

DECISION TO MODIFY SONI LIMITED'S TRANSMISSION LICENCE

**Amendments to the SONI Revenue Formula
Decision Paper
24 June 2026**

About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive and two Executive Directors lead teams in each of the main functional areas in the organisation: CEO Office; Price Controls; Networks and Energy Futures; and Markets and Consumer Protection. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Utility Regulator

OUR MISSION

To protect the short and long-term interests of consumers of electricity, gas and water.

OUR VISION

To ensure value and sustainability in energy and water.

OUR VALUES

ACCOUNTABLE:

We take ownership of our actions.

TRANSPARENT:

Ensuring trust through openness and honesty.

COLLABORATIVE:

Connecting and working with others for a shared purpose.

DILIGENT:

Working with care and rigour.

RESPECTFUL:

Treating everyone with dignity and fairness.

ABSTRACT

The SONI tariff process in 2025 highlighted a couple of revenue issues which merits consideration. This includes the ring-fencing of monies collected for a potential liability arising from Clean Energy Package (CEP) costs and treatment of the k-factor interest rate.

In April 2026 we consulted on licence modifications designed to address these concerns. We are now publishing our decision on licence modifications which will allow ring-fencing of CEP costs. We have also determined to adjust the k-factor interest rate application to two years.

AUDIENCE

This document is likely to be of interest to the licence holder affected, consumers and consumer groups, other regulated companies in the energy industry, government and other statutory bodies.

CONSUMER IMPACT

Changes to the k-factor are likely to be cost neutral and will be dependent upon the prevalence of over/under recoveries. Ring-fencing of CEP funds will be beneficial in avoiding large swings in tariffs from collecting and returning funds.

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| Annex A | Notice under Article 14(8)-(10) of the Electricity (NI) Order 1992 – Modifications to Annex 1 of the TSO Licence held by SONI. |
| Annex B | Modifications to Annex 1 of the TSO Licence (marked up version). |
| Annex C | Modifications to Annex 1 of the TSO Licence (clean version). |
| Annex D | Responses to the consultation. |

1. Introduction

Purpose of this document

- 1.1 Our principal objective in carrying out the duties associated with our electricity functions is to protect the interests of consumers of electricity supplied by authorised suppliers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity, as set out more fully in the Energy (Northern Ireland) Order 2003 (**the Energy Order**)¹.
- 1.2 The Utility Regulator (**UR**) must carry out its functions in the manner which it considers is best calculated to further the key objective, having regard to:
- a) the need to secure that all reasonable demands for electricity in Northern Ireland or Ireland are met; and,
 - b) the need to secure that licence holders can finance the activities which are the subject of obligations imposed by or under Part II of the Electricity (Northern Ireland) Order 1992² (**the Electricity Order**) or the Energy Order.
- 1.3 UR must also carry out its functions consistently with several other duties set out in full at Article 12 of the Energy Order.
- 1.4 In line with these duties, this document sets out our decision to modify the Transmission System Operator (**TSO**) licence held by SONI Limited (System Operator for Northern Ireland).
- 1.5 The licence changes set out in this decision paper will amend the SONI revenue formula in two key aspects:
- 1) Inclusion of an additional term for CEP costs which can be ringfenced based on the amount of money collected/directed.
 - 2) Amendment of the application of the k-factor interest rate from one to two years.
- 1.6 Need for the licence changes became apparent during the latest SONI tariff process for TY2025-26.³

¹ <https://www.legislation.gov.uk/nisi/2003/419/contents>

² <https://www.legislation.gov.uk/nisi/1992/231/contents>

³ TY2025-26 refers to the tariff year which in this case runs from 01 October 2025 to 30 September 2026.

Background for licence modifications

- 1.7 SONI is the independent electricity TSO for Northern Ireland. It operates under a licence first granted by the Department of Enterprise, Trade and Investment (now the Department for the Economy) in July 2007. The current consolidated version of the licence is published on UR's website.
- 1.8 In addition to licence conditions which set out SONI's rights and obligations to operate as the electricity TSO, the licence sets out the method for calculating the Maximum Core Revenue which SONI can recover from electricity suppliers and generators to fund its operations (Licence Annex 1 - Charge Restrictions).
- 1.9 Annex 1 to the SONI licence is modified from time to time through a price control process or as issues arise. During the 2025 tariff process two revenue formula issues arose which prompted the need for licence changes. This included the requirement for ringfencing CEP costs and application of a two-year interest rate to the k-factor adjustment.

CEP costs

- 1.10 Article 13(7) of Regulation 2019/943⁴, part of the Clean Energy Package (CEP), requires that System Operators compensate renewable generators with firm access in the event of non-market based redispatch. This compensation is related to net revenues from the sale of electricity on the day-ahead market including associated financial support.
- 1.11 In March 2022, the Single Electricity Market Committee (SEMC) published a decision paper (SEM-22-009)⁵ in relation to implementation of this aspect of the Regulation. This decision was challenged in the Irish Courts by generators on several areas including on the basis that it did not fully implement Article 13(7) as it proposed to defer payments and phase out curtailment compensation.
- 1.12 The decision was subsequently quashed by the Irish courts on 10 November 2023. Commission for the Regulation of Utilities (CRU) [on behalf of the SEM Committee] has been granted the right to appeal the matter and the Irish Supreme Court has referred this on to the European courts.
- 1.13 Since the Irish court decision, the SEM TSOs have considered it prudent to collect monies in tariffs to cover the potential compensation liability (which could be applicable from January 2020). No payments can however be made until the appeal is determined and any subsequent implementation processes followed. This implementation process will include consideration of two aspects

⁴ <https://eur-lex.europa.eu/eli/reg/2019/943/oj/eng>

⁵ <https://www.semcommittee.com/files/semcommittee/media-files/SEM-22-009%20Decision%20Paper%20on%20Dispatch%2C%20Redispatch%20and%20Compensation%20Pursuant%20to%20Regulation%20EU%202019943.pdf>

of the potential compensation for loss of net-revenue in the day-ahead market caused by non-market dispatch down of relevant generation:

- a) Loss of net revenue directly associated with SEM market outcomes, which is being managed on an all-island basis via the Imperfections Tariff; and
- b) Any relevant loss of financial support by renewable generation located in Northern Ireland, which is subject to the ongoing interpretation of Article 13(7) and which SONI would be liable for.

- 1.14 Within SONI's tariff revenue for TY2024-25⁶ a provision of £56.3m was made under the At (the pass-through amount) licence term to ensure that SONI would remain financeable should loss of net revenue related to the Northern Ireland's renewables support scheme (ROCs)⁷ turn out to be within the scope of Article 13(7).
- 1.15 As part of the TY2025-26 process, SONI requested a much larger provision to cover the full risk that its potential CEP liability could reach if ROCs were deemed to be within the scope of compensation under Article 13(7) (£123.5m). This included re-collection of the original provision.
- 1.16 The requirement for re-collection was because this licence term operates as a pass-through i.e. SONI revenue is aligned with actual spend. Where money has been forecasted and collected but no spend incurs, the excess is returned to consumers plus interest via the k-factor.
- 1.17 By way of example, the CEP issue has not been resolved in TY2024-25 and as such, the TSO has incurred no cost. Assuming the £56.3m was collected in full, this value (plus interest) would become a k-factor liability which has to be returned to consumers in TY2026-27.
- 1.18 Such an approach is problematic for a couple of reasons. In the first place, it means the collecting and returning of substantial sums of consumer monies leading to tariff fluctuations. It would also mean the requirement for double recovery of the previous forecast amount.
- 1.19 Most importantly, it could mean SONI may not have sufficient revenues in place should the full scale of the potential liability become actualised. For instance, whilst the money is collected over the entire year, it is possible that the outcome of the process that leads to resolution of the NI specific aspects of the issue may require the liability to be settled early in the tariff year. This could result in financing difficulties for SONI if the funds are not readily available.

⁶ TY2024-25 refers to the tariff year which in this case runs from 01 October 2024 to 30 September 2025.

⁷ ROCs = Renewable Obligation Certificates. This scheme operates via bilateral contracts outside of the wholesale market and is not linked to day-ahead market participation.

- 1.20 On the 09 April 2025 SONI wrote to the UR requesting interim licence modifications. These were designed to ringfence CEP funds and allow them to be retained in a separate bank account until such times as the European and Irish Courts have opined on this matter and any relevant processes related to jurisdictional issues have been resolved.
- 1.21 The request included a new licence term (CEPt) to be included as part of the pass-through At term. This would be ringfenced funds based on a direction issued by the UR. SONI foresaw this direction including the following detail:
- 1) SONI will establish a dedicated bank account.
 - 2) Interest on the funds held in the account will be used to address any fees associated with the account and CEP liabilities.
 - 3) SONI is prohibited from removing any funds from this account unless directed by UR, except to pay bank charges related to the account.
 - 4) If the courts and Regulatory Authorities decide that payments are due to be paid by SONI, the funds would be only used to pay settlements under Article 13 of 2019/943.
 - 5) If the outcome of the legal and associated processes is that payments are not due, the funds would be returned to customers based on a methodology directed by UR.
 - 6) The direction can be superseded in the event that this is necessary to implement a decision by the courts or the SEM Committee.
 - 7) That the direction expires, and the account may be closed, once the funds in the account have been processed in line with the methodology or methodologies eventually directed by the UR.
- 1.22 SONI also proposed that an annual direction would be required for adding revenue to the fund. This annual direction would state as a minimum:
- 1) The contribution that will be made by customers in p/kWh towards this fund in the relevant tariff year.
 - 2) That SONI will provide an estimate of the amount for the subsequent year before the end of June, along with supporting calculations.
 - 3) That the direction expires at the end of the relevant year.
 - 4) That SONI will provide information about the funds retained in the account as part of its annual submissions to the UR (e.g. regulatory accounts, RIGS or 3-month statement).

K-factor interest rate

1.23 The k-factor is a revenue correction term which for SONI applies on a two-year lag. SONI will forecast revenue in a particular tariff year and collect money based on this forecast. However, the amount collected may not reflect actual revenue required. This can be for several reasons including:

- Demand may be higher/lower than anticipated.
- Pass through spend on ancillary services may be higher/lower than forecast.
- SONI may receive a retrospective reward/penalty from the evaluative performance mechanism or cost-sharing framework.
- SONI may seek funding/allowances for projects not foreseen when undertaking tariff estimates.

1.24 When all these factors are known and established, including the amount collected, the k-factor is used to correct the differential. This is done on a two-year lag i.e. when forecasting revenue for TY2025-26, this included a k-factor correction for TY2023-24 revenue. The licence formula is as follows:

$$K_t = (F_{t-2} - R_{t-2})(1 + I_t)$$

1.25 In this case:

- a) F_{t-2} is SONI's revenue entitlement.
- b) R_{t-2} is the actual revenue collected.
- c) $(1 + I_t)$ is the applicable interest rate for the tariff year in question.

1.26 The applicable interest rate is calculated using the Bank of England Base Rate (BoEBR). If the k-factor value is positive, it means SONI has under collected, and revenue has to be added to future tariffs. If the value is negative SONI has over collected, and funds must be returned to consumers.

1.27 In the event of under recovery the applicable interest rate is BoEBR plus 2%. For over recovery it is BoEBR plus 1%. However, the tariff process has exposed the fact that the interest rate is only applicable for a single year. In contrast, the over/under recovery has to be carried for a period of two years.

1.28 SONI has stated that the interest rate application should extend to two years as the k-factor (either over or under) is carried for two years. This seems like an oversight in the existing licence which needs to be corrected.

1.29 The licence changes set out in this decision paper and itemised in Table 1.1 and Table 1.2 below, are required to:

- a) Make separate provision for CEP costs on an interim basis.
- b) Allow ringfencing of CEP spend to address the liability should it be realised and avoid having to collect and refund consumers.
- c) Provide details of what is included in CEP directions.
- d) Allow interest to be applied to over/under recoveries for the appropriate period of time.

1.30 The licence changes are summarised below.

Table 1.1: Overview of CEP licence modifications

| Type of Licence Modification | Reference |
|--|--------------------------------------|
| Modifications for CEP costs | |
| Definition amended for <i>SSS/TUoS Charges</i> to include Clean Energy Package (CEP) costs | Annex 1, Paragraph 1.1 (definitions) |
| Addition of a new term (CEPt) to <i>SSS/TUoS Charges</i> restriction formula | Annex 1, Paragraph 2.1(c) |
| Explanation that the CEPt amount is a positive or negative value set for each year by way of a direction | Annex 1, Paragraph 2.1(c) |
| Exclusion of CEP costs from actual opex (AOt) for cost-sharing calculations | Annex 1, Paragraph 2.2(d)(ii)(A)(6) |
| Exclusion of CEP costs from actual regulated revenue (Rt-2) so that the amount is not subject to k-factor considerations | Annex 1, Paragraph 2.2(i)(ii)(C) |
| Details on the ringfenced CEP fund and use of directions to add subtract funds | Annex 1, Paragraph 9 |

Table 1.2: Overview of k-factor licence modifications

| Type of Licence Modification | Reference |
|--|---|
| Modifications for k-factor interest rate | |
| Amendment of the k-factor definition to include two years interest rate | Annex 1, Paragraph 2.2(i) |
| Amendment of the interest rate definition for over and under recovery so that it applies for two years | Annex 1, Paragraph 2.2(i)(iii)(A) & (B) |

1.31 The closing date for responses to the licence consultation was 15 May 2026. In preparing this decision paper we have carefully considered the two responses received from SONI and the Consumer Council (CCNI). We have also considered whether any amendment to the proposals made in our consultation paper was merited.

1.32 Having reflected on the responses to the consultation, UR considers that the licence modifications now set out in this document are those which are best

calculated to comply with our statutory duties. Those modifications are substantially the same as those on which we consulted.

- 1.33 When making these licence modifications, UR must, under Article 14(8) – (10) of the Electricity Order:
- a) Publish the decision and the modifications in such manner as it considers appropriate for the purpose of bringing them to the attention of persons likely to be affected by the making of the modifications.
 - b) State the effect of the modifications.
 - c) State how it has taken account of any representations duly made to the consultation.
 - d) State the reason for any differences between the modifications and those set out in the original consultation notice.
- 1.34 Decisions under Article 14(8) – (10) of the Electricity Order are being issued in respect of the modifications to the TSO licence. These are included in this document as Annex A (notice), Annex B (licence changes - markup) and Annex C (licence changes – final) respectively.

Document structure

- 1.35 This paper is structured in a number of chapters as follows:
- Chapter 1 Introduction provides an overview of the purpose and structure of this consultation document and provides an overview of the licence modifications.
 - Chapter 2 Modifications to Ringfence CEP Funds sets out the changes to the licence necessary to implement interim ringfencing of Clean Energy Package compensation costs including reasons and effects, our consideration of the consultation responses and our final decision.
 - Chapter 3 Modifications to K-Factor sets out the changes necessary to implement a two-year application of the k-factor interest rate including reasons and effects, our consideration of the consultation responses and our final decision.
 - Chapter 4 Next Steps sets out process and timelines for the remainder of the licence modification process.
- 1.36 This decision document is complemented by the following annexes:
- a) Annex A – Setting out the statutory decision under Article 14(8) – (10) of the Electricity Order for UR to modify the TSO licence.

- b) Annex B – Showing the modified licence in tracked changes to clearly show the changes to Annex 1 of the SONI licence.
- c) Annex C – Showing a ‘tracked changes accepted’ final version of the changes to Annex 1 of the licence.
- d) Annex D – Publishing the responses received to the licence modification consultation by SONI and the Consumer Council (CCNI).

2. Changes to Ringfence CEP Funds

Proposals overview for CEP fund

- 2.1 Article 13(7) of Regulation 2019/943, part of the Clean Energy Package (CEP), requires that renewable generators with firm access be paid compensation for their net loss of revenue in the day-ahead market including any associated financial support in the event of non-market based redispatch.
- 2.2 On the 09 April 2025 SONI wrote to the UR requesting interim licence modifications to ringfence CEP funding and allow it to be retained in a separate bank account until such times as legal matters have been settled and the subsequent decisions made by the Regulatory Authorities. This would avoid collecting and handing back funds in the interim period whilst the matter is resolved. It would also avoid potential financeability issues.
- 2.3 The request included a new licence term (CEPt) to be included as part of the pass-through amount. The overall purpose of these modifications was to ensure that SONI has access to the requisite funds should the liability be realised.
- 2.4 While agreeing with the overall aims of the interim modifications and (to some extent) the mechanism for their delivery, we consulted on a different set of licence modifications to those initially suggested by SONI.
- 2.5 It should however be noted that we agreed with SONI that these should only be viewed as interim modifications. If the outcome of the litigation is that there is an ongoing duty to pay compensation, then a more permanent solution will need to be found to the collection of those revenues going forward.
- 2.6 In the first instance we did not see recovery of the fund as being equivalent to a pass-through item, and therefore suitable for inclusion in the At term. The CEP fund is not typical cost recovery, since at present it is unclear whether there will be a cost or what the amount of it might be. Consequently, recovery of the fund has little in common with any other item currently included in the At term.
- 2.7 Our consultation paper proposed recovery of the fund as a discrete item outside of core revenue. The impact of doing so still has the effect that SONI seeks, which is to take the sums outside the scope of the Kt term, so that they do not need to be automatically returned to customers if unspent. It does however create a specific CEP revenue stream and creates some other issues which will have to be considered.
- 2.8 SONI had also suggested that, if we needed to develop the provisions in a less minimalist way, we might make use of the currently unused paragraph 9 of Annex 1. We considered this to be a sensible approach and consulted on using

this paragraph to specify at a high level what falls within the scope of the direction-issuing power.

- 2.9 Each modification, alongside the reasons/effects are set out in detail below.

Definition amended for SSS/TUoS Charges

- 2.10 We proposed to amend the definition of the term 'SSS/TUoS Charges' in paragraph 1.1 of Annex 1 of the licence definitions section.

- 2.11 We proposed to add the following text (in red) by way of a definition:

'means the charges for System Support Services, Clean Energy Package costs and for use of the All-Island Transmission Networks as provided for under Condition 30.'

- 2.12 The proposed definition makes it clear that CEP costs are a part of SSS/TUoS charges. This is considered important as they do not form part of the Maximum Core Revenue.

Inclusion of a new term in SSS/TUoS Charges restriction formula

- 2.13 We proposed to include a new CEPT term as part of maximum regulated revenue for SSS/TUoS charges. This change modifies Annex 1 paragraph 2.1 with the following definition of the new term:

'CEPT has, in respect of each Relevant Year t, a value (which may be positive or negative) that is specified, or calculated in accordance with the method set out, in a direction issued by the Authority in accordance with paragraph 9.1 of this Annex; and where, in respect of any Relevant Year t, there is no such direction which makes provision for that value, then the value for that Relevant Year shall be deemed to be zero.'

- 2.14 This will facilitate creation of a distinct CEP fund. It will also provide for both addition and subtraction from the CEP fund by way of a direction from the UR.

Exclusion of CEP from cost-sharing and k-factor deliberations

- 2.15 We proposed to exclude CEP from the long list of exclusions for actual opex (AOt), see Annex 1, Paragraph 2.2(d)(ii)(A)(6). This followed a similar exclusion for CAIRt and ensures that these costs are not considered in cost sharing arrangements.

- 2.16 We further proposed to exclude CEP from actual regulated revenue (Rt-2), see Annex 1, Paragraph 2.2(i)(ii)(C) This followed a similar exclusion for CAIRt and ensures that these costs are not considered in k-factor deliberations.

Proposals for the scope of directions

- 2.17 In Annex 1, Paragraph 9.1 we set out the scope of directions associated with the CEP fund. The purpose for which directions may be issued is to make appropriate provision on an interim basis for the collection, retention and use of monies in respect of Article 13 CEP costs until such time as the position has been definitively established in law.
- 2.18 In other words, these powers exist and may be used only on an interim basis to establish an interim risk-management solution. If an obligation to make compensation crystallises in law in due course, then a different and enduring solution would be found for it. This section includes provision for:
- 1) Establishment of a fund to pay compensation associated with the ROCs scheme should it be determined that it falls within the scope of the net loss of revenues from the day-ahead market, as defined in Article 13(7).
 - 2) Imposing requirements as to the nature of the fund.
 - 3) Methodology for adding to and dispersing funds.
 - 4) Treatment of interest from use of the fund.
 - 5) Any other consequential or incidental provisions.
- 2.19 Paragraphs 9.2 to 9.7 provides detail on the making or revoking of directions in relation to the CEP fund. It also specifies that the licensee must comply with the provisions of the directions. This allows for some flexibility in that whilst a structure is in place, key issues are best dealt with not on the face of the licence but in directions to be issued in due course.

Reasons for CEP changes

- 2.20 As set out in the consultation, we considered that it was necessary to create a separate fund on an interim basis for the collection of CEP revenue in the event that generator compensation may be required.
- 2.21 Creation of a separate fund has various benefits. For instance:
- 1) It avoids large scale collection and return of funds via k-factor adjustments and the material fluctuation in tariffs that this causes.
 - 2) It ensures a fund is readily available should the relevant authorities make a decision and payments can be made quickly to generators.
 - 3) It avoids any financeability concerns for SONI around the timing mismatch between payments and revenue collection.

- 2.22 The licence changes will establish a legal framework for the use of directions to control the fund. This provides the necessary flexibility to make changes as and when decisions are implemented.
- 2.23 The powers of direction under Paragraph 9.1 set out at a high-level what areas a CEP direction might take. This includes how money would be added to or dispersed from the fund, timings of payments, treatment of interest etc.
- 2.24 Following concerns raised by SONI, for the consultation paper we made drafting amendments to ensure SONI does not have to disperse funds greater than it has available. We also included drafting in Paragraph 9.1 that the directions will be made consistent with good regulatory practice, on an interim basis for the collection, retention and use of monies in respect of the CEP fund.
- 2.25 In the event of this compensation payment becoming an enduring liability, we acknowledge that changes would be required to bring the costs into core revenue and possibly subject to a collection agent margin.

Effects of CEP changes

- 2.26 The effect of the licence modifications is to establish a separate CEP fund to collect and hold revenue for the purpose of potential generator compensation. This fund will ensure that such revenues are excluded from typical k-factor treatment.
- 2.27 Exclusion from core revenue, does however present some issues. Whilst the k-factor will typically address differences between revenue entitlements and actual revenue collected, this correction process will not be available for the CEP fund.
- 2.28 Consequently, UR needs to be aware of this and make suitable provision to address issues by way of future directions. For instance, if the liability does not arise, UR would need to ensure that returning money via a p/kWh reduction in the tariff did not mean SONI returning more money than it has collected in the CEP fund.
- 2.29 The changes will also implement a legal basis for directions which can be used to manage the fund. This includes the following:
- Para 9.1(a) – establishing a separate fund solely for the purpose of potential CEP liabilities.
 - Para 9.1(b) – ring-fencing of the account.
 - Para 9.1(c) – methodology for adding funds to the account (including on a retrospective basis).
 - Para 9.1(d) – timing of payments into the fund.

- Para 9.1(e) – treatment of interest accrued by the fund.
- Para 9.1(f) – authorising release of funds from the fund.
- Para 9.1(g) – use of the funds which are released.
- Para 9.1(h) – methodology for dispersing funds from the account (including interest).
- Para 9.1(i) – any other provisions which may be required from time to time.

2.30 Paragraphs 9.2 to 9.7 provide detail on the making or revoking of directions in relation to the CEP fund. The effect of this is to provide flexibility to address issues as they arise. Whilst no licence modification was included, we signalled an expectation that we would maintain a consolidated list of directions to ensure that the latest position is reflected and there is no confusion around which direction applies.

2.31 The licence modifications also avoid the need for an explicit sunset clause. If there is no direction specifying a sum of money that is to be recovered via the CEPt term, the value of that term is zero by default. We can therefore bring the effective operation of these provisions to an end through a cessation of use of direction-issuing powers. Closure of the account can also be addressed through this approach.

2.32 Within the consultation we made it clear that the CEP modifications are temporary in nature. Should the liability not arise, the term will likely be removed from the licence or use of directions will cease.

2.33 If the liability becomes an enduring requirement, changes will need to be implemented to include the term in core revenue and possibly consider inclusion in revenue collection remuneration activity.

Consultation responses

2.34 Two responses were received to the consultation. These came from CCNI and SONI respectively. Whilst both indicated general contentment, and no consultee raised a direct objection to the proposal, they did make a variety of points on the CEP fund which merit consideration.

2.35 These are set out in the table below alongside our views.

Table 2.1: Consultation feedback issues and UR response

| | Consultation Response | UR Views |
|---|--|---|
| 1 | <p>The current approach - where consumers pay SONI's estimation of the costs required to cover the compensation in one year and are refunded the funds two years later at the same time as paying SONI's updated cost estimate - is inefficient and adds unnecessary complexity to tariff calculations.</p> <p>[CCNI Response]</p> | <p>We agree and consider that our decision to implement the CEP fund will avoid such complexity.</p> |
| 2 | <p>We accept that the ring-fencing proposal allows SONI to build up the funds over time, if the European Court decision is not made within the current tariff year. This would spread the burden on consumers, who otherwise would be required to bear the full sum liable in a single tariff year, if the ruling is that generators are due compensation.</p> <p>[CCNI Response]</p> | <p>This is a key point and one which supports the need for the CEP fund. Given that the potential compensation claim dates back to 2020, covering the liability in a single year could create a material spike in tariffs.</p> |
| 3 | <p>We support the proposal for SONI to estimate and justify the level of funds it wishes to collect in advance of each tariff year, and to seek approval and direction from the UR. This will help provide confidence in, and explanations for, the tariff levels.</p> <p>[CCNI Response]</p> | <p>As part of initial CEP tariff collections, SONI provided analysis to justify the funds being sought. We expect this process to continue.</p> |
| 4 | <p>We recognise the need for SONI to remain financeable, if the decision is liable to compensate generators and that the ring-fenced account reduces the risk that it has to raise a significant sum of money in a short period of time.</p> <p>[CCNI Response]</p> | <p>Agreed.</p> |
| 5 | <p>We support the proposal that the UR will direct SONI as to how any sum is to be returned to consumers if the European Court rules that SONI does not need to provide compensation, or if its estimates are overly cautious.</p> <p>[CCNI Response]</p> | <p>The ability to return funds to consumers should the liability not materialise is a key component of the modifications. This will be done by way of direction and is expected to include both funds collected and interest accrued from the fund.</p> |

| | Consultation Response | UR Views |
|---|--|---|
| 6 | <p>We support the proposal to revisit SONI's licence requirement once the European Court has made its ruling.....If the decision is upheld that generators should be compensated on an ongoing basis, we would expect SONI to revisit its operational processes to ensure that costs passed through to consumers are efficiently incurred.</p> <p>[CCNI Response]</p> | <p>It is accepted that these are interim licence modifications. The revenue formula will have to be revisited depending on the outcome of the court deliberations.</p> |
| 7 | <p>SONI welcomes the explicit interim framing of the CEP modifications and supports the commitment to update the annex to our licence if an enduring liability arises. We ask that this commitment is repeated in the decision paper. We would also welcome confirmation that any future enduring modifications and their full implications will include a thorough risk and financeability assessment.</p> <p>[SONI Response]</p> | <p>Enduring modifications will be dependent on the outcome of the legal process. However, in the event of the liability becoming permanent, we would expect to review any changes to SONI's risk profile and financeability.</p> |
| 8 | <p>We remain concerned about the risk of unrecoverable shortfalls that could occur either during the initial settlement of any liabilities (should they arise) or due to the method by which funds are returned to customers. We therefore ask for confirmation within your decision paper that directions will not require SONI to return or pay more than has been collected, and request clarification on the safeguards against cash-flow mismatches and under-recovery.</p> <p>[SONI Response]</p> | <p>Release of monies from the fund can only be done by direction from the UR under paragraph 9.1 (f) or (h), depending on whether it is being used to pay generators or returning funds to consumers.</p> <p>Paragraph 9.1 (h) makes it clear that return of monies should not be greater than the amounts that have been added to the fund. In practical terms this may mean agreeing repayment schedules with generators or returning funds to consumers in stages or using the fund to address k-factor differences.</p> |
| 9 | <p>We also ask that consideration be given to moving this potential liability within the k-factor as part of any enduring modifications, should legal processes result in the potential liability crystallising.</p> <p>[SONI Response]</p> | <p>This point is accepted. The CEPt term will likely become part of SONI's core revenue if the liability becomes an ongoing obligation.</p> |

| | Consultation Response | UR Views |
|----|--|---|
| 10 | We appreciate the inclusion of a formal commitment to follow “ <i>good regulatory practice</i> ” when drafting directions and welcome the offer of a comfort letter.....The inclusion of further reassurance within the decision paper would be appreciated. [SONI Response] | The provision of a comfort letter regarding the use of directions can still be provided. It is also possible that a draft of the direction would be shared prior to issue to get TSO views before implementation. |
| 11 | We welcome the UR's commitment to maintaining and updating a consolidated register of directions, which would ideally be published. [SONI Response] | Given the implications for tariffs from these directions, we agree that maintaining a register and publishing decisions would be beneficial for the purposes of transparency. |
| 12 | We ask for confirmation within the decision paper that any requirements imposed via directions will allow SONI to continue to comply with accounting standards and operational best practice, and that SONI will be consulted before any material changes. [SONI Response] | We do not expect the direction process to have any impact on accounting standards. However, our expectation is that SONI will be kept informed if there are any material changes to the process. |
| 13 | We would appreciate confirmation that the Utility Regulator will actively monitor impacts and engage with SONI to address any emerging risks or unintended consequences. [SONI Response] | Agreed. |

2.36 The feedback was generally supportive of the CEP fund. We agree that the changes are only an interim solution until the final court decision is taken. Use of directions for standalone funds is not typical, but we expect to consult with SONI as the process develops.

Final decision

2.37 Given consultation feedback, we have determined that the extension modifications should be implemented in the same format to the consultation proposals.

2.38 Although not a licence requirement, we agree with SONI that they should provide information about the funds retained in the account as part of their annual submissions (e.g. regulatory accounts, RIGS and 3-month statement).

3. Modifications to K-Factor

Proposals overview for k-factor changes

3.1 The k-factor is a revenue correction term which for SONI's TSO licence applies on a two-year lag. SONI will forecast revenue in a particular tariff year and collect money based on this forecast. However, the amount collected may not reflect actual revenue required. This can be for several reasons including:

- Demand may be higher/lower than anticipated.
- Pass through spend on ancillary services may be higher/lower than forecast.
- SONI may receive a retrospective reward/penalty from the evaluative performance mechanism or cost-sharing framework.
- SONI may seek funding/allowances for projects not foreseen when undertaking tariff estimates.

3.2 When all these factors are known and established, including the amount collected, the k-factor is used to correct the differential. This is done on a two-year lag i.e. when forecasting revenue for TY2025-26, this included a k-factor correction for TY2023-24 revenue. The existing licence formula is as follows:

$$K_t = (F_{t-2} - R_{t-2})(1 + I_t)$$

3.3 In this case:

- F_{t-2} is SONI's revenue entitlement.
- R_{t-2} is the actual revenue collected.
- $(1 + I_t)$ is the applicable interest rate for the tariff year in question.

3.4 The applicable interest rate is calculated using the Bank of England Base Rate (BoEBR). If the k-factor value is positive, it means SONI has under collected, and revenue has to be added to future tariffs. If the value is negative SONI has over collected, and funds must be returned to consumers.

3.5 In the event of under recovery the applicable interest rate is BoEBR plus 2%. For over recovery it is BoEBR plus 1%. The BoEBR is currently around 4%. For under recovery of £10m this would mean a current interest rate of:

$$1 + 0.04 \text{ (4\% expressed in decimals)} + 0.02 \text{ (2\% expressed in decimals)} = 1.06$$

$$\text{And a k-factor of: } \mathbf{£10m * 1.06 = £10.6m}$$

- 3.6 However, the tariff process has exposed the fact that the interest rate is only applicable for a single year. In contrast, the over/under recovery has to be carried for a period of two years.
- 3.7 SONI has argued that the interest rate application should extend to two years as the k-factor (either over or under) is carried for two years. This seems like an oversight in the existing licence which needs to be corrected. This requires two licence changes.
- a) Amendment of the interest rate formula.
 - b) Amendment of the interest rate definition for over and under recovery so that it applies for two years.

Proposed modification of k-factor formula

- 3.8 The current licence formula for the k-factor is detailed in Paragraph 2.2(i) of Annex 1 of the licence. We proposed to amend this formula as follows:

$$K_t = (F_{t-2} - R_{t-2}) * ((1 + I_{t-2})(1 + I_{t-1}))$$

- 3.9 Using the example above but assuming BoEBR is 4% in relevant year t-2 and 2% in relevant year t-1, the applicable interest rate would now be as follows:

$$1.06 (4\% + 2\%) * 1.04 (2\% + 2\%) = 1.102$$

$$\text{And a k-factor of: } \mathbf{£10m * 1.102 = £11.02m}$$

- 3.10 This gives the company two years of interest. The same logic would apply to over recoveries. As the BoEBR may not be known for the entire period in tariff year t-1, we would propose for simplicity that the rate be constructed based on the average of the 8-months (October to May) which are known when tariffs are submitted.

Proposed modification of interest rate definitions

- 3.11 This treatment is also set out in the interest rate definitions of Paragraph 2.2.(i)(iii)(A) & (B). We consulted on the following amendments of the definitions in red text.

'where the amount derived from the calculations undertaken pursuant to paragraphs 2.2(i)(i) and (ii) is a positive figure, the Average Specified Rate for Relevant Year t-2 plus 2% multiplied by Average Specified Rate for Relevant Year t-1 plus 2% of that rate (as expressed in decimal figures); and'

'where the amount derived from the calculations undertaken pursuant to paragraphs 2.2(i)(i) and (ii) is a minus figure, the Average Specified Rate for Relevant Year t-2 plus 1% multiplied by Average Specified Rate for Relevant Year t-1 plus 1% of that rate (as expressed in decimal figures).'

3.12 This just confirms in the definitions what the formula is expressing i.e. recovery of interest for two years.

Reasons for k-factor changes

3.13 As set out above, we considered that it was appropriate to adjust the k-factor formula from a one to a two-year interest rate as the over/under recoveries will be carried for a longer period than a single year.

Effects of k-factor changes

3.14 The effect of the licence change will ensure that the TSO is appropriately remunerated for costs arising from carrying an under recovery. The change will also ensure that consumers are appropriately recompensed when the TSO holds more revenue than is required to fund their operations.

Consultation responses

3.15 Responses on the k-factor change were much more limited. These are set out in the table below alongside our views.

Table 3.1: Consultation feedback issues and UR response

| | Consultation Response | UR Views |
|---|---|---|
| 1 | <p>If there are funds to be returned to consumers that were collected two years ago, we agree that it is appropriate for the k-factor to correctly inflate the funds to today's prices, and so we support the proposed change.</p> <p>[CCNI Response]</p> | <p>We welcome support for the proposed change. However, it is important to note that the k-factor is not uplifted for inflation. Rather a <i>nominal</i> interest rate is applied on these balances to ensure that neither consumers nor SONI lose out on the time value of money i.e. the gains they could have made had they access to the funds at the time.</p> |
| 2 | <p>We agree with the approach to ensuring that the algebra better reflects the circumstances and are content with the approach taken. However, we ask for confirmation that the methodology will be kept under ongoing review, with a clear commitment to future adjustments if market conditions change.</p> <p>[SONI Response]</p> | <p>Licence changes are regularly subject to review. It is expected that the revenue formula in general and the k-factor will certainly be under consideration for the upcoming SRP27 price control decisions.</p> |

Final decision

- 3.16 Feedback with respect to the k-factor licence change was generally positive. Given this engagement, we have determined that the k-factor modifications should be implemented in the same format to the consultation proposals.
- 3.17 We will of course keep the arrangements under consideration if market conditions changes or financeability concerns merit change.

4. Next Steps

- 4.1 This paper sets out UR decisions on modifications to the SONI transmission licence to ringfence CEP funds and adjust the k-factor interest rate. The next steps and associated timelines for the remainder of the licence modification process are outlined below.

Table 4.1: Licence modification programme

| Next Steps | Date |
|---|----------------|
| Decision on licence modifications published | 24 June 2026 |
| Licence modifications come into effect | 20 August 2026 |

- 4.2 The effective date of the licence modifications is 56 days after the publication of the licence modification decision, in line with the requirements of Article 14(10) of the Electricity Order. This period provides an opportunity for SONI, any other licence holder materially affected by the decision, a qualifying body or association representing one of those licence holders, and/or CCNI to appeal the decision on the licence modifications to the Competition and Markets Authority (CMA).
- 4.3 An application to the CMA for permission to appeal must be made within 20 working days from the 24 June 2026 decision. If an appeal was brought to the CMA, the CMA would in a first step decide whether to give permission for the appeal to proceed or not. If permission were granted, the CMA would have a period of six months in which to determine the appeal.
- 4.4 In the event of an appeal to the CMA, the CMA may decide to suspend this decision or part of this decision for the duration of the appeal.
- 4.5 This document is available in other accessible formats, such as large print, Braille, audio cassette and a variety of relevant minority languages if required. To request alternative formats please contact:

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