staff numbers.

SONI has, therefore, not demonstrated, with evidence or plausible justification, why the benchmark is unreasonable. But we have uplifted the allowance slightly above the UK benchmark, as headroom, to ensure a reasonable allowance of £69k per FTE and the procurement of appropriately qualified staff.¹⁵

¹⁴ ASHE benchmarking would indicate that the £69k determined is ample in comparison to similar roles (i.e. engineers, IT specialists, managers) and is based on Gross pay (so would include overtime, for example).

¹⁵ Our allowance is also broadly in line with the recommended 80k euros average cost per annum per FTE assumption, in the February 2018 SEMO price control decision.

Number of FTEs

SONI requests an additional 8.5 (4M 17/18), 8.2 (12M 18/19), and 8.7 (12M 19/20) internal FTE's. We are proposing a reduction of 0.4 FTEs in total for each of these 3 periods. This is for the following reasons:

- Balancing market senior constraints modelling analyst: this resource can be carried out by capacity market modelling staff requested.
- Capacity market data registration and registration support service: this resource can be carried out by capacity operations staff requested.

IT support and maintenance costs

We have decided to reduce various IT application support items by 5% each for the following reasons:

- Many of the requirements are not adequately defined for an accurate estimate to be determined. SONI has not defined what these costs are for and have not provided evidence to justify the amounts.¹⁶
- In some cases the percentage of opex is very high on the capital project estimate.¹⁷

A reduction of 5% reflects more prudent estimates which are well provided for, as balanced against the importance of the ISEM project.

Our assumptions for approval

The bullets below explain how this D_t fits with the wider price control framework:

- Adjustment will be made in the K-factor for actual spend below the cap. This will include any amounts recovered, but not spent, by SONI due to a decision not to progress any of the projects.
- Unless subject to a projection variation approval, overspend of the cap allowance without approval will not be allowed in tariffs.
- 50:50 cost/benefit share does not apply to this D_t application.

¹⁶ For example, SONI are proposing to include £75k in market monitoring costs related to the support costs for the hardware to provide interface to European Monitoring Agencies. SONI has not fully defined what these costs are. Also other support costs detail days and rates were not provided. We have decided to reject a small proportion to allow for this.

¹⁷ Between 20-25% of the capital project for some line items, whereas other IT related projects are coming in at 10-15%.

- UR reserves the right to audit actual expenditure and review for DIWE in line with the relevant DIWE guidance document¹⁸ and the Dt requirements and guidance document¹⁹.
- SONI must report on progress at least annually, via the April Submission and the Three Month Statement, using the template proposed by the UR following consultation with SONI.
- In the event that Dt staff costs cannot be separately identified from costs allowed under the Bt term through reporting, we would subtract the annual amount allowed in relation to such costs under this Dt decision from the actuals provided in the reporting, in order to calculate the value of Ct.

¹⁸<https://www.uregni.gov.uk/publications/guidance-interpretation-and-application-demonstrably-inefficient-or-wasteful>

¹⁹ <https://www.uregni.gov.uk/publications/tnpp-and-dt-decision-paper-docs>