



SEMO Price Control Submission

Paper 1

Executive Summary

1st April 2010

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BACKGROUND

The Single Electricity Market (SEM) is the wholesale electricity Market operating across the Republic of Ireland and Northern Ireland. Created through a contractual joint venture between EirGrid and SONI, the Single Electricity Market Operator (SEMO) is responsible for the continuous operation, administration and development of the SEM.

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To date, SEMO has been subject to three Price Controls each covering a duration of one tariff year, with the current Price Control due to expire on 30th September 2010. This, the fourth SEMO Price Control Submission outlines SEMO's projected requirements for the period encompassing the 2010-2013 tariff years.

SEMO's role initially has been in the growth and development of the Central Market Systems and the facilitation of the new Market. As SEMO matures and enters this longer Price Control period it is not envisaged that a significant increase in resources will be necessary under the current Market conditions. It is however outlined in Paper No 3 Forward Work Program that a number of emerging developments in the Market will have an affect on SEMO's Capex and Opex costs.

The SEMO Price Control Submission consists of seven strategic documents detailing estimates for Capital and Operational requirements over the course of the Price Control period. A Forward Work Program outlining a number of forthcoming policy directions with likely implications for the SEM, however, which cannot be sufficiently detailed in fiscal terms at this time. It is noted that the WACC and Indexation papers are covered by the Parent Companies and therefore not included as part of this Submission.

Attached in Appendix No 1 is a summary of the costs over the three year period. The key influence on SEMO's costs is depreciation – as the Market systems mature, depreciation on these assets decreases. SEMO needs to continue to invest in these systems and a Capital program of some €17m is required over the period in order to maintain the level of system efficiency currently being provided.

The costs proposed reflect SEMO's ability to drive efficiencies whilst continuing to operate the Market and acknowledging key developments planed for within the period.

SEMO PRICE CONTROL SUBMISSION SUMMARY

A summary of the documents comprising the SEMO Price Control Submission for the tariff period covering 2010-2013 is provided herewith. In dividing the Submission into its various parts, SEMO has attempted to minimise the delay in the completion of the Submission and any queries it might generate, thereby mitigating delays to the overall Price Control.

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- Paper 2: Price Control Principles
- Paper 3: Forward Work Program
- Paper 4: Operational Expenditure
- Paper 5: Capital Expenditure
- Paper 6: Incentivisation
- Paper 7: Market Operator Charges

PAPER 2: PRICE CONTROL PRINCIPLES

On the basis of the degree to which the SEM has stabilised and matured since go-live in November 2007, SEMO believes that the application of a multi-annual incentive regulation has the potential to deliver optimal results for the Market and benefits to its stakeholders. SEMO holds that the Regulatory Authorities and participants alike are now familiar with the workings and associated costs of running the Market, and hence proposes a revised format for this period of Price Control. The following key principles guide the SEMO Price Control Submission and are detailed within Paper 2:

1. The Price Control period should run for a term of three years (1st October 2010 to 30th September 2013)
2. The regulatory reporting arrangements should be consistent with a three year price control.
3. Appropriate and reasonable cost indexation is to be applied.
4. Exchange Rate risks should be catered for on a cost pass through basis.
5. The Price Control should exclude Exceptional Market Changes and Developments.
6. Energy and capacity cash-flows will be treated on a cost pass-through basis.
7. Incentives on Key Performance Indicators are to be applied on an annual basis for the 3 year duration.
8. A form of incentivisation is to be included for Capex
9. Reasonably predictable capital costs are to be provided for over the duration of the Price Control.

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10. The cost of capital (WACC) is to remain consistent with the figures provided by the Parent Companies EirGrid and SONI and is to be blended by a 75:25 weighting consistent with the specified proportions.
 11. Uncertain costs which were either too uncertain to be provided for, or not identified, at the outset of the control by the business should be dealt with annually on a cost pass-through basis.
 12. Forecasts of the following items will be identified on a yearly basis for the 3 year Price Control:
 - TSO Dispatch Balancing Costs
 - The number of Demand Units, Generator Units and Supplier Units
 - Annual Load Forecasts
 - Energy Imbalances
 - Make Whole Payments
 13. Imperfection costs (Constraints to be submitted by the TSOs).

PAPER 3: FORWARD WORK PROGRAM

The Forward Work Program included within this Price Control Submission outlines a number of forthcoming policy and development initiatives on the SEMO agenda. While these projects may be further along the horizon than can be adequately detailed herein, it is important that the longer term direction of the Market be included when considering SEMO's undertakings. Further, although SEMO may not be the lead consultative body on these matters there is likely to be significant buy-in and impact on either the Market Rules, the Central Market Systems, or both.

It is SEMO's strategy not to include these costs within this Submission but to address the appropriate Capex and Opex requirements in the future as key decisions in the Market are made. The following key initiatives are included within the Paper 3: Forward Work Program:

- SEM Regional Integration – The readiness of the Market to cope with increased interconnection with the UK and Europe, and its ability to adopt EU policy commitments is integral to the continued operation of the SEM as a world class marketplace.
- Capacity Payment Mechanism Medium Term Review – The review aims to examine if the potential exists to improve the Capacity Payments Mechanism in the evolving marketplace. Any changes to the current system will require caution and certainty.
- Principles of Dispatch and the Design of the Market Schedule – As the Irish, British and EU governments push towards the increased inclusion of renewable energy sources it is pertinent that SEMO identify the practical implications of these high level policy requirements including changes to both the Market Rules and Central Systems.
- Global Settlement – The implementation of a strategy of global aggregation is currently under consideration by the Trading and Settlement Code Modifications Committee which is responsible for making decisions on changes to the Market Rules.

- Generator Short Term Test – A Modification Proposal is currently being considered in relation to the implementation of a short term test status for within day generator testing. This would progress the market and remove the need for a work around situation as is currently the case.
- Market Power and Liquidity in the SEM – The Regulatory Authorities have indicated that they intend to review this area with particular concentration on the levels of Market power/liquidity, the effects of Market power mitigation measures, impacts of the ESB reintegration proposal and other related proposals.
- Uplift Review – It is pertinent that any proposed changes to the use of Uplift in key SEM calculations be assessed and reviewed by SEMO and expressed ahead of any potential change to policy on this issue.
- Fuel Mix Disclosure – EU Directive 2003/54/EC, places on the Regulatory Authorities within each jurisdiction the responsibility for the disclosure of information on the contribution of each energy source to the overall fuel mix available to end customers. SEMO is considering potential mechanisms for delivering this EU requirement in an automated and permanent way.

PAPER 4: OPERATIONAL EXPENDITURE

Contained within Paper 4 Operational Expenditure (Opex) is a set of proposals in support of the Questionnaire which was received from the Regulatory Authorities in January 2010.

The paper sets out the key principles applied to Opex for the Revenue period 1st October 2010 to 30th September 2013. In line with this longer Price Control period SEMO has outlined what it believes to be the necessary operational costs going forward allowing for continued operation of the Central Market Systems and with consideration for the future development of the Market.

The costs outlined in the Opex paper reflect incremental increases during the period with Payroll costs reflecting a workforce of 55 personnel. Added pension costs are included, which would have been covered from within the Price Control Submissions of the Parent Companies, EirGrid and SONI. It is noted that staff requirements that may result from major initiatives and undertakings which attract capital expenditure will be addressed as part of those decisions going forward.

The inclusion of General and Administrative costs covers general business operations services including travel and subsistence, office supplies, banking charges and staff training otherwise not captured. Further, an allocation is sought for Group Services costs accounting for those services procured from within the EirGrid Group.

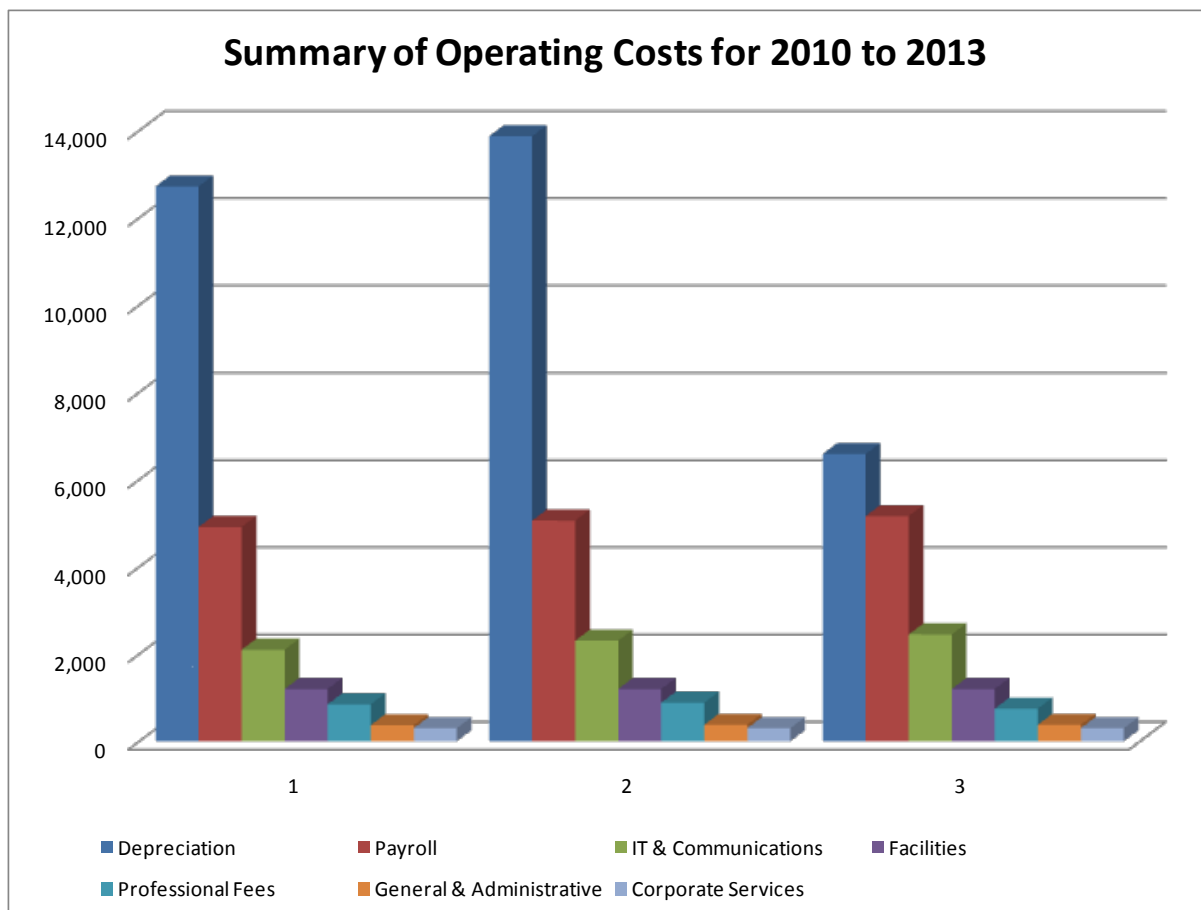
This paper also outlines the required costs for the ongoing support and development of the SEMO Central Market Systems and its underlying communication links, on which the operation of the overall Market is reliant. Facilities costs are also detailed and include requirements such as cleaning and maintenance, as well as rent, insurance and utilities costs.

The paper notes that Professional Fees increase in the first two years of the Price Control period and reduces in year three as it is anticipated that by this time key Market decisions (requiring additional professional expertise and assistance) will have been taken and initiatives either implemented or in project mode.

A summary of internal operational costs is provided herewith.

OPERATING COSTS	SEMO Operating Costs		
	2010/11	2011/12	2012/13
	Current Prices €'000		
Payroll	4,911	5,057	5,161
IT & Communications	2,098	2,304	2,448
Facilities	1,196	1,196	1,196
Professional Fees	847	884	747
General & Administrative	367	377	377
Group Services	300	300	300
Total Internal Costs	9,719	10,118	10,229

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PAPER 5: CAPITAL EXPENDITURE

Capital Expenditure (Capex) is designed to allow SEMO to invest in new and improved systems in order to fulfil its operational and Market management requirements. SEMO is seeking three capital allowances for:

- Biannual IT Market Release Capex – To be used to facilitate the rollout of Central Market System software releases, the content of which will be approved by the Regulatory Authorities.
- a. IT Release Capex – A formal contract has been negotiated between SEMO and the software vendor for the provision of two releases per year for the three years beginning with the April 2010 release. The total minimum commitment for across the period is 36,750 hours or €6,798,750.
- b. IT Release Support Capex– There is a requirement for support services to ensure the smooth transition between system releases, including subcontractor costs, vendor support, application upgrades and support associated with testing.
- Predictable Business Capex – Enables SEMO to plan for hardware and software upgrades and the implementation of additional operational support systems as and when the need arises. A number of business cases are included within this paper to outline the more specific requirements.
- Unpredictable Business Capex – Required for IT related issues that occur on a daily basis, which cannot be accurately budgeted for but require immediate attention when they arise e.g. hardware failures, additional data storage devices, Digital Certificates etc.

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Future Business Capex that cannot be accounted for at this time does not form any part of the Revenue Submission. The Market System Development Plan (MSDP) and the Forward Work Programmes of the respective Regulatory Authorities, however, provide some indication of major projects facing SEMO in the near future. It is proposed that SEMO will seek further Capital and Operational allowances as part of the annual adjustment process as and when the Regulatory Authorities make new policy decisions which significantly impact the SEM.

Capex Category	Year 1	Year 2	Year 3	Total
Biannual IT Release Capex	€2,266,250	€2,266,250	€2,266,250	€6,798,750
Predictable Business Capex	€2,710,000	€5,230,000	€700,000	€8,640,000
Unpredictable Business Capex	€250,000	€250,000	€250,000	€750,000
Total proposed Capex Allowance	€5,226,250	€7,446,250	€3,216,250	€15,948,750

Summary Capital Expenditure

PAPER 6: INCENTIVISATION

SEMO is currently rewarded through Key Performance Indicators (KPIs) and Capex, for achieving a number of incentivised outcomes aimed at improving performance, promoting customer service, increasing efficiencies and delivering value to customers. SEMO proposes continuing with this mechanism and implementing incentives applied to KPIs and Capital Projects (Predictable Business Capex and IT Release Capex incentives).

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- KPIs – SEMO proposes retaining the four KPIs delivered as part of the previous Price Control and adopting an additional two aimed at reducing the number of resettlements and improving SEMO's customer service standards. SEMO proposes the application of an incentive of 3% per annum (approx €300k of Internal Opex) set on an annual basis and rewarded on a quarterly measurement.
- Predictable Business Capex – Savings in this area achieved through detailed engagement, good project management and delivery, and negotiations should form the basis of an incentive. SEMO believes that there should be an equal sharing of any savings if it can deliver the associated capital project to scope, on time and within the Regulatory approved allowance. SEMO also considers that the threshold for incentivisation on Capex projects should be reduced from its current value of €500k to €100k as this would provide a very strong incentive for SEMO to actively pursue the very best costs for all types of Capital Expenditure.
- IT Release Capex – SEMO delivers two IT releases per annum. It is proposed be rewarded for delivering these release on-time and within budget.

PAPER 7: MARKET OPERATOR CHARGES

Details to follow summer 2010.

APPENDIX 1 SEMO COSTS OCTOBER 2010 TO SEPTEMBER 2013

	EUR ' 000	EUR ' 000	EUR ' 000
OPERATING COSTS	SEMO Input Costs March 2010 Prices		
	2010/11	2011/12	2012/13
Payroll	4,911	5,057	5,161
Salaries	3,132	3,239	3,316
Contractors	236	229	219
Bonus	378	390	400
Employer's PRSI	390	404	413
Employer's Pension Contribution	596	614	629
On Call / Shift	117	120	121
Car Other Benefits	61	61	61
IT & Communications	2,098	2,434	2,608
Warranty, Support & Maintenance	1,820	2,157	2,170
SMO Telecommunications Requirements	278	278	438
Facilities	1,196	1,196	1,196
Rent & Facilities Charges	1,146	1,146	1,146
Insurance	50	50	50
Professional Fees	847	884	747
Legal	50	50	50
Recruitment	40	40	40
Internal Audit	25	25	30
Market Auditor	250	300	300
Committees	53	53	53
Consultancy	411	398	258
RPE	19	19	16
General & Administrative	367	377	377
Travel & Subsistence	168	168	168
Office Supplies	10	10	10
Bank Charges	35	45	45
Training	124	124	124
Miscellaneous incl. Meetings/Conferences	31	31	31
Corporate Services	300	300	300
Total Internal Costs	9,720	10,250	10,389
Depreciation	12,835	13,927	6,627
WACC	1,528	1,066	877
Total Operating Costs	24,083	25,242	17,893

APPENDIX 2 BREAKDOWN OF MARKET COSTS AND DEPRECIATION

