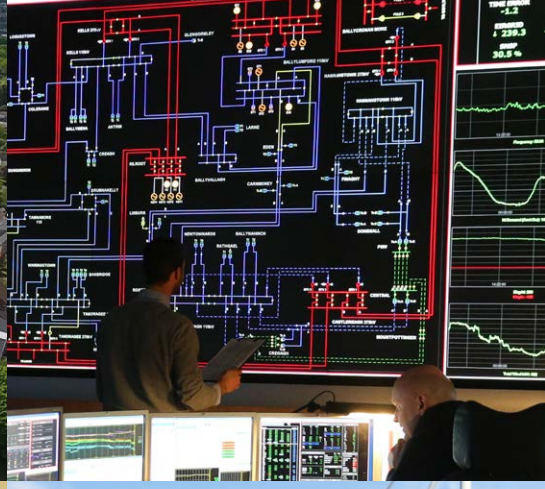
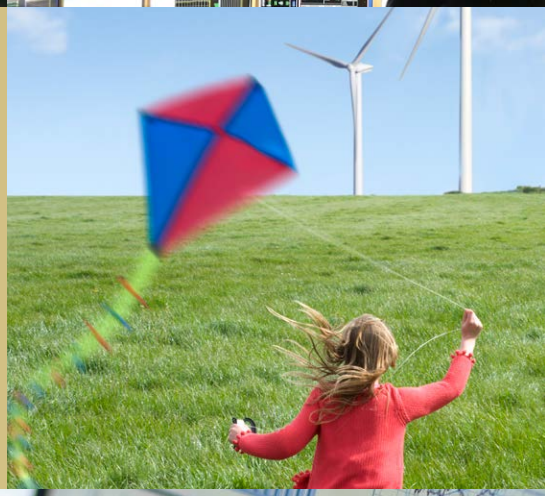


SONI Business Plan 2020-25

Executive Summary



SONI

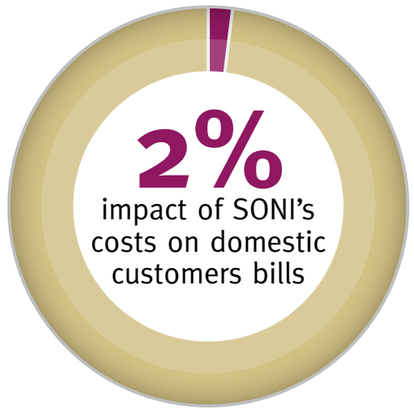
The current. The future.

1. Introduction

1.1. SONI (System Operator for Northern Ireland) plans and operates the electricity transmission system. We bring electricity to every part of Northern Ireland and plan ahead for future growth. From our control centre in Belfast, we match supply and demand for power every second of every day by using the transmission system.

1.2. This document sets out the SONI Business Plan submission to the Utility Regulator (UR), for the period from 1 October 2020 to 30 September 2025. The UR has consulted upon its approach to this price control and has set out clear test areas that it will use to evaluate our business plan. We have found this helpful and we have reflected these test areas in our submission.

1.3. While SONI's direct costs are currently less than 2% of the typical domestic electricity bill, our actions and decisions can positively influence a much larger portion of the costs that customers pay. Unlocking the value for customers in these areas is a key focus of our business plan.



£10.50

This is the impact of SONI's current costs on domestic customer bills per year.

£535

This is the average domestic electricity bill in Northern Ireland per year.

It's made up of a number of items. SONI's costs are approximately 2% of this.

1.4. SONI consults with industry and wider stakeholders as a core part of our service delivery. This business plan was further informed by valuable engagement with the Stakeholder Expert Challenge Group (SECG) established by the UR as part of this process. SONI has engaged with the SECG throughout this process and this has helped to shape the development of this submission.

1.5. Our Strategy 2020-25 is also underpinned by extensive consultation with external stakeholders. We have found these inputs valuable and have reflected them in this submission.

1.6. There has been a significant change in the energy system during the 2015 - 2020 Price Control period. SONI has successfully enabled 40% of the electricity demand being met by renewable sources. This was in parallel with the delivering of the Integrated Single Electricity Market (I-SEM).

1.7. These changes have resulted in SONI managing a significant increase in the volume and complexity of our day to day work, which was not envisaged during the time of the submission of the 2015 – 2020 Price Control plan. For example there has been a twofold increase in the number of generating units which SONI interacts with.

2. SONI's Key Achievements 2015-20

I-SEM
New market implemented whilst maintaining core activities. Three capacity auctions held to date, with the first held in December 2017.

DS3
World leading levels of System Non-Synchronous Penetration (SNSP) of 65% achieved. New System Services arrangements implemented.

Interconnector
Following a public enquiry a recommendation of planning permission for the North-South Interconnector was given. This will unlock significant savings in final electricity bills for customers.

Renewable Electricity
SONI has helped ensure that Northern Ireland has already met and exceeded the 2020 target of having 40% of its demand come from renewable sources. This target was set out in the Strategic Energy Framework.

New Records
At one point in 2018, 129% of electricity in Northern Ireland was powered by renewable sources. The excess electricity was exported to Scotland and to Ireland.

Wind
497 MW of wind has connected during the current Price Control period. This is an increase of 76%. These windfarms are tested by SONI and NIE Networks.

Solar
115 MW of solar PV has connected during the current Price Control period. These solar PV sites are tested by SONI and NIE Networks.

Demand Side Units
120 individual sites, totaling 96 MW are now registered as Demand Side Units. SONI, NIE Networks and the Industry have collaborated closely on this new technology.

Resilience
System Security was maintained to a very high level during the current Price Control period. This is in the context of increased climate change activity and increased levels of variable generation.

Cost Savings
SONI delivered £10m in Imperfection Cost savings for the end consumer. These savings last for several years into the future.

Stakeholder Engagement
A step change in the level of engagement expected by members of the public and our stakeholders changed the way SONI carries out our engagement.

Strategy
In 2019 SONI launched a new Strategy for the next 5 years. This was developed through extensive stakeholder engagement in Northern Ireland.

Increased Volume
The number of units which SONI interacts with has doubled during the first three years of the current Price Control. This increases the day to day volume of our workload.

Security of Supply
There were no events during the first three years of the current Price Control period where normal domestic customers were disconnected due to underfrequency events.

Outturn
The forecast outturn for the final year of the current Price Control is broadly in line with the challenging allowance set by UR. This is in the context of SONI delivering further volume and complexity of activities.

3. Financial Performance in the 2015-20 Period

3.1. The current regulatory framework incentivises SONI to operate within the allowances provided by UR for the Price Control period as it bears 50% of any costs incurred over and above this.

3.2. With the increased volume and complexity of the day to day work during the 2015 - 2020 Price Control period, SONI found it extremely challenging to operate within the allowances provided by UR. Ultimately the allowances proved inadequate and SONI bore 50% of any delta.

3.3. SONI has however continued to deliver efficiencies to the benefit of customers throughout the control period. These efficiencies have been difficult to achieve as SONI has a largely fixed cost base and SONI found itself the subject of industrial action at one point during the control.

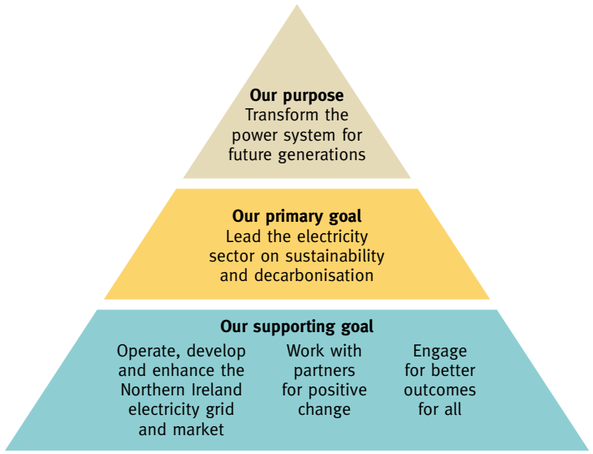
3.4. The savings delivered through these measures have however enabled SONI to forecast spend for the final year of the current control period (2019/20) broadly in line with the allowances proposed by UR.

3.5. Many of these efficiencies were delivered through realising further synergies with EirGrid. Both the transmission system and market are operated on an all island basis and with the changes in I-SEM are increasingly integrated. SONI bears only a proportion of the costs of delivery of all island initiatives, often as low as 20 - 25%. Northern Ireland customers therefore benefit from significant economies of scale and see significantly lower costs than if SONI had to carry out these functions standalone.

3.6. SONI has therefore established a firm base level of costs and is operating at the efficiency frontier. This provides a solid platform where consumers can be assured they are receiving value for money from SONI as we plan to deliver for the future.

4. Transform the Power System for Future Generations

4.1 In October 2019, we formally launched our strategy for 2020-25. The aims of the strategy are reflected in the core purpose, which is to "transform the power system for future generations."



4.2. The primary goal of the strategy is to 'lead the electricity sector on sustainability and decarbonisation'. This reflects our large sphere of influence in the energy sector. We work collaboratively with partners to realise the best outcomes for Northern Ireland consumers.

4.3. We are already working closely with the Department for the Economy to inform the development of the next Strategic Energy Framework which will determine the enhanced level of renewables that we will need to achieve on the system and by when. The United Kingdom (UK) has committed to deliver net zero carbon emissions by 2050. This requires the UK to deliver 75% of its electricity from renewable sources by 2030.

4.4. We are also working in partnership with NIE Networks to ensure that we optimise the current network assets and planning of future transmission and distribution networks.

4.5. We recognise the importance of taking a holistic, collaborative and partnership based approach to delivery. Our submission sets out an approach to further enhance our partnerships and engagements.

4.6. We have scoped and costed initiatives within this submission, that will be essential to ensure that we have a green energy system which is ready to facilitate the level of renewables required to meet the 2030 target, once this is decided as part of the energy strategy for Northern Ireland.

5. New Initiatives 2020 – 2025

5.1. In this submission we set out the initiatives that we need to progress for a green energy system which is ready for the energy transition. Initiatives which are also essential to enable Northern Ireland to contribute to the UK net zero target by 2050.

5.2. We also remain focused on our primary role to operate, develop and enhance the grid and market. This is essential if we are to ensure a safe, reliable and cost effective power system.

5.3. SONI understands the importance of keeping the impact on consumer bills to a minimum. We have therefore adopted a meticulous approach to challenging the new initiatives. This has involved extensive challenge at all levels of SONI to ensure the right initiatives have been brought forward at the lowest possible costs for our customers. Furthermore we have retained KPMG as independent advisors to assist in this challenge process.

5.4. SONI is part of the wider EirGrid Group and therefore benefits from economies of scale. SONI contributes to the overall cost of new initiatives in line with the EirGrid Group Cost Allocation policy. This results in Northern Ireland consumers paying less for outcomes and outputs than would otherwise be the case.

5.5. These initiatives are summarised in the table below, categorised under three strategic themes linking to our strategy for 2020-2025.

Sustainability and Decarbonisation

	Initiative	Description
F1	Renewables Strategy (DS3+)	This programme will ensure the system can operate with world leading levels of renewables and new technologies
F2	Control Centre Tools	These tools will ensure that the system can operate with world leading levels of renewables and new technologies
F3	Smarter Outage Management	To manage the increased complexity of managing transmission outages
F4	IP Communications	To facilitate the increased volume of communications with decentralised sites
F5	Data Science	Initial funding to help scope requirements to manage increased volumes of data
F6	System Panning	To manage the increased complexity associated with the new technologies and renewables
F7	Promoting Change	To build internal and stakeholder trust
F8	Clean Energy Package	Initial Funding to help scope requirements in this legislation

Operate, Develop and Enhance the Grid and Market

	Initiative	Description
G1	Disaster Recovery Site	Investment is needed in this area
G2	Control Centre Training	Due to new systems and tools we need to keep pace in our training environments
G3	Physical Security	We need to keep pace with threats in this area
G4	Cyber Security	We need to keep pace with threats in this area
G5	Network Codes	We need to manage increased obligations
G6	Capacity Market: Secondary Trading	To deliver on this functionality which was de-scoped for I-SEM go-live
G7	DSU Compliance with State Aid	This is required to ensure compliance with the European Commission state aid decision
G8	Capacity Market: Algorithm Change	This will help drive savings for customers
G9	Capacity Market: State Aid Cross Border	To facilitate cross border participation
G10	Governance, Risk Management & Compliance	To manage increased requirements in this area
G11	Metering System	To ensure this can manage increased volume into the future
G12	Project Delivery Support	Skilled operational staff are required to support IT project delivery
G13	Electricity Balancing Guideline	This refers to the resources required to apply the requirements of the EBGL to current balancing practices
G14	Multi - NEMO Arrangements in the SEM	This will see the introduction of designed NEMOs into SEM

Partnership and Engagement for Better Outcomes

	Initiative	Description
H1	Targeted Education & Engagement Campaign	To increase our stakeholder engagement to help SONI shape an energy transition to benefit consumers
H2	Customer Journey	To improve and streamline the connection process, from initial enquiry through to commissioning

6. Unlocking the Value for Customers

6.1. We were tasked by UR to propose a framework to incentivise the delivery of services and outcomes.

6.2. In many examples of regulatory incentive design, incentive packages have been an additional element to the overall regulatory framework. In these cases the main price control will assess the Business as Usual (BAU) state of the regulated company and then 'bolt on' incentive mechanisms to encourage certain behaviours.

6.3. The aim of the framework proposed by SONI in this business plan is to enhance the price control in an important way, to one where every decision made is about doing the right thing for customers. In doing so, and in applying a holistic package, it not only complements the revenue cap framework but also fully encapsulates and embraces it.

6.4. By creating a holistic program that intrinsically joins together all of the elements of value for customers and 'bolts in' this framework to the existing regulatory design, creating value for customers is no longer an optional extra but vital to the overall framework. SONI is ultimately held to account not only for the management of its costs, but also for delivery and ensuring that additional value is unlocked for customers.

DECARBONISATION
The decarbonisation of the electricity system is of great importance to customers and something SONI's activities can contribute towards.

GRID SECURITY
A secure and reliable electricity network that is fit for the future of the electricity systems needs is vital to customers and market participants and SONI should be incentivised to push and maintain the quality of the system to the highest standards.

COSTS
Ensuring customers get value for money and cost efficiency and benefit from a greener and more secure grid the costs should be looked at holistically.

PERFORMANCE
Whilst delivering on decarbonisation, grid security and cost, SONI will also need to meet the expectations of its stakeholders.

6.5. These benefit areas have been selected to make up the components of the benefit sharing framework. SONI's performance in these areas should be proportionate to, and driven by, the value to customers.

6.6. SONI outlines this proposed framework in detail in Chapter 11 of the business plan submission, where we propose a 15% benefit sharing factor. As part of the implementation of this new framework we are proposing that the calibration of the benefit areas and metrics is carried out in conjunction with the UR and a stakeholder group, which could be SECG.

6.7. To ensure that customer bills remain acceptable, SONI proposes a cap and collar around the Benefit Sharing Mechanism. Based on an assessment of SONI's financeability and its ability to influence final costs, we consider a range between -£1.5 million on the downside and £3.0 million on the upside per annum would deliver balance without placing excessive risk on either SONI or customers.

7. Remuneration of Capital and Risks

7.1. SONI has retained the existing regulatory framework for the remuneration of capital. This was the subject of significant discussion as part of the finalisation of the last price control. This is aligned with the UR's approach paper.

7.2. Overall, under the proposals in this submission SONI will see lower returns on capital employed in the forthcoming period than for the current one. This delivers further savings and value to customers.

The Weighted Average Cost of Capital (WACC) that SONI are proposing is 5.08%, CPIH indexed.

This is a reduction of 2% in nominal terms from the WACC in Price Control 2015 - 2020.

This reduction will help deliver cost savings to customers.

SONI are proposing an increase in the Collection Agent Revenue from 0.5% to 0.6%.

At the CMA it was agreed that SONI would face increased risk during the final years of Price Control 2015 - 2020 with the introduction of I-SEM.

This increased risk has materialised for SONI since the introduction of I-SEM.

SONI therefore propose this modest increase to account for this increased risk.

Comparing our total return on capital employed using the parameters set out by SONI in this submission, to those within the current price control, our required return on capital employed is 12.2%, or approximately £535,000 per annum lower.

This will reduce the impact on customer bills.

8. The Cost of these Proposals

8.1. The initiatives set out in this plan will be delivered for less than £3 per domestic electricity customer per annum. This is approximately 0.5% of an average domestic customer's annual electricity bill.

£2.76

This is the additional cost to the average domestic customer of the new initiative proposed by SONI for the 2020 - 2025 period.

0.5%

This is the percentage change of the average domestic customer of the new initiatives proposed by SONI for the 2020 - 2025 period.

8.2. However, even though SONI's costs are a relatively modest part of the overall electricity bill, we can influence a significant portion of the bill. For example, SONI has delivered in excess of £10 million in Imperfection Cost savings during the first three years of the current Price Control period. Furthermore the introduction of the new Capacity Market has delivered substantial savings of an estimated £50 million* per annum for Northern Ireland electricity consumers.

8.3. The initiatives set out in this plan, delivered through the benefit sharing framework, will see the delivery of further customer savings which are significantly greater than the costs of the plan itself.

* https://www.uregni.gov.uk/news-centre/utility-regulator-comments-isem-capacity-auction-outcome

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