



# SONI Governance A Call for Evidence

9 July 2019



## 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 leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.



### 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

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.



## Abstract

The structure of the electricity transmission sector in Northern Ireland has undergone significant change since SONI was acquired by Eirgrid in 2009. Moreover in the next few years the sector is expected to play a critical role in the development of the power industry as a whole. A review of SONI's governance arrangements has not been undertaken since its acquisition by Eirgrid and during the implementation process for ISEM it was signalled that the UR would review the governance of SONI to ensure that it continues to adequately address the requirements of an independent TSO for Northern Ireland. The Utility Regulator considers it appropriate now to undertake a review of these arrangements to ensure they will be fit for purpose going forward. Matters relating to SEMO are SEM Committee matters and are outside the scope of the governance review.

As the TSO licence holder in NI funded by NI consumers, SONI is accountable for the decisions it makes and may be called upon to answer and account for outcomes it delivers. This involves being able to demonstrate the integrity of its decision-making and in so doing maintaining successful relationships with stakeholders that are based on trust and confidence. In SONI's case, given the complexity of its role and ownership structure and its small size relative to its parent, there is an argument for the particular importance of transparency. Consequently, the aim of the review is to:

- ensure SONI's licence conditions on independence are clear and fit for purpose;
- determine how SONI's governance structures work in practice;
- identify whether these arrangements pose any risk of harm to NI consumers to require additional regulation;
- if additional measures (e.g. licence modifications) are needed, identify and develop the measures needed;
- ensure that governance arrangements are fit for purpose into the future energy transition and do not place limits on the effective regulatory discretion of the UR or policy discretion of the UK Government and NI Executive;
- ensure transparency and confidence in the arrangements among market participants in NI.

This paper is the first stage of this review. It takes the form of a call for evidence as, at this stage, we are seeking views of all interested stakeholders as to any issues that may arise from the current SONI governance arrangements in the light of recent, and the likely future, industry developments. The responses we receive will assist us in identifying whether there are any issues with SONI's current governance arrangements and (if so) in understanding what steps may be needed to address them.

## Audience

This document is likely to be of interest to; SONI, NIE Networks, electricity generators, electricity suppliers, government, consumers, consumer groups with an interest in the energy industry.

## Consumer impact

The purpose of this paper is to review the current governance arrangements of SONI TSO to secure the protection of the interests of consumers and other stakeholders now and into the future. Any measures to change SONI's governance could have a cost to the NI consumer. If this process identifies any issues with SONI's current governance arrangements the cost to the consumer will be considered and we will consult separately on any proposals for change.



# Contents

<b>1.</b>	<b>Introduction</b> .....	<b>4</b>
<b>2.</b>	<b>Background</b> .....	<b>6</b>
	SONI as TSO.....	6
	Single Electricity Market .....	6
	Eirgrid Acquisition of SONI .....	7
	Transmission Planning .....	8
<b>3.</b>	<b>Transmission Licence</b> .....	<b>9</b>
<b>4.</b>	<b>Eirgrid Group</b> .....	<b>13</b>
	Corporate Structure .....	13
	Company Boards.....	13
	Working Arrangements.....	14
<b>5.</b>	<b>Energy Transition</b> .....	<b>16</b>
<b>6.</b>	<b>Discussion</b> .....	<b>17</b>
	Group Structure .....	17
	Inter-TSO Agreements .....	18
	Decision Making .....	19
	Condition 12 .....	20
<b>7.</b>	<b>Options</b> .....	<b>23</b>
	Option 1: No change.....	23
	Option 2: Clarify Licence Condition 12 .....	23
	Option 3: Managerial independence of SONI from Eirgrid Plc.....	24
	Option 4: Managerial independence of SONI from Eirgrid Plc plus strengthened SONI Board .....	24
	Option 5 – Majority of Independent Non-executive Directors.....	25
<b>8.</b>	<b>Call for Evidence Questions</b> .....	<b>26</b>
	Stakeholder views on decision-making in SONI .....	27
	UK Corporate Governance Code.....	28
	Transparency and accountability .....	29
	Flexibility for Future Arrangements.....	30
	Questions for SONI .....	31
<b>9.</b>	<b>Next Steps</b> .....	<b>33</b>
	Process and Timetable.....	33



How to respond .....	33
Confidentiality .....	34
<b>10. Acronyms and Glossary .....</b>	<b>35</b>
<b>11. Appendices.....</b>	<b>36</b>
Appendix 1 – SONI TSO Functions .....	36
Appendix 2 - SEMO Functions and Governance Arrangements.....	38
Appendix 3 – SONI TSO Licence Condition 12 .....	40

# 1. Introduction

1.1 The structure of the electricity transmission sector in Northern Ireland has undergone significant change since the Single Electricity Market (SEM) first went live in 2007 and SONI was acquired by Eirgrid in 2009. Moreover in the next few years the sector is expected to play a critical role in the development of the power industry as a whole.

1.2 A review of SONI's governance arrangements has not been undertaken since its acquisition by Eirgrid. The Utility Regulator considers it appropriate now to undertake a review of these arrangements to ensure they will be fit for purpose going forward, in particular by being appropriately designed and implemented so as to:

- secure the protection of the interests of consumers and other stakeholders, including generators and suppliers, in Northern Ireland (NI);
- allow for the implementation of regulatory policy;
- enable SONI to play its role in the implementation of the policy of the UK Government and/or Northern Ireland Executive, and in particular to facilitate the industry's energy transition; and
- maintain cross-jurisdictional relationships necessary to facilitate the SEM;

while also:

- to the extent compatible with the above requirements, permitting appropriate synergies and efficiencies that stem from SONI's position as part of the Eirgrid group.

1.3 The review was signalled during the implementation process for ISEM which confirmed that the UR would review the governance of SONI to ensure that it continues to adequately address the requirements of an independent TSO for Northern Ireland.<sup>1</sup>

1.4 This paper is the first stage of this review. It takes the form of a call for evidence as, at this stage, we are seeking views of all interested stakeholders as to any issues that may arise from the current SONI governance arrangements in the light of recent, and the likely future, industry developments.

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<sup>1</sup> SEM-16-041 Mitigation measures for potential conflicts of interest in the Eirgrid group

- 1.5 The options we present towards the end of this paper are intended merely as a vehicle for discussion by indicating the types of changes that might in principle be made. They should not be regarded as proposals for action, and the Utility Regulator currently has no view in favour of any particular option. The ultimate option to deal with any harm arising from SONI's relationship with Eirgrid is divestment of SONI by Eirgrid Plc. We do not consider this here, or seek any views on it, as it is not within the UR's vires to effect. Divestment would require legislative change and would give rise to much more significant policy issues, which it would be for Government to form a view on.
- 1.6 The responses we receive will assist us in identifying whether there are any issues with SONI's current governance arrangements and (if so) in understanding what steps may be needed to address them. To the extent that we form the view that changes may be needed, we will consult separately on proposals for change before making any decisions.
- 1.7 The responses to this call for evidence will therefore help to shape our policy thinking, and in due course may shape the content of a separate consultation.
- 1.8 Therefore, while we have set out specific questions that consultees may use as the basis of their responses, we would welcome views on any related matters that are not covered in this document but which consultees consider relevant to the issues under consideration in this review. Every effort has been made to ensure the factual accuracy of statements made in this Call for Evidence. However, we would also welcome comments on any issues of factual accuracy respondents may wish to draw to our attention.
- 1.9 The structure of the document is as follows. After this introduction, Section 2 gives background to developments in the electricity transmission sector in NI; Section 3 describes the current governance arrangements as set out in SONI's TSO licence; Section 4 describes the Eirgrid Group Structure; Section 5 discusses the energy transition in which we expect SONI to play a crucial role; Section 6 discusses issues arising; Section 7 describes a number of possible options concerning SONI governance; while Section 8 sets out a number of questions we hope will aid consultees formulate their responses; while Section 9 concludes with the next steps. Appendices A and B list the functions of the TSO and MO, respectively, while Appendix C gives the current Condition 12 of SONI's TSO Licence.

## 2. Background

### SONI as TSO

- 2.1 SONI is licensed under Article 10 of The Electricity (Northern Ireland) Order 1992 as the Transmission System Operator (TSO) for Northern Ireland. As TSO, SONI has general duties under the legislation to:
- ensure the development and maintenance of an efficient, co-ordinated and economical system of electricity transmission;
  - contribute to security of supply through adequate transmission capacity and system reliability; and
  - facilitate competition in the supply and generation of electricity.
- 2.2 SONI's licence obliges it to undertake a number of activities, collectively referred to as the Transmission System Operator Business, which include:
- planning and operating, and co-ordinating and directing the flow of electricity onto and over, the transmission system;
  - maintaining security standards;
  - operating the balancing market,
  - procuring System Support Services (including DS3 services);
  - operating the Capacity Market
- 2.3 SONI is thus responsible for carrying out functions that are at the core of the Northern Ireland electricity system and vital to the Northern Ireland economy as a whole.

### Single Electricity Market

- 2.4 Until the Single Electricity Market (the "SEM") was implemented in 2007, the electricity systems of Northern Ireland and Ireland were separate, with separate trading arrangements and separate arrangements for the two transmission systems. An interconnector allowed power flows to be scheduled between the two systems when requested for commercial reasons by interconnector users, and for operational reasons by agreement between Eirgrid, as the TSO in Ireland, and SONI. However, the SEM created an all-island market for electricity, with generators and suppliers across the island of Ireland participating on the same basis, under a single set of trading arrangements.

2.5 As part of the implementation of the SEM, the licences of both SONI and Eirgrid were amended to create obligations for them to act in conjunction with each other in performing various functions on an all-island basis, including operational planning, scheduling and dispatch of generation, operating the Capacity Market, and required each TSO to offer connectees use of the all-island transmission system rather than only the transmission system in their own jurisdiction. New conditions in both the SONI and Eirgrid TSO licences were introduced, requiring them to comply with a System Operator Agreement that is intended to: ensure each TSO can, where necessary, rely on the co-operation of the other TSO; facilitate the development and operation of an efficient all-island transmission system; and protect consumers in both jurisdictions.

### **Eirgrid Acquisition of SONI**

2.6 When the SEM arrangements, including the System Operator Agreement, were first put in place, SONI and Eirgrid were separate companies, with SONI being a separately managed subsidiary of Northern Ireland Electricity plc (NIE), while Eirgrid was and continues to be owned by the Irish State. Whereas SONI is regulated by the Utility Regulator, Eirgrid is licensed and regulated by the Commission for Regulation of Utilities (CRU) in Ireland.

2.7 DETI and the UR reached agreement to divest SONI from NIE in order to further enhance the independence of the TSO in Northern Ireland in light of the package of measures under the various Internal Market for Electricity (IME) Directives. Subsequently in 2009, SONI was acquired by Eirgrid.

2.8 The acquisition gave rise to concerns as to whether consumers on the island of Ireland, and particularly in Northern Ireland, would continue to be protected, and would not be disadvantaged by the change in control of SONI. The concern was as to whether SONI would be managed purely with the objectives set out its own licence conditions in mind, or whether SONI might be unduly influenced by Eirgrid's pursuit of its objectives. This concern is exacerbated as consequence of Eirgrid being owned by the Irish State, with a risk of a perception that the interests of consumers and government policy in Ireland could be prioritised over the interests of consumers and government policy in Northern Ireland. Likewise, it was perceived that there is a risk that the interests of generators in Ireland could be prioritised over the interests in Northern Ireland.

2.9 A number of measures were thus voluntarily put in place by Eirgrid, specifically:

- the addition of two new directors of appropriate standing and with extensive Northern Ireland backgrounds to the Eirgrid board; and

- amending Eirgrid's Articles of Association and Directors' Code of Conduct to require the interests of consumers of electricity in Northern Ireland and Ireland at all times to be protected.

2.10 Although their duties are the same as the other directors, the new directors are intended to enhance the understanding of issues concerning Northern Ireland. At the time of the acquisition, the SEM Committee welcomed these measures, while noting that the measures were outside the jurisdiction of the SEM Committee and not enshrined in licence conditions.

2.11 In addition, a new obligation was added to the Eirgrid TSO licence, requiring it to at all times have regard for the interests of consumers in NI as well as Ireland. While such a condition is helpful, the Utility Regulator does not have any powers or role in relation to the Eirgrid TSO licence, and has no visibility of the effectiveness of the measure.

2.12 Concerns had been expressed, in response to a consultation on the acquisition, that consumers in NI needed to be treated on a fair and equitable basis with consumers in Ireland. That the various measures were accepted as being appropriate was acknowledgement of the legitimacy of those concerns.

## **Transmission Planning**

2.13 At the same time as its divestment of SONI, NIE also divested its transmission and distribution business, NIE Networks. NIE Networks was acquired by ESB Networks.

2.14 Licence obligations were placed on both SONI and NIE Networks, requiring them to comply with a Transmission Interface Agreement which defines the obligations that each licensee owes to the other to allow SONI, as TSO, and NIE Networks, as Transmission Owner, to provide an integrated transmission service to users.

2.15 Initially, NIE Networks retained an important role in planning the transmission system. However, in 2014, SONI's role was expanded to embrace transmission investment planning and pre-construction development of grid development projects.

### 3. Transmission Licence

- 3.1 Apart from general duties set down in legislation, the licences are the principal means by which licensees are regulated, with conditions that may place obligations to carry out certain functions, as well as restrictions on the manner in which these functions are carried out and prohibitions on carrying out certain other activities at all.
- 3.2 SONI holds two licences: one being to participate in the transmission of electricity, which licenses SONI's TSO business; and the other being SEM Operator, which licenses SONI to act as the SEMO. This Call for Evidence concerns only the TSO business.
- 3.3 In addition to obligations to carry out the Transmission System Operator Business, SONI's TSO licence includes conditions relating to maintaining an appropriate level of independence. In particular, Condition 12, "Independence of the Transmission System Operator Business", is intended ensure the independence of SONI and separation of control of it from generation and supply interests. The policy rationale for this is primarily to ensure equitable treatment between generation companies or suppliers, who rely on access to the transmission system.
- 3.4 In particular, Condition 12 imposes on SONI a general duty to "maintain full operational independence of the Transmission System Operator Business". Previously this condition also required managerial independence but the SEM Committee considered this inappropriate in light of the acquisition by Eirgrid.
- 3.5 Condition 12 also imposes a number of specific duties, which rely on a number of definitions. Specifically:
- an "affiliate" is any subsidiary, any parent company or any other subsidiary of a parent company;
  - a "related undertaking" is any company in which the licensee has a "participating interest"<sup>2</sup>;
  - a "relevant holding company" is any parent company which does not generate or supply electricity on the island of Ireland;
  - "Transmission System Operator Business" is the business of the Licensee, or any affiliate or related undertaking, in planning and

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<sup>2</sup>This refers to the Financial Services and Markets Act 2000, where participating interest means "securing a contribution to its activities by the exercise of control or influence arising from or related to that interest".

operating the transmission system, operating the Balancing and Capacity Markets, etc.; and

- “Associated Business” means any business of the Licensee or affiliate or related undertaking other than the relevant holding company.

3.6 In addition, other conditions rely on the definition of “ultimate controller” being any parent company which is not itself a subsidiary of another company, or any person who can control or exercise significant influence over the licensee through ownership or other contractual arrangements.

3.7 Thus, Eirgrid plc and its interconnector and telecoms subsidiaries are affiliates of SONI, while Eirgrid plc is also a relevant holding company. SONI does not have a related undertaking. The Transmission System Operator Business refers to all of the activities that SONI is required to undertake by its TSO licence (but not, for example, to the Market Operator Business, which is the subject of a separate licence). An Associated Business is any business of any member of the Eirgrid group, other than Eirgrid plc itself.

3.8 Condition 12(2) also conveys a number of specific duties:

- the Transmission System Operator Business be provided with premises, system, equipment, facilities, property, personnel, data and management resources that are necessary for its efficient and effective managerial and operational independence from any Associated Business;
- SONI does not acquire shares in any of its parent companies or in any company engaged in generation or supply on the island of Ireland;
- decisions relating to the transmission system in NI are taken by directors of SONI or personnel of the Transmission System Operator Business;
- any Associated Business does not use or have access to premises, systems, equipment, facilities or properties used by the Transmission System Operator Business, or to the services of Transmission System Operator Business personnel.
- no SONI director is also a director of an Associated Business engaged in generation or supply.

3.9 Thus, paragraphs 12(2)(a) requires managerial and operational independence from any company having interests in generation and supply, although it does not preclude such a company being a parent company of SONI. Paragraph 12(2)(a) does not, however, require managerial and operational independence from Eirgrid, as Eirgrid plc does not fall within the

definition of Associated Business. Paragraphs 12(2)(b) prevents SONI from having any interest in a company that has interests in generation or supply, but does not preclude a company having interests in generation and supply having interest in SONI.

- 3.10 As a means to monitor compliance, Condition 12 also requires the licensee to submit and comply with a compliance plan, and to appoint a compliance manager. A number of issues with Condition 12 have delayed the implementation of these aspects of the condition, and a submission of a compliance plan to the UR will be one of the objectives of governance review.
- 3.11 There are a number of other conditions in SONI's TSO licence that relate to independence, some of which were modified to facilitate the acquisition by Eirgrid. In particular,
- Condition 3, "Availability of Resources and Undertaking of Ultimate Controller", requires SONI to obtain an undertaking from the ultimate controller that it will refrain from any action which would be likely to cause the Licensee to breach any of its obligations. To facilitate the acquisition by Eirgrid, this provision was suspended and replaced with a provision requiring the licensee to obtain the undertaking from Eirgrid;
  - Condition 3A, "Parent Company Undertaking from Eirgrid plc", was a new condition added requiring Eirgrid plc to provide an undertaking that the licensee shall have adequate financial and non-financial resources;
  - Condition 5, "Prohibition of Cross-Subsidies", requires SONI to procure that the Transmission System Operator Business gives no cross-subsidy to, and receives no cross-subsidy from, any other business of the Licensee or of any affiliate or related undertaking of the Licensee. No change was made to this condition upon the acquisition by Eirgrid;
  - Condition 7, "Provision of Information to the Authority", requires SONI to obtain an undertaking from the ultimate controller that it will provide information. To facilitate the acquisition by Eirgrid, this provision was suspended and replaced with a provision requiring the licensee to obtain the undertaking from Eirgrid;
  - Condition 9, "Disposal of Relevant Assets", restricts the disposal of assets by SONI. No change was made to this condition upon the acquisition by Eirgrid; and

- Condition 13, “Prohibited Activities”: This condition prohibits, except with the Authority’s consent, SONI from acquiring electricity except to the extent necessary in undertaking the Transmission System Operator Business. Moreover, it prohibits, from the time SONI ceased to be affiliate of NIE, (a) SONI or any affiliate undertaking generation or supply or (b) SONI being controlled by any person who undertakes or controls a person who undertakes generation or supply. To facilitate the acquisition by Eirgrid the prohibition on SONI being controlled by any person who undertakes or controls a person who undertakes generation or supply is suspended as long as Eirgrid owns SONI and is state-owned.

3.12 Minor changes were also made by the CRU to Eirgrid’s TSO licence. Specifically, in:

- Condition 3, “General Functions”, to add “when carrying out the functions in paragraphs (a) - (h) at all times have regard to the need to protect the interests of consumers of electricity in Northern Ireland and Ireland”; and
- Condition 4, “System Operator Agreement”, to add the design objective to “at all times protect the interests of consumers of electricity in Northern Ireland and Ireland”.

3.13 The Utility Regulator has powers to amend SONI’s licence conditions, which we may do in order to further our own statutory objectives, principal of which is the requirement to protect the interests of existing and future consumers of electricity. In addition, from time to time, Government policy will result in legislation which may require us to make changes to give effect to the policy and give us powers to do so.

## 4. Eirgrid Group

### Corporate Structure

- 4.1 SONI is a wholly-owned subsidiary of UK-registered holding company, Eirgrid UK Holdings Limited, which is itself wholly-owned by Eirgrid plc. Eirgrid plc is owned by the Irish State, while also owning two subsidiaries registered in Ireland, Eirgrid Interconnectors DAC and Eirgrid Telecoms DAC.
- 4.2 SONI and Eirgrid also have contractual joint ventures (CJVs) in respect of the Single Electricity Market Operator (SEMO), administering the real-time Balancing Market, and in respect of SEMOpx, which is the designated National Electricity Market Operator<sup>3</sup>, operating day-ahead and intraday markets. These CJVs are not set up as separate companies, but SONI and Eirgrid agree to provide the resources for these activities in the ratio 25% and 75%, respectively.
- 4.3 While SONI holds the TSO licence in Northern Ireland and is regulated by the Utility Regulator, Eirgrid holds the TSO licence in Ireland and is regulated by the CRU. Also, while SONI and Eirgrid undertake the SEMO function jointly, they each have a SEM Operator Licence issued by the UR and CRU, respectively.

### Company Boards

- 4.4 The Eirgrid board comprises eleven members, comprising the Eirgrid Group Chief Executive and ten non-executive members. The ten non-executive directors are appointed by the Irish Government Minister for Communications, Climate Action and Environment. As mentioned earlier, following Eirgrid's acquisition of SONI, it was agreed that the Eirgrid board should have "two independent directors of appropriate standing with extensive Northern Ireland backgrounds"<sup>4</sup>. Moreover, a review was undertaken of possible conflicts of interest arising from I-SEM and DS3<sup>5</sup>. In view of the perceived ability for Eirgrid and SONI to favour its own

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<sup>3</sup>Designated by the Utility Regulator under Article 4 of the Capacity Allocation and Congestion Management (CACM) Guidelines

<sup>4</sup>See also, "The Proposed Acquisition of SONI Limited by Eirgrid plc", SEM-084 76, 18 December 2008.

<sup>5</sup>See "Integrated Single Electricity Market (I-SEM) and DS3 (Delivering a Secure, Sustainable Electricity System): Mitigation measures for potential conflicts of interest in the Eirgrid group." Information Paper, SEM-16-041, 29 July 2016.

interconnection<sup>6</sup> and to excessively influence the design of detailed market rules to suit the interests of its system operation responsibilities, there was further agreement that one of these two independent directors would be deputy chair.

- 4.5 The review arising from I-SEM and DS3 also resulted changes to the SONI board, with the Eirgrid plc CEO and Eirgrid Grid Development and Interconnection Director no longer being members of the SONI board. Thus, the SONI board now comprises three directors: the SONI General Manager (as chair) a further member of the SONI senior management team, and the Eirgrid Group CFO. As well as being a member of the SONI senior management team, the SONI General Manager is a member of the Eirgrid senior management team.
- 4.6 The board of Eirgrid UK Holdings Limited currently comprises three directors, being the chairman of the SONI board, who is also a member of the senior management teams of both SONI and Eirgrid; the Group Financial Controller and Company Secretary of Eirgrid; and the Eirgrid Group Chief Executive.

### **Working Arrangements**

- 4.7 As mentioned earlier, conditions in each of the SONI and Eirgrid licences oblige SONI and Eirgrid to comply with a System Operator Agreement, with this agreement being established as part of the implementing the SEM, predating the acquisition. Given that the SEM introduced obligations on SONI and Eirgrid to undertake various functions “in conjunction with” each other, the agreement was intended to ensure that each TSO could rely on the other where it was necessary in order for each to discharge its obligations under its licence.
- 4.8 SONI’s licence does not preclude its Transmission System Operation Business from being undertaken by SONI affiliates as well as SONI. This includes Eirgrid. Moreover, the fact that Eirgrid carries out very similar functions to SONI, and does so alongside SONI on the all-island transmission network, affords considerable scope for either TSO to carry out the functions of the other. These interactions are not necessarily covered by the System Operator Agreement, as in these interactions one TSO is performing functions on behalf of the other rather than in conjunction with it. However, we understand that a Service Level Agreement exists between SONI and Eirgrid. In addition, a proportion of group costs are allocated to SONI under a Cost Allocation and Recharge Policy developed by Eirgrid.

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<sup>6</sup>Eirgrid Group owns the East-West Interconnector between Ireland and Wales, while the Moyle Interconnector, joining Northern Ireland and Scotland is owned by Mutual Energy Limited.

4.9 Moreover, since acquisition the two companies have made organisational changes which have facilitated closer working across a range of areas. We understand that, in 2011, the organisation of the group was changed to facilitate a functional model based around centres of operation in Belfast and Dublin, with the intent of driving synergies and efficiencies within the Eirgrid group and maximising the benefits of common ownership for all consumers on the island.

## 5. Energy Transition

- 5.1 The energy system is in transition towards decarbonisation and more decentralisation, due to UK government policy on climate change and technological advancements which facilitate distributed generation and allow consumers to manage their demand and provide system services. In addition, the EU has recognised the importance of the energy transition and is in the process of updating its energy policy framework to accommodate it, with a set of legislative proposals known the “Clean Energy Package”. The UR recognises the importance of the energy transition in our Corporate Strategy for 2019-2024, and believe that it will be a key strategic driver influencing our ongoing strategy.
- 5.2 SONI will be a key delivery body for the energy transition. Not least this arises from SONI having taken on the role of transmission planning, which now gives SONI a direct role in facilitating NI policy on matters such as the timely connection of renewable generation and other developments critical for the energy transition agenda. SONI will need to work closely with NIE Networks and market participants, as well as Government, the UR, and consumers. The relationship between SONI and NIE Networks, in particular, could become even more critical in the future than it is today due to a number of emerging trends.
- 5.3 Firstly, it may be that, in the future, more of the balancing of the system will happen at the distribution level through local generation, storage and demand management. NIE Networks has launched a consultation in this area, a theme of which is that the consumers of the future may wish to participate in the energy market and provide system services, and will likely wish to do so in both TSO and DSO markets. It is not at all clear how future arrangements may develop but it may result in greater coordination between TSO and a potential DSO.
- 5.4 Secondly, evidence from GB indicates that both transport and heat have the potential to be integrated into the electricity system and would also impact on the gas network. This has the potential to create a significant relationship between gas and electricity networks.
- 5.5 Quite how any of these trends will develop in NI, or the pace at which they will emerge is unknown, but Government policy in NI will be key to managing the transition. EU Exit also has the potential to create policy divergence. The strategic policy direction in NI may therefore take a steer from what is happening in GB and could therefore be different in emphasis from government policy in Ireland.

## 6. Discussion

### Group Structure

- 6.1 The similarity in the roles of SONI and Eirgrid, and the fact that they perform these roles on adjacent parts of an islanded system, and that, even prior to the acquisition, they performed these roles 'in conjunction with' each other has meant there is perhaps more potential for synergies and possibly economies of scale than might have been the case had SONI been acquired by any other bidder. However, it is also the case that there is more scope for loss of independence. Clearly, had SONI been acquired by company that was not a TSO then SONI would have had to maintain all of the necessary TSO processes and be entirely self-standing. Alternatively, had SONI been acquired by a TSO not on the island of Ireland then, while the parent company might have had the necessary capabilities, it is likely there would have been far less overlap, in terms of the models, data, overall system knowledge and interactions with market participants, than is likely the case with SONI and Eirgrid. It seems thus that there is a tension between the level of independence SONI maintains from Eirgrid and the ability of the two companies to realise synergies and efficiencies across the TSO businesses.
- 6.2 When SONI was acquired by Eirgrid concern was expressed that consumers in Northern Ireland must be treated on a fair and equitable basis with their counterparts in Ireland. Moreover, the close relationship between Eirgrid and SONI since acquisition has given rise to a perception of Eirgrid plc dominance over SONI, and a suspicion that Eirgrid strategy has influenced SONI policies arising, for example, from the frequency with which Eirgrid staff represent SONI in dealings with NI counterparties, including the UR. There is also a perception that this dominance has an impact on pay and industrial relations. Some parties in Northern Ireland have therefore expressed concerns about whether other Northern Ireland stakeholders, including consumers, are being treated on a fair and equitable basis as compared to their counterparts in Ireland.
- 6.3 While, ideally, it would be possible to specify in detail the obligations a TSO (or any other licence holder) must discharge and the constraints on its behaviour, in practice there is a considerable information asymmetry between the licensee and other parties, including the regulator. Hence, great emphasis has been placed by most regulators in all jurisdictions on unbundling and independence of TSOs from market participants, such as generators and suppliers. Such requirements are generally accepted as being necessary in order that stakeholders may have confidence that the TSO is performing its functions in an equitable fashion. They have therefore been a prominent feature of EU legal requirements in relation to the role of

TSOs.

- 6.4 In addition, in the case of SONI and Eirgrid – while, when independent of each other, additional comfort could be derived from the fact that there would be many decisions (particularly those decisions taken in conjunction with each other) in respect of which the actions of each TSO would be subject to highly-informed scrutiny by the other – there is a danger that this scrutiny is lost with Eirgrid ownership of SONI.
- 6.5 State ownership of a TSO is far from being unprecedented. Moreover, the two Governments accepted that state ownership of Eirgrid and its role in the Irish electricity industry was not of concern to the SEMC at the time of the 2009 decisions relating to the acquisition.
- 6.6 Nevertheless, while within a single system there may be limited scope to benefit any one set of stakeholders at the expense of any other, any more than is the case through general government policy, in the case of Eirgrid's acquisition of SONI the state represents only some of the stakeholders that can be affected by TSO decisions and actions. In such circumstances, it would be understandable if group policies and the design of practices were influenced by the priorities in the one jurisdiction more than the priorities in the other. As noted, earlier, this was acknowledged during the review of conflicts of interest during the I-SEM and DS3 projects, where it was recognised that the increasing scope of TSO activities gave rise to some concerns, and hence to some adjustments to the constitution of both the SONI and Eirgrid boards.
- 6.7 In particular, as the energy transition gathers momentum, Eirgrid ownership of SONI, and in turn ownership of Eirgrid by the Irish government, could arguably have the potential to frustrate government policy in NI in the absence of robust independence arrangements. Practically, this problem could arise, for instance, because the strategic direction of the Eirgrid group is influenced by the direction of policy in Ireland and SONI is so integrated into the Eirgrid group that it cannot depart from the group direction of travel, or at the operational level cannot create new ways of working with NIE Networks because it does not control the personnel, resources and systems needed to manage the energy transition in NI.

### **Inter-TSO Agreements**

- 6.8 The interactions between SONI and Eirgrid are governed by a number of documents, including the System Operator Agreement and the Cost Allocation and Recharge Policy. However, the System Operator Agreement was developed when the two TSOs were separate companies. It was anticipated that disputes could arise under the agreement, and a mechanism

for resolving such disputes was included that involved disagreements being referred to Regulatory Authorities. However, where the two counterparties to an agreement have common interests, such as a result of ownership of one by the other, there may be little incentive to raise formal disputes under the agreement, and it is more likely that the disputes will be resolved informally, if the corporate governance allows them even to arise in the first place. In effect, there is nothing to prevent the two parties from agreeing to deviate from the agreement, resulting in a loss of transparency.

- 6.9 Similar concerns apply to the Service Level Agreement (SLA), which is a formal contract under which SONI acquires services from Eirgrid, but without any of the detail as to the nature, quality or cost of those services that would normally be expected in a binding agreement between two separate legal entities.
- 6.10 Likewise, the Cost Allocation and Recharge Policy may give transparency to charges made between the TSOs. However, we note that the policy is developed by Eirgrid alone and, while charges may be transparent, it is not clear how it provides transparency of the services supplied in respect of those charges.
- 6.11 Lastly, SONI's price control is intended to provide SONI with the resources it needs to undertake its licence obligations. However, this may be undermined to the extent that SONI staff become engaged in matters of specific interest to Eirgrid. Also, the functional model may require SONI to mirror the functional organisation of Eirgrid whereas, if SONI were focussed purely on NI, it is possible that it might have fewer functional /managed streams and fewer senior managers, within a structure in which staff would generally be less specialised.
- 6.12 The price control review should establish what shared services are provided in common, but the governance review will need to establish how the two organisations control and manage these and what influence SONI has on any relevant policies.

## **Decision Making**

- 6.13 Two of the three members of the SONI board are also members of the SONI management team, and there are no independent directors. This raises questions as to whether the composition of the board is best suited to holding the SONI senior management team to account for its performance of SONI's obligations. Moreover, the scope of the Board's authority is unclear, in particular whether the SONI board has any role in developing and approving Eirgrid group strategy and policies which will apply to SONI. Nor is it clear what matters are reserved for the Eirgrid board.

- 6.14 We acknowledge the recent appointment of a new Managing Director for SONI. The previous role of General Manager overlapped with the role of Eirgrid Operations and Planning Director, which would suggest that the role was primarily engaged with matters of relevance to Eirgrid. Nevertheless, we are not aware that the new arrangement is enshrined in SONI's constitution and hence that there is any assurance that it would survive any future internal reorganisation.
- 6.15 Notwithstanding the board arrangements, a consequence of the functional model, introduced in 2011, is that SONI managers will report into functional directors, who will be part of the Eirgrid executive. It appears from this that the SONI board may have little or no direct governance or decision-making role in these areas; their role is unclear.
- 6.16 For instance, we understand that Eirgrid has a highly structured governance process for approval of internal projects, which consists of a management level review group that passes approved proposals up to an executive committee. Subject to approval by the executive committee proposals are then submitted up to an Eirgrid board committee or the Eirgrid board. It is unclear the extent to which this process applies to SONI projects. To the extent this is so, this could make it difficult for SONI to act in the interests of NI users and may inhibit timely decision making as decisions go through group governance procedures. In section 8 we invite SONI to set out how the integrated decision making structure with Eirgrid works in practice (para. 8.24).
- 6.17 As regards sharing of services, we note that there is no process for SONI to exercise discretion on the allocation of Eirgrid group management costs to SONI, including for such items as "Public Affairs", which may not be of direct relevance to SONI. The fact that the Cost Allocation and Recharge Policy is developed exclusively by Eirgrid would seem to limit SONI's control of these costs. And while it was noted at the time of the acquisition that ownership of SONI by Eirgrid afforded opportunities for synergies and efficiencies, it is also possible that, in some cases, SONI compliance with Eirgrid procurement practices and working methods may have increased costs compared to those SONI would have incurred if operating in a purely NI context.
- 6.18 We note that other licence holders who rely heavily on contracting-in services have licence obligations to produce a procurement plan when requested by the UR; SONI currently does not have any such obligation and we therefore invite comments on whether such an obligation would be desirable.

## **Condition 12**

- 6.19 We have already formed the view (which is shared by SONI) that Condition 12 requires changes to improve clarity, irrespective of whether substantive changes are made to SONI's governance consequent on this review. We intend to discuss these changes with SONI and to bring forward proposals for consultation later in the governance review. Once these changes are made we will need to give SONI notice to submit its compliance plan.
- 6.20 If more substantive changes to SONI's governance arrangements are made consequent on the governance review, then further licence changes may be necessary beyond those mentioned below. As required, these would be consulted on later in the governance review, after any policy decisions have been made.
- 6.21 We have not posed specific consultation questions on Condition 12 in this Call for Evidence, although any observations consultees may have on whether and how Condition 12 might be improved would be welcome.
- 6.22 Issues with Condition 12 that we think would benefit from greater clarity include:
- While the general duty in paragraph 12(1) is to maintain 'full operational independence of the Transmission System Operator Business', full operational independence is not defined, and it is not stated from whom (or what) such independence must be maintained. In addition, while the requirement for managerial independence was dropped from the general duty it remains in the specific duty in paragraph 12(2)(a).
  - The scope of the paragraph 12(1) general duty refers only to operational independence and not to management independence. However the concept of managerial independence features in the specific duties imposed on SONI in paragraph 12(2)(a) and (c) in particular. Hence, there would seem to be a mismatch between the general duty and the specific duties.
  - While paragraph 12(2)(d) requires that an Associated Business does not have access to the services of anyone engaged in the Transmission System Operator Business, it does not impinge on capturing synergies and efficiencies between the TSOs, as Eirgrid plc is not an Associated Business to whom this paragraph applies. Consequently, services do not need to be defined in the context of the independence licence condition to facilitate the provision of specified corporate services by Eirgrid plc. Ongoing cost reporting has been established for SONI which will provide some transparency over the extent and cost of services provided by Eirgrid Plc to SONI (and vice

versa).

- Paragraph 12(2)(e) may need to be drafted more widely to capture not only former staff of Associated Businesses engaged in generation or supply but also staff of any Associated Business. The condition could also be strengthened to ensure an appropriate cooling off period for personnel transferring into SONI from elsewhere in the Eirgrid Group or from generators or suppliers.
- The definition of Associated Business encompasses all businesses of the licensee and affiliates, other than the relevant holding company, but it may be appropriate to revisit the exclusions if only to exclude also the Transmission System Operator Business.

6.23 We also note that the effectiveness of the independence obligations is interdependent with the ongoing structure of the Eirgrid group as a whole. Hence, we consider it may be necessary to place an obligation on SONI to alert the UR if material changes to the structure of the group are made, or if changes in business practice are likely (whether in reality or in perception) to impact on the effectiveness of SONI, such that the UR can consider whether a formal review of the independence requirements should be undertaken.

## 7. Options

- 7.1 We have set out here a number of options for change for the governance arrangements. These are not proposals for action, nor necessarily solutions to all of the issues that may arise from a consideration of the current governance arrangement.
- 7.2 It is our intention that any issues that need to be addressed will be identified following this Call for Evidence, and potential solutions to address these will be developed and subject to further consultation. Nevertheless, we include the options here as a vehicle for discussion of the issues, by way of indicating the kinds of policies that could be developed.

### **Option 1: No change**

- 7.3 This option is effectively the status quo in that it does not foresee any changes to the regulated arrangements for SONI governance. SONI would be free to make its own governance changes provided these are in compliance with its existing licence obligations.
- 7.4 Indeed SONI has already begun to make some changes with the appointment of a new Managing Director (MD) for SONI in May 2019. We understand that the MD will report to the Group Chief Executive as a member of the Group Executive Team and that the MD will have direct responsibility for the financial performance of SONI. We understand that the MD role is intended as a means to ensure that SONI, as a business, has its own distinct identity within the Eirgrid Group, and to ensure local accountability for the performance of the SONI business.
- 7.5 However, we consider that, as a minimum, Condition 12 of SONI's licence needs amendment to achieve greater clarity. Once this has been done, we will need to give SONI notice to amend its compliance plan. We understand that SONI also considers that the conditions should be amended for clarity, although no detailed drafting has been discussed. Hence, we consider that no change should be ruled out.

### **Option 2: Clarify Licence Condition 12**

- 7.6 This option would entail amending condition 12 of the SONI TSO licence to improve clarity, but without making substantive changes to the level of independence required of SONI from Eirgrid. Inconsistencies between the general and specific duties, and in various definitions, would be rectified. However, the intention would be to continue to allow management decisions to be taken by SONI employees or SONI directors who are also members of the Eirgrid executive team.

- 7.7 This option would continue to rely on the Eirgrid board and the obligations in Eirgrid's licence and its regulation by CRU to safeguard the interests of NI consumers. Nevertheless, this option would ensure that Condition 12 is fit for purpose and facilitate the submission of a new compliance plan resulting in improved regulatory monitoring and reporting.

### **Option 3: Managerial independence of SONI from Eirgrid Plc**

- 7.8 This option would create greater managerial independence of SONI from Eirgrid plc. This could be achieved by adding managerial independence back into the general duty in Condition 12 and at the same time bolstering the specific managerial independence duty by requiring that management decisions, or a sub-set of decisions, relating to TSO functions are taken by SONI employees only (whether Directors or otherwise).
- 7.9 The new MD could be required to be a Board member. We also consider that this option would present the opportunity for a SONI workforce representative to be appointed to the SONI board, as is the case with Eirgrid.
- 7.10 We would expect, under this option that the scope of matters reserved for the Eirgrid board would be clarified, and a SONI board scheme of delegation implemented. The SONI board would also establish a system of effective internal controls to enable risks specific to SONI to be assessed and managed.
- 7.11 The aim of this option would be to ensure better accountability to NI stakeholders regarding SONI decisions and outcomes, and provide confidence that such decisions and outcomes are in the best interests of NI consumers.

### **Option 4: Managerial independence of SONI from Eirgrid Plc plus strengthened SONI Board**

- 7.12 This option would follow the structure of option 3 outlined above with the addition of a new licence condition or amended Condition 12 requiring independence of the SONI board from Eirgrid.
- 7.13 An independent non-executive could be required to be appointed to chair the SONI Board. There could also be a requirement for a second independent non-executive, or for a member of the Eirgrid board to sit with observer status to provide a link to the Eirgrid board.
- 7.14 As with option 3 the new MD could be required to be a Board member. We also consider that this option would present the opportunity for a SONI workforce representative to be appointed to the SONI board. Also the scope

of matters reserved for the Eirgrid board would be clarified, and a scheme of delegation to be implemented and that the SONI board would also establish a system of effective internal controls to enable risks specific to SONI to be assessed and managed.

- 7.15 This option would aim to bolster the accountability to NI stakeholders provided in option 3 with a greater degree of independent membership of the board.

### **Option 5 – Majority of Independent Non-executive Directors**

- 7.16 This option goes significantly further than Option 4 in that the Board would be comprised of a majority of independent non-executive directors, one of whom would also chair the board. Notwithstanding that it is not mandatory for the UK Corporate Governance Code to be applied to subsidiary companies, this option could apply the principles of the Code to SONI, and could therefore drive the advantages envisaged by the Code.
- 7.17 The option could be thought of as limiting the ability of Eirgrid Group to maintain a common strategic approach for the group as a whole. However, it could be argued that this approach would not preclude SONI from adopting Eirgrid strategy, except where that conflicted with SONI-specific objectives.
- 7.18 We note that the NIE Networks board has a majority of non-executive directors, albeit none of the non-executive directors is chair.

## 8. Call for Evidence Questions

8.1 The aim of the review is to:

- ensure SONI's licence conditions on independence are clear and fit for purpose;
- determine how SONI's governance structures work in practice;
- identify whether these arrangements pose any risk of harm to NI consumers to require additional regulation;
- if additional measures (e.g. licence modifications) are needed, identify and develop the measures needed;
- ensure that governance arrangements are fit for purpose into the future energy transition and do not place limits on the effective regulatory discretion of the UR or policy discretion of the UK Government and NI Executive;
- ensure transparency and confidence in the arrangements among market participants in NI.

8.2 Matters relating to SEMO are SEM Committee matters and are therefore outside of the scope of the governance review. Matters relating to SEMO are separately regulated under different licences, and are not being considered as part of this review. To the extent that any responses received as part of the governance review relate to matters that fall within SEMC's jurisdiction, we propose to seek views as to the compatibility of any potential changes to the SONI TSO with SONI's SEMO Licence and pass any responses pertaining to SEMO gathered to SEMC.

8.3 Call for Evidence questions in this section are grouped into five sections:

- (i) stakeholder views on decision making in SONI and whether it is working in the best interests of NI consumers or could be improved. The focus here is predominantly on decision making in SONI both at Board and senior management team level;
- (ii) whether the principles of the UK Corporate Governance Code should be applicable to SONI
- (iii) whether transparency and accountability could be improved and if so how; and
- (iv) whether the arrangements are flexible enough to continue protecting the interests of NI consumers, generators and other

stakeholders in the context of the energy transition.

- (v) specific questions for SONI

## **Stakeholder views on decision-making in SONI**

- 8.4 As discussed above, there are reasons to consider that the scope of the SONI board's authority is not clear and that greater clarity is desirable, particularly in respect of whether the SONI board has a role in developing and approving Eirgrid group strategy and policies which apply to SONI. In principle, NI stakeholders need to understand who establishes SONI's purpose, values, and strategy and, to the extent that role has been taken by Eirgrid plc and not the SONI board, be content that this is in the best interests of NI consumers.
- 8.5 We would welcome views on the need for clarity on the role of the SONI Board. Also, more particularly, views are welcome on:
- the extent to which the SONI board should have the ability to set strategy and policies for SONI;
  - whether the SONI board should hold the SONI senior management team to account;
  - whether the appointment of independent non-executives would be beneficial, including in respect of holding the senior management team to account and in setting SONI strategy and policies;
  - the matters that stakeholders consider should be within the scope of the SONI's Board's decision making responsibility and why;
  - the matters that it would be appropriate to be reserved for the Eirgrid plc board, and why; and
  - the extent to which reinforcing the independence of the SONI Board and ensuring transparency around the scope of delegated and reserved matters would allay any perception that the SONI TSO is less than independent from Eirgrid TSO.
- 8.6 Within the overall organisational structure of the Eirgrid Group, decisions will be made that will result in cost allocation and recharges across the two companies. These decisions should in principle drive synergies and efficiencies to the benefit of all consumers, which should be taken account of in the jurisdictional price controls. Whether the allocation of these benefits is fair across the jurisdictions is partly a price control issue, and partly a governance question. The current cost allocation and recharge policy is an

Eirgrid policy, over which the UR has no right of approval. Hence, the question arises as to the role SONI should have in developing and agreeing this policy, and the role of the UR in approving it, given its impacts on NI consumers.

- 8.7 Also, in contracting for services, e.g. corporate services, from Eirgrid, the question arises whether SONI should be able to specify the service specification and standards, and agree the pricing of the service, in the same manner as it would if it was contracting with an entity outside the Eirgrid Group for the same service.
- 8.8 We note that other licence holders who rely heavily on contracting for services have obligations in their licences to produce a procurement plan when requested by the UR. SONI does not currently have any such obligation and we invite views on whether such an obligation would be appropriate.

## **UK Corporate Governance Code**

- 8.9 The current composition of the SONI board, with its lack of independent directors, is not in line with the UK Corporate Governance Code. While SONI is not required to comply with the code, its parent company Eirgrid plc has indicated that it will have regard to the Code. There is a trend towards improvement in increased independent board leadership, transparency and governance among regulated utility companies.
- 8.10 The UK Corporate Governance Code stresses the importance of independent non-executive directors, stating that they should be a majority on the board, and defines a test for independence. A board composed of a majority of independent non-executive directors is considered to provide a number of benefits including more constructive challenge to management, creation of a clear strategic direction for the company, provision of a non-operational perspective, and help to balance any conflicting needs arising from stakeholders, the business and its shareholder.
- 8.11 It is not clear whether the current board arrangements are more effective than those set out in the Code. We consider that this is worth exploring bearing in mind the complexity of SONI's functions and its ownership structure, together with the fact that it is an NI regulated company which discharges its obligations primarily for the benefit of NI consumers.
- 8.12 Consequently we would welcome views on:
- whether it is appropriate to apply the principles in the Code to SONI, in whole or in part;

- the extent to which SONI could already be said to meet the principles contained in the Code;
- whether the principles, to the extent respondents consider they should apply, should be codified in the licence or could be implemented on a voluntary basis by SONI.

## **Transparency and accountability**

- 8.13 As a licence holder in NI funded by NI consumers, SONI is accountable for the decisions it makes and may be called upon to answer and account for outcomes it delivers. This involves being able to demonstrate the integrity of its decision-making and in so doing maintaining successful relationships with stakeholders that are based on trust and confidence. In SONI's case, given the complexity of its role and ownership structure and its small size relative to its parent, there is an argument for the particular importance of transparency.
- 8.14 The organisational relationships and governance structures within the Eirgrid Group appear to indicate overlapping roles and responsibilities between SONI and Eirgrid plc which, as a minimum, may not serve the interests of transparency for NI stakeholders. It is arguable that they do not provide the confidence that conflicts of interest (should any arise) will be managed effectively. To the extent to which there is a lack of transparency, it has the potential to undermine trust and confidence in SONI, and would need to be addressed.
- 8.15 Some parties have raised informal concerns that SONI's relationship with Eirgrid makes it difficult for the company to act in the interests of NI consumers. The rationale for the recent threatened strike action partially echoed these accountability issues.
- 8.16 To the extent that there are negative perceptions of SONI, the business will likely wish to understand the causes of this and develop measures to change perceptions over time. To this end, it would be useful to know what metrics SONI is using or intends to use to measure changes in perception of SONI and it would be useful for SONI to set these out in its reply to the call for evidence. Also it would be useful if SONI could provide any historic information indicating whether there is or has been issues with stakeholders' perceptions of SONI.
- 8.17 From a stakeholder perspective, we would welcome views on:
- whether stakeholders believe transparency in SONI's governance procedures be improved, and if so how; and

- whether there are specific areas where information flow could be improved.
- 8.18 It would be useful to have SONI staff perspective on the transparency of the company and whether it needs to be improved.
- 8.19 The UR will use any evidence gathered to assess whether regulatory intervention is necessary in this area or whether SONI is already taking sufficient action.

### **Flexibility for Future Arrangements**

- 8.20 SONI engagement with NIE Networks is critical to NI security of supply and the delivery of infrastructure in NI, including the North South Interconnector. SONI holds a unique function in planning the electricity network. This it performs in conjunction with NIE Networks, under the terms of the Transmission Interface Agreement, with NIE Networks building the network and being the ultimate owner.
- 8.21 The energy transition could also result in a blurring of the distinction between transmission and distribution systems, due to the growth of distributed generation and the potential for more active management of local networks.
- 8.22 The question arising in the context of the governance review is how we can ensure that SONI and NIE Networks work together to ensure the approach across the transmission and distribution networks is optimised to deliver the best overall outcome for NI consumers and other stakeholders. More active management of the distribution system, as well as the transmission system is likely to be a key component in enabling the uptake of low distributed low-carbon generation and consumption in low carbon applications, such as electric vehicles and electric space-heating, without imposing greatly increased infrastructure costs on consumers.
- 8.23 We consider that, at the operational level, a key driver of SONI's ability to create new ways of working with NIE Networks is the extent to which SONI has the resources, personnel and systems needed to manage the energy transition and develop appropriate solutions in NI.
- 8.24 We would thus welcome views as to:
- what enablers stakeholders consider will be important for SONI's role in the energy transition, and what barriers to these enablers might exist;
  - what resources, including SONI personnel and systems will be necessary for the energy transition;

- whether local knowledge needs to be retained in SONI or whether this can be contracted in, and the extent to which such knowledge is important now and will be in future;

## Questions for SONI

8.25 In addition to the views of all stakeholders on the questions above, we would appreciate the views of SONI on the matters discussed in this review. In particular:

- We invite SONI to set out the nature of the day to day interactions between it and Eirgrid, the governance structures which facilitate these interactions, together with a SONI organisation chart. We would invite SONI to provide commentary on how it meets the licence requirements that SONI has both to all-island consumers through the SOA, and more specifically to NI consumers;
- We invite SONI to set out what Group policies apply to SONI (such as the Cost Allocation and Recharge Policy and the Eirgrid Information Services (IS) Strategy for 2015 – 2017), and whether these policies are decided by the Eirgrid plc board. NI stakeholders need to understand who establishes SONI's purpose, values, and strategy the extent that role is undertaken by the Eirgrid plc rather than the SONI board, and be content that this is in the best interests of NI consumers;
- We invite SONI to set out how the structure of the Group and the composition of the various boards provide benefit to NI stakeholders;
- We invite SONI to set out how the integrated structure works and is managed in practice, including: how decisions are made, and authority is delegated downwards in the organisation; how decisions about allocation of staff resources (both SONI and Eirgrid staff) are made, and the pros and cons of these arrangements;
- Similarly, we request that SONI provide information about the scope of TSO functions that are integrated with Eirgrid, including identifying which of these are SEMO functions, which are functions under the SOA, and which are NI-only functions, and which are Eirgrid-only functions. We particularly wish to understand the contractual or other arrangements with Eirgrid for sharing resources and staff, and how the SLA works in practice. We invite SONI to explain how it monitors that it is getting value for money for the services it receives from Eirgrid under the SLA and, in particular, what services are received, how frequent a review is undertaken of the effectiveness and value for

money being provided and, and what the results of those reviews have been;

- We invite SONI to set out how the current governance arrangements apply to NI-facing activities, such as planning, and the extent to which this work is wholly managed and directed within SONI;
- We invite to SONI so set out any measures it has in place to ensure the retention of specific, detailed local knowledge relating to the NI transmission system.

8.26 As with other stakeholders, we would welcome SONI's views on any related other matter not covered in this document here but which it considers relevant to the issues under consideration in this review.

## 9. Next Steps

### Process and Timetable

- 9.1 This call for evidence will be open to consultation until 10 September 2019. The responses and evidence received will inform the structure of the next stage in the policy development process.
- 9.2 Following receipt and consideration of responses we intend to publish a follow up paper in Q4 2019. This paper will consult on specific proposals as necessary and will set out a timeline of the governance review process.
- 9.3 We expect to make any final policy decisions, as necessary, towards the end of Q1 2020. Any necessary licence changes would then be published for consultation. Once the licence modification process is concluded SONI will then need to prepare and submit (potentially in Q3 2020) a new compliance plan for approval.
- 9.4 SONI's existing price control runs until 30 September 2020, and we are developing a price control to take effect from that date. SONI is due to submit a business plan for in July 2019, and we intend to publish a draft determination in December 2019, and a final determination in May 2020. The timetable for the governance review will therefore be in parallel with, but separate to, the price control review.

### How to respond

- 9.5 Representations may be made on or before 5pm on 10 September 2019. Responses can be sent in writing to or by emailing:

Natalie Dowey  
The Utility Regulator  
Queens House  
14 Queen Street  
Belfast  
BT1 6ED

e-mail: [Natalie.Dowey@uregni.gov.uk](mailto:Natalie.Dowey@uregni.gov.uk)

**and**

e-mail: [Electricity\\_Networks\\_Responses@uregni.gov.uk](mailto:Electricity_Networks_Responses@uregni.gov.uk)

Our preference is for responses to be submitted by e-mail.

## Confidentiality

- 9.6 Please note that we intend to publish all responses unless marked confidential. While respondents may wish to identify some aspects of their responses as confidential, we request that non-confidential versions are also provided, or that the confidential information is provided in a separate annex.
- 9.7 As a public body and non-ministerial government department, the Utility Regulator is required to comply with the Freedom of Information Act (“FOIA”). The effect of FOIA may be that certain recorded information contained in consultation responses is required to be put into the public domain. Hence it is now possible that all responses made to consultations will be discoverable under FOIA, even if respondents ask us to treat responses as confidential. It is therefore important that respondents take account of this. In particular, if asking the Utility Regulator to treat responses as confidential, respondents should specify why they consider the information in question should be treated as such.
- 9.8 The Utility Regulator has published a privacy notice for consumers and stakeholders which sets out the approach to data retention in respect of consultations. This can be found at <https://www.uregni.gov.uk/privacy-notice> or, alternatively, a copy can be obtained by calling 028 9031 1575 or by email at [info@uregni.gov.uk](mailto:info@uregni.gov.uk).

This paper is available in alternative formats such as audio, Braille etc. If an alternative format is required, please contact the office of the Utility Regulator to request.

## 10. Acronyms and Glossary

CFO	Chief Financial Officer
CJV	Contractual joint venture
CRU	Commission for Regulation of Utilities
DSO	Distribution System Operator
DS3	Delivering a Secure, Sustainable Electricity System
ISEM	Integrated Single Electricity Market
JMC	Joint Management Committee
MO	Market Operator
NI	Northern Ireland
OPEX	Operating expenditure
RAB	Regulated asset base
SC	Steering Committee
SEM	Single Electricity Market
SEMC	Single Electricity Market Committee
SEMO	Single Electricity Market Operator
SOA	System Operator Agreement
SONI	System Operator for Northern Ireland
TIA	Transmission Interface Agreement
TSO	Transmission System Operator
UR	Utility Regulator

# 11. Appendices

## Appendix 1 – SONI TSO Functions

SONI's TSO licence was issued pursuant to article 10(1)(b) of the Electricity Order. The general duties of the TSO as defined by legislation include:

- Ensuring the development and maintenance of an efficient, co-ordinated and economical system of electricity transmission in NI.
- Contribute to security of supply through adequate capacity and system reliability in NI.
- Facilitate competition in the supply and generation of electricity in NI.

Under the TSO Licence the term Transmission System Operator Business is defined and its key elements are:

- Planning and operation of the transmission system
- Operation of the Capacity Market
- Procurement of System Support Services (including DS3),
- Co-ordinating the flow of electricity on the transmission system
- Operating the Balancing Market
- Undertaking obligations under the Licence in respect of Northern Ireland Interconnector
- Undertaking of electricity trades with the operators of systems other than the transmission system as approved by the UR
- Any business in offering to enter into, and entering into, Connection Agreements and Use of System Agreements

In delivering many of these functions SONI must interface with Eirgrid TSO and the terms of this interaction is set out in the SOA. The SOA defines areas of coordination ('interface obligations') between SONI and Eirgrid. Within these areas of interface each individual TSO has their jurisdictional responsibilities and the interfaces manage how they 'work with one and other', 'liaise', 'agree jointly', 'co-ordinate'. The SOA does not imply that the TSOs act as one entity in the activities it governs, unlike with the MO, which is a contractual joint venture between SONI and Eirgrid and is discussed in the next section.

It is clear from the construct and governance of the SOA, in particular the existence of a formal dispute resolution process that the intention is that the TSOs operate as independent entities at either side of the interfaces and the representatives on the Steering Committee and the Joint Management Committee are to come from two independent entities.

To deliver some of its TSO functions SONI must also interface NIE Networks. For example, when managing increased renewable connections on the grid as a consequence of NI government targets, progressing significant infrastructure development and network planning.

The planning function in particular illustrates the complexity of the relationships in which SONI is engaged. For the purposes of all-island system planning SONI produces a number of documents in regard to the Northern Ireland system 'in consultation with' the ROI TSO and these must be prepared on a 'consistent basis' with similar documents that the ROI TSO is required to produce under its Licence. These documents are NI TSO facing responsibilities under SONI's Licence that inform functions and planning that are to be considered in conjunction with Eirgrid TSO via the interface under the SOA.

It is critically important that these documents are prepared within SONI so that the specificities of the NI system are represented (notwithstanding the requirement to produce the documents in consultation with the ROI TOS). This becomes more important in the context of the SEM where for example the generation capacity statement informs the capacity requirement for the capacity remuneration mechanism. As the capacity remuneration mechanism is an all island auction it is vitally important that the NI requirement has been factored in from SONI acting independently to provide necessary challenge to all island assumptions where appropriate.

Since 2013 when pre-construction of network projects was moved from NIE Networks, SONI's planning function also has an NI-facing element where SONI is required to produce high level need analysis, secure planning permission and landowner consent for network projects to be built by NIE Networks. NIE Networks retain the detailed network development and maintenance function. The joint working arrangements relating to this function are governed by the Transmission Interface Agreement between SONI and NIE Networks.

## Appendix 2 - SEMO Functions and Governance Arrangements

The SEMO is referred to as the 'SEM Operator' in the legislation. The SEM Operator's duties in the legislation are limited to those covered by the SEM trading and settlement code.

In the SEMO Licence, the functions of the 'Market Operator Activity' and 'Nominated Electricity Market Operator (NEMO) Activity' are defined as follows:

### 'Market Operator Activity'

- Administration and maintenance of the 'Single Electricity Trading and Settlement Code' (the Code) which includes
  - ◆ setting out the terms of the trading and settlement arrangements for the sale and purchase of wholesale electricity in the Balancing Market;
  - ◆ in conjunction with the Capacity Market Code, setting out the settlement arrangements for the Capacity Market
- Facilitation of modifications to the code under modifications procedures (ultimate approval by the Regulatory Authorities)
- Operation and maintenance of the SEM Trading and Settlement System under the Code
- Carrying out market operator obligations under the Code
- Acting as 'Agent of Last Resort'

### Nominated Electricity Market Operator (NEMO) Activity:

- Performance of the day-ahead and intraday market coupling arrangements which includes (as defined by the CACM Regulation);
- Operation of the day ahead market
- Operation of the intraday market

The structure and governance of the MO is very different to that of the TSOs, working in conjunction under the SOA. This reflects the fact that the SEMO is a contractual joint venture (CJV) between Eirgrid and SONI.

While there are two MO licences to SONI in NI and Eirgrid in ROI, the CJV 'SEMO' has its own resources separate to the TSO's. SEMO has a separate price control,

which is distinct from the SONI TSO Price Control in NI and the Eirgrid TSO Price Control in ROI. There is a Market Operator Agreement (MOA), but this is not an interface agreement as per the SOA.

The MOA governance structure is also quite different than that of the SOA, particularly given that SEMO is a CJV with its own resources. Specifically, the SEMO governance structure comprises a Governing Committee and a General Manager. The functions of the Governing Committee are as follows:

- Appointment and replacement of the General Manager
- Approval of the submission to the Regulatory Authorities for the SEMO price control
- Approval of the SEMO budget annually (all resources including staff)
- Approval of any matters outside of the budget (including staff recruitment outside of the budget)
- Determining (and notifying where appropriate) a Force Majeure under the MOA or the Trading and Settlement Code.

The functions of the Governing Committee clearly show how different the structure of the MOA is to the SOA in both form and effect. It follows that SONI's MO and NEMO functions are deliberately designed to be integrated with Eirgrid's MO and NEMO functions.

## Appendix 3 – SONI TSO Licence Condition 12

### “Independence of the Transmission System Operator Business”

The full text of Condition 12 is as follows:

#### “General Duty

- 1 The Licensee shall:
  - (a) unless it has already done so prior to this Condition coming into force, establish; and
  - (b) at all times thereafter maintain, the full operational independence of the Transmission System Operator Business.

#### Specific Duties

- 2 For the purpose of facilitating its compliance with paragraph 1, the Licensee shall ensure that:
  - (a) the Transmission System Operator Business is provided with the premises, systems, equipment, facilities, property, personnel, data and management resources that are necessary for its efficient and effective managerial and operational independence from any Associated Business;
  - (b) it does not hold or acquire shares in a holding company of the Licensee or in any electricity undertaking engaged in the generation or supply of electricity on the Island of Ireland;
  - (c) decisions relating to the transmission system (or any part of it) for which it is responsible are taken by those persons who are directors of the Licensee or who are employed by, and are engaged in the operation and management of, the Transmission System Operator Business (and no others);
  - (d) any Associated Business does not use or have access to:
    - (a) premises or parts of premises occupied by persons engaged in the management or operation of the Transmission System Operator Business (provided always that nothing in this paragraph shall prevent the Market Operation Activity and / or the NEMO Activity being carried on in such premises);
    - (b) systems for the recording, processing or storage of data to which persons engaged in the management or operation of the Transmission System Operator Business also have access;

- (c) equipment, facilities or property employed for the management or operation of the Transmission System Operator Business;
- (d) the services of persons who are (whether or not as their principal occupation) engaged in the management or operation of the Transmission System Operator Business;
- (e) it can and does, in so far as is legally possible:
  - (a) ensure that any director of the Licensee is not at the same time also a director of a company which carries on an Associated Business engaged in the generation or supply of electricity; and
  - (b) prevent any person who has ceased to be engaged in the management or operation of the Transmission System Operator Business from being engaged in the activities of any Associated Business that is engaged in the generation or supply of electricity until the expiry of an appropriate time from the date on which he ceased to be engaged by the Transmission System Operator Business; and
- (f) an up-to-date register of all persons engaged in the Transmission System Operator Business, confirming that the provisions of paragraph (e) have been complied with in respect of each person so engaged, is established.

#### Compliance Plan

3. The Licensee shall, by no later than SEM Go-Live, prepare and submit to the Authority for its approval a compliance plan setting out the practices, procedures, systems and rules of conduct which the Licensee has adopted, or intends to adopt, together with the timescales for adoption, to ensure its compliance with this Condition.
4. The Licensee shall use all reasonable endeavours to comply with its approved compliance plan (the "Compliance Plan") and shall publish the up to date Compliance Plan on its website.
- 5 The Authority may:
  - (a) within 30 days of the Licensee submitting an initial or revised Compliance Plan; and
  - (b) following any review of the Compliance Plan that the Authority may conduct from time to time, notify the Licensee that, in its opinion, the Compliance Plan is not, or is no longer, sufficient for the purposes of the Licensee's compliance with this Condition, and require such revisions to be made to the Compliance Plan as are in the Authority's opinion necessary or expedient in order for it to

be sufficient for the purposes of ensuring the Licensee's compliance or continued compliance with this Condition.

- 6 Where the Licensee receives a notification in accordance with paragraph 5, it shall within 30 days revise the Compliance Plan in such manner and to such extent as will reflect the Authority's requirements.
- 7 The Licensee shall at least once every year during which this Condition is in force review the Compliance Plan so as to ensure:
  - (a) its continued compliance with its obligations under this Condition; and
  - (b) that the information set out in the Compliance Plan continues to be accurate in all material respects.
- 8 Where the Licensee revises the Compliance Plan, either in accordance with paragraph 6 or following a review conducted by it in accordance with paragraph 7, it shall submit the revised Compliance Plan to the Authority for its approval.
- 9 The Licensee shall ensure that persons engaged in the management and operation of the Transmission System Operator Business:
  - (a) are made aware of the practices, procedures, systems and rules of conduct set out in the Compliance Plan;
  - (b) have the necessary information and facilities to comply with their respective obligations as provided for in the Compliance Plan; and
  - (c) are aware of the disciplinary procedures that may be activated should they fail to comply with their obligations under the Compliance Plan.

#### Compliance Manager

- 10 The Licensee shall, following consultation with the Authority, appoint a senior member of its personnel engaged in the management and operation of the Transmission System Operator Business as a manager (the "Compliance Manager") for the purpose of facilitating compliance with its obligations under this Condition and with the Compliance Plan.
- 11 The Licensee shall ensure that the Compliance Manager has access to such staff, premises, systems, information, documentation, equipment, facilities and other resources as he might reasonably expect to require to fulfil the duties and tasks assigned to him.
- 12 The duties and tasks assigned to the Compliance Manager shall include:
  - (a) providing relevant advice and information to the Licensee for the purpose of ensuring its compliance with this Condition and with the Compliance Plan;

- (b) monitoring the effectiveness of and the Licensee's compliance with the Compliance Plan;
- (c) investigating any complaint or representation received by the Licensee from any person in respect of any matter arising under or by virtue of this Condition or in relation to the Compliance Plan;
- (d) recommending and advising upon the remedial action which any such investigation has demonstrated to be necessary or desirable, including where necessary revising the Compliance Plan to reflect such recommendation and advice; and
- (e) reporting, at such frequency as is determined in writing by the Authority, to the directors of the Licensee on his activities during the period covered by the report, the investigations he has conducted and on progress towards implementation of the Compliance Plan.

13 The Licensee shall, at such frequency as is determined in writing by the Authority, submit a report to the Authority:

- (a) detailing the activities of the Compliance Manager during the period covered by the report;
- (b) providing a progress update on the Licensee's implementation of the Compliance Plan;
- (c) setting out the details of any investigations conducted by the Compliance Manager, including:
  - (a) the number, type and source of the complaint or representation on which such investigations were based;
  - (b) the outcome of such investigations; and
  - (c) any remedial action taken by the Licensee following such investigations.

#### Definitions

14 In this Condition, unless the context otherwise requires:

- |                             |  |
|-----------------------------|--|
| <b>“appropriate time”</b>   | means the period of 6 months or such other period as the Authority may specify in respect of any person or class of persons. |
| <b>“Compliance Manager”</b> | shall have the meaning attributed to that expression in paragraph 10.  |
| <b>“Compliance Plan”</b>    | shall have the meaning attributed to that expression in paragraph 4.   |

**“relevant holding company”** means each holding company of the Licensee which does not itself generate or supply electricity on the Island of Ireland and which has no holding company that itself generates or supplies electricity on the Island of Ireland (regardless of whether any subsidiaries of such companies undertake such generation or supply).”

In addition, Condition 1 includes a number of definitions upon which Condition 12 relies, including:

**“affiliate”** means, in relation to any person, any company which is a subsidiary of such person or a company of which such person is a subsidiary or a company which is another subsidiary of a company of which such person is a subsidiary.

**“Associated Business”** means any business of the Licensee (or of any affiliate or related undertaking of the Licensee) other than a relevant holding company.