EirGrid response to *SONI Price Control 2026-31: Approach Document Consultation*

27 March 2024

The Oval, 160 Shelbourne Road, Ballsbridge, Dublin D04 FW28
Telephone: +353 1 677 1700 | www.eirgrid.com

Introduction

EirGrid plc (“EirGrid”) is the ultimate parent company of SONI Ltd (“SONI”) and indirectly owns 100% of SONI’s share capital. As such, we believe it is important that UR take account of our views in its final approach to the SONI Price Control 2026-2031 (SONI Review of Prices 2026-2031 or SRP26-31).

We welcome the publication of the UR’s consultation on SRP26-31 which represents the first full price control where SONI will be operating under the recently adopted licence Condition 42. We would like to make the following points with regards to the proposed approach outlined in the UR consultation paper. The below paragraph references are those contained in the UR paper.

Parent Company Guarantee Framework

Paragraph 4.58 of the UR consultation states:

> *SONI are currently remunerated at a rate of 1.75% of their PCG. This was agreed by the CMA. No change to the mechanism is proposed for SRP26. However, we note this value has remained constant from when it was put in place and would welcome feedback as to whether £10m is the appropriate amount by way of a financial guarantee.*

In the first instance, we note that, in 2008, the EirGrid acquisition of SONI was considered by the SEM Committee (SEMC) to be a SEMC matter. As per paragraph 5 of SEM-08-176:

> *The SEM Committee has determined that the purchase of SONI and the exercise of certain regulatory functions in connection with the matter constitute SEM Matters for the purposes of the relevant legislation, i.e. that the exercise by the Utility Regulator and CER of their regulatory functions are matters which materially affect or are likely to materially effect the SEM.*

The requirement for the Parent Company Guarantee (PCG) was outlined, in principle, in paragraph 36 of SEM-08-176 and its purpose, framework, quantum etc is considered to be a SEMC matter. Therefore we believe that any proposed change to the PCG, as now consulted on by UR in its SRP26-31 paper, is a matter for the SEMC and not solely UR. It follows that any decisions on amending, removing, modifying the PCG should sit with the SEMC and not solely UR.

We would note that the requirement for a PCG was inserted into SONI’s TSO Licence in March 2009 after the acquisition of SONI Ltd by EirGrid Plc. We are not aware of any similar instrument being in place under SONI’s previous ownership structure with Viridian / Northern Ireland Electricity plc. As noted above, the maximum aggregate financial support detailed in the PCG is not to exceed £10m. The PCG was central in allowing SONI to fulfil its functions during the Price Control 2015-2020, until the 2017 CMA re-determination and updating of allowed revenues.

EirGrid Plc has previously made its position clear to the Regulatory Authorities (RAs) on the adoption of SONI Licence Condition 42. We believe that it requires fundamental changes to the governance of the EirGrid Group business and will have knock on impacts across its operations. One such impact is that the EirGrid Plc Board has effectively no control over SONI Ltd as a subsidiary. As per SONI Licence Condition 42 Part A:

> *no decisions relating to the business of the Licensee may be reserved to a vote of shareholders except those decisions in respect of which such a vote is required by or under the Companies Act 2006.*

Given this limited level of oversight we believe there is merit in examining whether the PCG, that EirGrid Plc provides to SONI, continues to be appropriate vehicle to guarantee SONI’s obligations and liabilities as

TSO and MO. This is particularly the case given, as discussed below, that UR has a statutory obligation to ensure SONI is financeable and can meet its licence obligations.

The UR consultation references Condition 3A of SONI's licence and the requirement on EirGrid Plc, as the parent company, to ensure that SONI has adequate financial and non-financial resources in order that it may perform its obligations. However, UR also has a legislative obligation to ensure that the licence holder (SONI Ltd.) can finance its activities as outlined below:

- Section 12(2) of the 2003 Energy (Northern Ireland) Order, alongside DETI, states that in carrying out its electricity functions, to do so (with)… *"having regard to the need to secure: (i) that all reasonable demands in NI or RoI for electricity are met; and (ii) that licence holders are able to finance the activities which are the subject of obligations under the regulatory framework"*.

- Under Article 9(2) of SEM Order (NI) 2007 – UR is required to have regard to "*the need to secure that authorised persons are able to finance the activities which are the subject of obligations imposed by or under Part II of the Electricity Order or the Energy Order or any corresponding provision of the law of Ireland*".

Given the re-structuring effects of Licence Condition 42, it is suggested that this "Financeability Duty" placed on UR, as confirmed by the CMA in its 2017 re-determination, should be re-examined for the upcoming SRP26-31.

Parent Company Guarantee Margin

Notwithstanding our view above as to whether the PCG remains appropriate, in the event that that the PCG continues to sit with EirGrid Plc we also believe it is important to examine the percentage level of PCG remuneration (currently 1.75%). This is especially the case given its adoption seven years ago and the level of change in financial markets since the 2017 CMA re-determination. If the logic of examining the £10m threshold is the length of time since its implementation in March 2009, similar logic should be applied to the remuneration level of 1.75%. The CMA indicated as much in its 2017 re-determination. Sections 12.70 and 12.74 of that paper state the following:

- *12.70 …we consider that valuing the PCG will require some judgment. Our analysis of the submissions to the appeal, particularly that provided by KPMG, demonstrates that there are a range of potential, and some uncertainty about the values that would result from those approaches. We have identified that there is a wide range of 1.7% - 3.1% per year for the value of the PCG.*

- *12.74 We note that it is currently expected that allowances for the PCG within the SEMO price control(s) will change, following the implementation of the I-SEM. It is therefore likely that the UR will need to revisit the combined value of the guarantee when setting the allowances for SEMO and/or SONI for the period of the price control following implementation of the I-SEM. We have not made any assumptions in our decision about any changes to the future level of the cost of the guarantee following the wind-down of the SEM and the introduction of the I-SEM.*

The CMA re-determination in section 12.5 also defines an approach for measuring the remuneration of the PCG:

- The provider of a PCG faces a comparable return profile to that of a lender to the firm: both the guarantor and a lender would have the expectation of a fixed positive return, but with a risk of significant downside.

- The principal difference between guarantor and lender is that the former does not provide funds upfront, and so would not expect to earn the time value of money on the sum it had committed to. In other words, the guarantor would not earn the risk-free rate of return on that sum.

- Therefore, the value of the PCG can be measured as premium over the time-value of money, i.e. the risk-free rate, of required return on comparable market securities.

Having considered a number of approaches brought forward by appellants, the CMA considered the margin to be expected to lie within the range between debt premium and preference shares premium, while the equity premium could, in principle, be seen as the upper bond of the range (CMA 2017 section 12.58). We believe it is important for the UR, as part of the SRP26-31 review, to examine (i) whether the current 1.75% margin is adequate and (ii) these three approaches to estimation of the PCG margin (preferences shares, cost of debt being the lower bound and cost of equity being the upper bound).

SONI Governance

We have, on several occasions, communicated to UR the implications of its August 2022 decision on SONI Governance and more specifically the Condition 42 SONI licence amendment. We do not intend, in this response, to repeat these arguments.

However, we note that Section 42 Part B states that "*on and from the Effective Date, and at all times after that date, the Licensee must ensure that all activities carried out by it in the course of the Transmission System Operator Business are carried out by means of Separate Management and Separate Resources*".

Part B goes on to state that *"Separate Resources means, in relation to activities carried out by the Licensee (SONI) in the course of the Transmission System Operator Business, that those activities are carried out using managerial and operational resources – including in particular premises, IT and other systems, equipment, facilities, processes and tangible and intellectual property – which are not shared with or accessible to any Associated Company (i.e. EirGrid)"*.

We note that the UR consultation states that "*SONI should be allowed the efficient cost of complying with obligations placed on it under statute or by its Licence…and it follows from this that the efficient costs of complying with Condition 42 will be funded*". EirGrid Plc is determining the exact cost of the impact of compliance with Condition 42 and SONI is similarly determining the cost impact of compliance on its business, noting the separate resources highlighted in Part B. Both TSOs will be making funding applications related to the efficient costs of licence condition 42 compliance as part of the revenue setting processes, namely SRP26-31 and the PR6 review (2026-2030).

Revenue Collection Margin

Paragraphs 4.53 and 4.54 of the UR consultation states:

> *4.53. At present, SONI are remunerated for collection agent risk ($CAIRt$) associated with TUoS, ancillary service and imperfection costs. This is based on 0.5% of those costs and was established by the CMA as SONI's remuneration for the liquidity risk associated with this activity.*
> *4.54 It is anticipated that the TUoS risk will be transferred to NIE Networks.*

In its 2017 Final Determination the Competition and Markets Authority (CMA) considered that SONI faced material risks associated with the collection agent functions. As per paragraph 7.330 of the decision:[1]

[1] Please see paper at the following link here.

SONI's revenues including its revenue collection and dispatch balancing functions are approximately five times its Price Control revenues. Given this scale, we do not accept that any other regulated company, nor any private company, would accept such very significant cash flow management risks without some form of remuneration for doing so.

These risks have a direct cost in respect of relevant financing facilities, but also increase SONI's financing costs as a whole. In recognition of this the SONI price control provides a specific remuneration in the form a Revenue Collection Margin (RCM). This is calculated as 0.5% of the sum of the Imperfection charges, TUoS charges and other system services.

The UR paper proposes to transfer one element of the RCM, TUoS, to NIE Networks and that a consultation on the matter will take place in 2024. It is worth noting that the three elements do not have the same levels of risk on the company and that the 0.5% RCM was a 'blended' rate. TUoS is considered the least risky revenue stream, given its steady form of recovery from customers. It follows that if the RCM element with the lowest risk is removed then UR must re-evaluate the 0.5% margin to reflect the new (riskier) profile. Future expected changes to System Services, under the Future Arrangements for System Services (FASS) workstream, and the impact this may have on future SONI revenue streams, should also considered as part of the margin review.

In addition, even with the proposed transfer of the TUoS element to NIE Networks, we expect that the principles of the CMA decision will continue to be applied to the calculation of the RCM for its remaining element. This means that the margin provided through SONI revenues adequately reflects the risks associated with the level of revenue collected by the company.

Finally, considering this proposal has not been adopted and may not be adopted by the start of SRP26-31, we expect that the SONI RCM will continue to be calculated in its current form, until regulatory changes are implemented.