Single Electricity Market Operator (SEMO) Revenue Requirement

Price control commencing 1 October 2016

Decision Paper

03 August 2016

SEM-16-043

1. EXECUTIVE SUMMARY

1.1 BACKGROUND

The current Single Electricity Market Operator (SEMO) Price Control[1] covers the period from 1 October 2013 to 30 September 2016. This paper details the decisions made by the Single Electricity Market Committee (SEMC) on the form of SEMO regulation and SEMO's revenue allowance for the period beginning 1 October 2016, through to the conclusion of the decommissioning of the Single Electricity Market (SEM). This price control will be referred to as the 2016-19 Price Control. The Regulatory Authorities (RAs) published the 2016-19 Price Control consultation paper on 12 May 2016[2] (the Consultation Paper).

As the all-island market prepares for the introduction of the Integrated Single Electricity Market (I-SEM) arrangements, the existing SEM will move from a design and build market to an operate and maintain market model, through to the SEM resettlement and decommissioning periods. SEMO's revenue allowance reflects the winding down of SEM operations. This revenue allowance is related to SEM activities only and does not cover any requirements for I-SEM operation, including any initial market registration or training. I-SEM operational requirements and revenues will be subject to separate engagements with the RAs as required.

1.2 FORM, SCOPE AND DURATION OF PRICE CONTROL

Consistent with previous SEMO price controls this price control is provided on a combined basis between Eirgrid and SONI on a 75% to 25% basis respectively. The 2016-19 Price Control is designed to cover a two and a half period spanning over three tariff years[3] as detailed in Figure 1 below:

<table>
<tr><th>Tariff Year 16/17</th><th colspan="2">Tariff Year 17/18</th><th colspan="6">Tariff Year 18/19</th></tr>
<tr><td>Oct-16 - Sep-17</td><td>Oct-17</td><td>Nov-17 - Sep-18</td><td>Oct-18</td><td>Nov-18</td><td>Dec-18</td><td>Jan-19</td><td>Feb-19</td><td>Mar-19</td></tr>
<tr><td>SEM Trading</td><td>Final Settlement of SEM</td><td colspan="3">Resettlement (M+13)</td><td>Formal Query</td><td colspan="3">Decommissioning</td></tr>
<tr><td colspan="2">SEM</td><td colspan="4">SEM Resettlement</td><td colspan="3">SEM Decommissioning</td></tr>
</table>

Figure 1: 2016-19 Price Control Tariff Year Components

[1] SEM-13-054 SEMO 2013-2016 Price Control Decision Paper
[2] SEM-16-023 SEMO Price Control commencing 1 October 2016 Consultation Paper, 12 May 2016
[3] Tariff years run from 1 October to the following 30 September

The 2016-19 Price Control is composed of the following three distinct periods:

1. The ‘SEM’ period, which includes the SEM trading period and the associated final settlement of the SEM, as shown in Figure 1 above. The SEM period will end on the last day of the calendar month following the final SEM trading date, which given the current planned I-SEM Go-Live date of 1 October 2017, equates to an end date of 31 October 2017.

2. The ‘SEM resettlement period’ which encapsulates M+13 resettlement and the one month long formal query window at the end of this 13 month period. The SEM resettlement period is due to begin on 1 November 2017 and end on 31 December 2018, given the current predicted I-SEM Go-Live date of 1 October 2017.

3. The ‘SEM decommissioning period’ which is three months in length and scheduled to run from 1 January 2019 to 31 March 2019.

The 2016-19 Price Control is designed to be flexible and will be adjusted, on a proportionate basis, to take account of any movements in the I-SEM commencement date. The allowances provided for in this decision paper are done so on a tariff year basis and take into account the components of each tariff year as shown in figure 1 above.

1.3 SEMC DECISIONS

Three responses were received to the Consultation Paper, from the following participants;

- SEMO
- Power NI Energy Limited Power Procurement Business (PPB)
- Brookfield Renewable

The SEMC have considered the responses and following ongoing engagement with SEMO have arrived at the following decisions regarding the form of regulation and the revenue allowance to be provided to SEMO under the 2016-19 Price Control:

- To provide an allowance of €12.78 million for operating expenditure (OPEX). This compares to SEMO’s submission for €13.28 million and represents a reduction of 4%. This OPEX allowance includes provision for 42 Full Time Equivalents (FTEs), 15 FTEs and 7 FTEs in each of the respective tariff years of the Price Control.

- OPEX will be subject to a revenue-cap regime adjusted by an inflation-X rate, with an X of 0.3, for the SEM period. This will provide an incentive for efficiency, as any savings within the allowed revenue can be kept by SEMO. OPEX within the SEM resettlement and decommissioning periods will be treated on a cost pass-through basis.
- To provide an allowance of €1.02 million for capital expenditure (CAPEX). This compares to SEMO's submission for €1.64 million and represents a reduction of 38%. A key driver behind this reduced figure is the removal of the CAPEX allowance for bi-annual releases, the requirement for which does not exist in the next price control period.
- CAPEX will be provided for on a cost pass-through basis during the 2016-19 Price Control.
- SEMO will be remunerated for 100% of their residual Regulatory Asset Base (RAB) value as at the end of the SEM decommissioning period, through an appropriate tariff mechanism in the I-SEM.
- The SONI Market Operator (MO) licence requirement for contingent capital will be remunerated at a value of €0.3 million per annum for the remainder of the SEM period. This allowance will fall, in line with SEMO's reduced working capital risk, to a level of €0.06 million per annum during the SEM resettlement period and a level of zero during the SEM decommissioning period.
- SEMO will be subject to a Weighted Average Cost of Capital (WACC) rate of 5.07%, calculated using the WACC rates from the SONI and Eirgrid System Operator price controls[4] in line with specified proportions.
- SEMO will continue to be incentivised through the use of Key Performance Indicators (KPIs) up to the end of the SEM resettlement period, with an additional Modified Interconnector Unit Nomination (MIUN) KPI being added for the SEM period.
- SEMO are to consult on available options for the decommissioning of the SEM and have in place a decommissioning plan by no later than 31 July 2017.
- SEMO's revenue will be corrected year by year by the outturn rate of inflation. All figures in this decision paper are presented in March 2015 prices, unless stated otherwise.

[4] Utility Regulator Decision on SONI Price Control 2010-2015 and CER Decision on TSO and TAO Transmission Revenue for 2016 to 2020

The table below provides a summary of SEMO's revenue allowance for the 2016-19 Price Control.

€ million	**SEMO's Submission for 2016-19**	**RAs Proposal for 2016-19**	**SEMC Decision for 2016-19**
OPEX			
Total Payroll	4.79	3.68	4.44
Total IT & Communications	5.62	5.62	5.66*
Total Facilities and Insurance	1.02	-	0.97
Total Professional Fees	0.56	0.56	0.51
Total General and Administrative	0.35	0.35	0.31
Total Corporate Services	0.94	0.94	0.89
Total	**13.28**	**11.15**	**12.78**
Cost of Capital			
Depreciation	5.87	5.46	5.10
WACC	0.49	0.47	0.41
Total	**19.64**	**17.08**	**18.29**
Parent Company Guarantee	**0.41**	**0.30**	**0.39**
Total Revenue Requirement	**20.05**	**17.38**	**18.68**
CAPEX Submission (incorporated in Depreciation Charge above)	**1.64**	**1.08**	**1.02**

Table 1: SEMC Decision on SEMO allowance

*Includes €20k per annum for maintenance of SEMO website for 2 years after I-SEM Go-Live date

The 2016-19 Price Control will take effect from 1 October 2016. Licence modifications will be consulted on shortly after publication of this decision paper. Decisions set out in the decision paper represent direction under Sections 36A and 36B of the Electricity Regulation Act.

2. CONTENTS

TABLE OF CONTENTS

All figures are in March 2015 prices, unless stated otherwise

3. INTRODUCTION

3.1 THE SINGLE ELECTRICITY MARKET

The all-island wholesale electricity market was established as the SEM in November 2007. The SEM is a centralised gross mandatory pool market, with electricity being bought and sold through the pool under a market clearing mechanism.

Generators receive the System Marginal Price (SMP) for their scheduled dispatch quantities, Capacity Payments for their actual availability and Constraint Payments for dispatches outside the market schedule due to system constraints and other specific factors.

Suppliers purchasing energy from the pool will pay the SMP for each trading period, Capacity Charges, and System Support Charges. The SEM market rules are set out in the Trading and Settlement Code (TSC)[5]. The SEM is governed by the SEMC which was set up by the Governments in the Republic of Ireland (ROI) and Northern Ireland (NI). This Committee has representatives from both RAs, the Utility Regulator (UR) in NI and the Commission for Energy Regulation (CER) in ROI, together with an Independent Member.

3.2 ROLE OF SEMO

The development of the SEM led to the requirement for a Single Electricity Market Operator (SEMO), to administer the market. The RAs approved the creation of a cross jurisdictional joint venture between Eirgrid and SONI, the Transmission System Operators in ROI and NI respectively, to from SEMO to administer the SEM.

SEMO's role in the market is explicitly defined in the SEM TSC, which sets out the rules, procedures and terms and conditions, which all parties, including SEMO, must adhere to in order to participate in the SEM. Additionally, both EirGrid and SONI must comply with the conditions imposed on this activity by their respective MO Licences.

As defined in section 1.3 of the TSC, SEMO's role is to 'facilitate the efficient, economic and coordinated operation, administration and development of the Single Electricity Market in a financially secure manner'.

[5] http://www.sem-o.com/MarketDevelopment/MarketRules/TSC.docx

3.3 SEMO REVENUE & CHARGES

SEMO's operational and capital costs are recovered through MO tariffs and fees, which are levied on market participants.

As part of the 2016-19 Price Control process, the RAs issued a price control questionnaire to SEMO, and SEMO completed the questionnaire by submitting proposals for their revenue requirement, on a combined basis, for the two MO licensees. SEMO's questionnaire was completed on a tariff year basis. In line with previous price controls, SEMO's price control allowance will be recovered by SONI and Eirgrid, per the agreed specified proportions. The current agreed apportionment between EirGrid and SONI is 75% and 25% respectively and this is based on comparative levels of energy consumption in ROI and NI. This current apportionment is also detailed in the Market Operator Agreement (MOA) between Eirgrid and SONI. EirGrid plc and SONI Ltd entered into this MOA in 2007, in accordance with the requirements of their respective MO licences.

3.4 REGULATORY APPROVAL PROCESS

In order to determine an appropriate revenue entitlement for SEMO, the RAs analysed and reviewed SEMO's submission and associated supporting information. The RAs published the Consultation Paper[6] on the basis of that review, in May 2016. The objective of this was to solicit comments from stakeholders on the RAs' proposals.

Three responses to the consultation were received. These have been published alongside this decision paper. Comments were received from:

- SEMO
- Power NI Energy Limited Power Procurement Business (PPB)
- Brookfield Renewable

The RAs met with SEMO after SEMO's response had been received to discuss their views and obtain clarification on various issues.

[6] SEM-16-023 SEMO Price Control commencing 1 October 2016 Consultation Paper, 12 May 2016

3.5 SEM REDESIGN

Currently, the RAs are involved in redesigning the SEM, in the context of creating the Integrated Single Electricity Market (I-SEM), on the island of Ireland. The I-SEM is being implemented for economic reasons and will most likely be significantly different from the current SEM. Any costs associated with the design, implementation and operation of the I-SEM are not included in this price control.

3.6 DECISION PAPER

This SEMC decision paper relates to the SEMO revenue allowance for the two and a half year period from 1 October 2016 to 30 March 2019. The decision takes into account comments received during the consultation process. Licence modifications will be consulted on shortly after publication of this decision paper. Decisions set out in the decision paper represent direction under Sections 36A and 36B of the Electricity Regulation Act.

4. REGULATORY PRINCIPLES

The principal objective of the SEMC is to protect the interests of consumers of electricity on the island of Ireland and, where possible, to do so by promoting effective competition.

The SEM Committee, in carrying out their functions, shall have regard to the principles underpinning regulatory activities[7]:

- Transparent
- Accountable
- Proportionate
- Consistent
- Targeted.

5. FORM, SCOPE & DURATION

5.1 FORM

SEMO exists as a contractual joint venture between the System Operator in ROI (EirGrid) and the System Operator for NI (SONI) and is not a separate legal entity in its own right. Therefore, the SEMO price control incorporates factors affecting each of the companies making up the joint venture e.g. financeability (Parent Company Guarantee), Weighted Average Cost of Capital (WACC) and recharges. SEMO operates on a cross-jurisdictional basis and is governed by two MO licences, issued by the two RAs on the island.

A combined RA price control will apply for the MO business as a whole. This is consistent with the approach taken for previous SEMO price controls.

[7] The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007

5.2 OPEX & CAPEX REGULATION

OPEX

In the Consultation Paper the RAs advocated the incentivisation of OPEX for the remainder of the SEM, under revenue cap (Inflation-X) regulation, with an X of 0.3 to be applied. Revenue cap regulation incentivises the regulated company to reduce costs by increased efficiency of processes and lower input prices. Any efficiency and price savings are retained by the regulated company while overspends must be absorbed by the regulated company unless approved by the RAs on the basis that they have been efficiently and prudently incurred.

As the required OPEX under the SEM resettlement and decommissioning periods is uncertain at this stage, with no comparables, the RAs proposed allowing for OPEX on a cost pass-through basis during these periods. Under this approach, any underspend on OPEX is returned to consumers through the k-factor mechanism. Additionally, any overspend on OPEX would only be recoverable by SEMO if the RAs approve such costs on the basis that they have been efficiently and prudently incurred.

RESPONSE

In their response SEMO consider that for a cost pass-through model to work, the base assumption must be that any cost overspend would be recoverable by the company, subject to normal regulatory oversight that any such costs are efficiently and prudently incurred.

PPB agrees with the proposed regulatory framework in relation to OPEX.

SEMC DECISION

SEMC Decision: OPEX to be regulated under an Inflation-X regime, with an X factor of 0.3 to be applied, for the SEM period. OPEX to be regulated on a cost pass-through basis for the SEM resettlement and decommissioning periods.

RA approval is required for any amounts SEMO wish to be compensated for, over and above the allowances provided for in this decision paper.

CAPEX

The RAs proposed to continue with rate of return regulation for SEMO's historical and new CAPEX. This method of regulation provides a return to SEMO based on their RAB. SEMO's RAB is calculated based on the actual historical costs of their RAB, depreciated on a straight line basis over five years and increased each year for any RAB additions, which are then subject to the same depreciation policy. The RAB value is indexed each year, to account for inflation, and a rate of return (representing compensation for risk and the opportunity cost of the capital) is provided. This rate of return is referred to as the WACC and is directly derived from a combination of the WACC applicable to EirGrid and SONI.

As part of the menu regulation approach to CAPEX, within the current price control, SEMO chose a CAPEX allowance of €8.807m. SEMO's outperformance against this CAPEX budget entitles SEMO to an incentive payment. This incentive payment will be issued to SEMO via the k-factor mechanism. As stated in the Consultation Paper, the RAs were not minded to include this menu regulation incentivisation approach in the 2016-19 Price Control, due to the low levels of CAPEX involved. The RAs considered that CAPEX in all periods of the 2016-19 Price Control should be treated on a cost pass-through basis. As stated previously, under this approach any underspend on CAPEX would be returned to consumers via the k-factor mechanism, with any overspend on CAPEX being recoverable by SEMO, only if approved by the RAs on the basis that such costs have been efficiently and prudently incurred.

RESPONSE

PPB considers the rate of return regulation to be appropriate, except in cases where the investment is relatively minor (e.g. less than £100k).

SEMC DECISION

SEMC Decision: CAPEX to be regulated by rate of return regulation and on a cost pass-through basis during the 2016-19 Price Control.

5.3 TARIFFS

Tariffs will be calculated to enable SEMO to recover its allowance based on forecasted market demand. Any difference between forecasted and actual market demand will necessitate a balancing of the resultant over or under recovery experienced by SEMO, when finalising tariffs for the following year. This 'truing up' figure forms part of the k-factor applied to the following year's tariffs.

In the Consultation Paper the RAs advocated that the Imperfection k-factor/tariff process and MO k-factor/MO Charges arrangements, be recovered through a tariff in the I-SEM, once the SEM ceases.

RESPONSE

In their response SEMO welcomed the RAs' proposal that any under or over recovery (k-factors) be recovered via I-SEM tariffs. SEMO expressed concerns that such a tariff in I-SEM had yet to be developed and proposed that any outstanding amounts be recovered through the Transmission Use of System (TUOS) tariffs in ROI and the System Support Services (SSS) tariffs in NI.

SEMO also suggested that this mechanism needs to be extended to the recovery of any residual RAB and any further costs that may be required as a result of RA requests, such as those required to maintain the website post decommissioning. The recovery of the residual RAB is discussed in section 9 of this decision paper.

In their response to the Consultation Paper, PPB state that they agree with the proposal to allow the final k-factors, associated with the Imperfections tariff and MO charges, to be recovered by a tariff in the I-SEM.

SEMC DECISION

SEMC Decision: Any outstanding k-factor amounts and allowances specifically referred to in this decision paper are to be recovered through an appropriate tariff mechanism in the I-SEM.

5.4 SCOPE

The SEM has provided a platform for the wholesale trade of electricity in ROI and NI since Go-Live in 2007. However, development towards European electricity market integration, through the I-SEM, has the potential to significantly change the current SEM design. This represents the next major development of the trading arrangements on the island of Ireland.

When the price control questionnaire was issued to SEMO, in February 2016, the RAs requested that SEMO assume a 'business as usual' approach to maintaining the current structure of the SEM. Any expenditure associated with the I-SEM is considered outside the scope of the 2016-19 Price Control.

SEMC DECISION

SEMC Decision: The 2016-19 Price Control is provided on a 'business as usual' basis, and contains no allowances in relation to the I-SEM project.

5.5 DURATION

The current (2013-16) price control is three years in length and comes to an end on 30 September 2016. The Consultation Paper discussed the implementation of a price control to cover the following periods:

- Period 1 - the remainder of the SEM (currently due to end on 31 October 2017)
- Period 2 - the SEM resettlement period (currently M+13 from 1 November 2017 to 30 November 2018)
- Period 3 – the SEM decommissioning period (SEMO assumed a period of 12 months from 1 December 2018 to 30 November 2019)

In the Consultation Paper the RAs required that the 2016-19 Price Control be flexible enough to account for any shift in the above dates.

RESPONSE

SEMO met with the RAs following the issuance of the Consultation Paper and they advised that the decommissioning period would last for approximately three months, rather than the initially assumed 12 months. SEMO also advised that their submission was made on a tariff year basis, incorporating the following periods:

<table>
<tr><th>Tariff Year 16/17</th><th colspan="2">Tariff Year 17/18</th><th colspan="6">Tariff Year 18/19</th></tr>
<tr><td>Oct-16 - Sep-17</td><td>Oct-17</td><td>Nov-17 - Sep-18</td><td>Oct-18</td><td>Nov-18</td><td>Dec-18</td><td>Jan-19</td><td>Feb-19</td><td>Mar-19</td></tr>
<tr><td>SEM Trading</td><td>Final Settlement of SEM</td><td colspan="3">Resettlement (M+13)</td><td>Formal Query</td><td colspan="3">Decommisioning</td></tr>
<tr><td colspan="2">SEM</td><td colspan="4">SEM Resettlement</td><td colspan="3">SEM Decommissioning</td></tr>
</table>

Figure 1: 2016-19 Price Control Tariff Year Components

This Price Control covers three periods as follows:

1. The 'SEM' period, which includes the SEM trading period and the associated final settlement of the SEM, as shown in the diagram above. The SEM period will end on the last day of the calendar month following the final SEM trading date, which given the current planned I-SEM Go-Live date of 1 October 2017, equates to an end date of 31 October 2017.

2. The 'SEM resettlement period' which encapsulates M+13[8] resettlement and the one month long formal query window at the end of this 13 month resettlement period[9]. The SEM resettlement period is due to begin on 1 November 2017 and end on 31 December 2018, given the current predicted I-SEM Go-Live date.

3. The 'SEM decommissioning period' which is three months in length and scheduled to run from 1 January 2019 to 31 March 2019. This reduction in the length of the decommissioning period directly impacted SEMO's OPEX requirements and also the depreciation and WACC calculations and residual RAB estimate. OPEX costs have been reduced by 50% in the 2018/19 tariff year, to reflect the fact that costs will only run for six months. SEMO advised that CAPEX amounts in the 2018/19 tariff year are not affected by the reduced length of the decommissioning period.

[8] Based on likely rejection of M+4 proposal at June Modifications Committee meeting

[9] Agreed Procedure 13 and Trading & Settlement Code clauses 6.93 to 6.102. These indicate that the final deadline to submit a formal query is 20 working days following the end of the Resettlement Period of M+13

RESPONSE

PPB agrees with the proposal to roll forward the price control should there be any slippage in the I-SEM commencement date provided the slippage does not extend beyond two years. PPB argue that in such a case a new price control should be put in place.

SEMC DECISION

SEMC Decision: 2016-19 Price Control to cover the periods and duration displayed in Figure 1 above.

SEMO's revenue allowance is to be rolled forward (adjusted for inflation) on a proportionate basis in the event of any delay to the I-SEM commencement date, currently scheduled as 1 October 2017.

6. INDEXATION

At the request of the RAs, SEMO made their price control submission using a mid tariff (March 2015) price base. Figures presented in this decision paper are also presented using a March 2015 price base.

In the Consultation Paper the RAs proposed that, as part of the tariff process, SEMO's allowance should be adjusted to account for out-turn inflation up to March of each year, with any further adjustment to be recognised in the k-factor mechanism.

The indexation rate applicable to the current price control is a blended rate of the Consumer Price Index[10], in ROI (75%) and the Retail Price Index[11], in NI (25%). The RAs proposed that SEMO's revenue allowance should continue to be indexed with the existing blended indexation approach for the duration of this 2016-19 Price Control.

RESPONSE

PPB agree with the proposal to use out-turn inflation.

SEMC DECISION

SEMC Decision: SEMO's revenue allowance is to be corrected by the blended out-turn inflation figure, based on the Consumer Price Index, in ROI (75%) and the Retail Price Index, in NI (25%). An X-factor of 0.3 will be applied to this outturn inflation figure for the SEM period.

[10] Based on publication by the Central Statistics Office, Ireland

11 The Office for National Statistics, UK

7. OPERATIONAL EXPENDITURE (OPEX)

SEMO sought an OPEX allowance of €13.28 million for the 2016-19 Price Control. This compares to an actual expenditure of €24.46 million[12], during the current 2013-16 price control. The OPEX sought for the 2016-19 Price Control is substantially lower than OPEX within the current price control based on the fact that the 2016-19 Price Control only contains one year of SEM operations, with the remainder of the 2016-19 Price Control being composed of the SEM resettlement and decommissioning periods. The reduced OPEX allowance reflects the winding down of the SEM and its operations.

The table below displays SEMO's OPEX submission for the 2016-19 Price Control and the RAs' Consultation Paper proposals.

	SEMO's Submission				RAs Consultation Paper			
€ million	**2016-17**	**2017-18**	**2018-19**	**Total**	**2016-17**	**2017-18**	**2018-19**	**Total**
No. Of FTEs	42	15	7		35	10	4	
OPEX								
Total Payroll	2.92	1.19	0.68	4.79	2.46	0.81	0.41	3.68
Total IT & Communications	2.92	2.70	-	5.62	2.92	2.70	-	5.62
Total Facilities and Insurance	0.65	0.26	0.11	1.02	-	-	-	-
Total Professional Fees	0.31	0.15	0.10	0.56	0.31	0.15	0.10	0.56
Total General and Administrative	0.22	0.09	0.04	0.35	0.22	0.09	0.03	0.35
Total Corporate Services	0.45	0.39	0.10	0.94	0.45	0.39	0.10	0.94
Total	**7.47**	**4.78**	**1.03**	**13.28**	**6.36**	**4.14**	**0.64**	**11.15**

Table 2: Consultation Paper OPEX Proposals

[12] Based on actual data for 2013/14 and 2014/15 and an estimate for 2015/16

7.1 PAYROLL

This section discusses the Consultation Paper's payroll recommendations and details the SEMC's decision on the same.

SEMO submission

For the 2016-19 Price Control, SEMO requested a three year payroll allowance totaling €4.79 million. Payroll represented the second largest cost item in the OPEX submission.

SEMO's payroll submission, compared to actual payroll expenditure incurred in the current 2013-16 price control, is summarised in Table 3 below:

	2013-16 Price Control				**SEMO Submission**			
€ million	**Actual**	**Actual**	**Estimate**		**Forecast**	**Forecast**	**Forecast**	
	2013-14	**2014-15**	**2015-16**	**Total**	**2016-17**	**2017-18**	**2018-19**	**Total**
No. of FTEs	58	45	42		42	15	7	
Salaries	3.25	2.28	2.00	7.53	2.00	0.83	0.45	3.28
Bonus	0.36	0.28	0.14	0.78	0.14	0.07	0.04	0.25
Employer's PRSI	0.38	0.24	0.29	0.91	0.29	0.10	0.05	0.44
Employer's Pension Contribution	0.42	0.34	0.32	1.08	0.32	0.12	0.07	0.51
Overtime	-	-	-	-	-	-	-	-
Car Other Benefits	(0.03)	0.05	0.07	0.09	0.07	0.02	0.01	0.10
Contractors/Agency costs	0.11	0.06	0.09	0.26	0.09	0.05	0.06	0.20
Other	0.04	0.07	0.01	0.12	0.01	-	-	0.01
Total Payroll	**4.53**	**3.32**	**2.92**	**10.77**	**2.92**	**1.19**	**0.68**	**4.79**

Table 3: SEMO's Payroll Submission

Tariff year 2016/17

SEMO's requested payroll for the 2016/17 tariff year was consistent with their expectations for the current tariff year outturn, with all elements of payroll remaining at 2015/16 levels.

In the Consultation Paper the RAs questioned the inclusion of 42 FTEs in the 2016/17 tariff year, as SEMO themselves, in their SEMO Revenue Control 2016-19 submission, state, *"As we move into this Operate and Maintain arrangement the requirement for Market Systems Analysis and Design (Impact Assessments, Modification Requests, etc.) will decrease, in line with the level of development expected (System Defects, SEM Design Service Requests etc.) over the 2016-2017* *period. Under these arrangements SEMO is moving away from the Biannual Release strategy with the last major market release due in June 2016. There will however be a need for ad hoc releases".*

The Consultation Paper proposed disallowing any provision for ad hoc releases as they are no longer required. Based on the statement above and the continual efficiency trend in SEMO's operations, the RAs expected the number of FTEs to decrease relative to current levels. The RAs proposed that the headcount provided for the 2016/17 tariff year be reduced from 42 to 35 FTEs.

RESPONSE

In their response SEMO stated that the OPEX payroll proposals, contained within the RAs' Consultation Paper, were insufficient to enable SEMO to continue to carry out its functions. SEMO considered that if the proposed level of resourcing was not amended it would be necessary to engage with the RAs to determine the impact on service quality, including potentially which functions SEMO should cease to provide during the control period. SEMO further argued that the RAs did not take account of the reduction in FTEs already achieved by SEMO in the current price control, with allowed FTEs falling from 61 to 42 over the three year period. SEMO asserted that this reduction in headcount already takes into account the reduction in FTEs associated with the removal of the bi-annual release process. Additionally, SEMO considered that while bi-annual market releases will cease in 2016, leading to a reduction in the level of associated modifications, there is an understanding on the part of SEMO that the Modifications Committee will continue to meet and function for the period up to I-SEM Go-Live and beyond.

Moreover, in their response SEMO pointed out that they now undertake new activities, such as those associated with REMIT, and that there are also additional resources required in support of the maintenance mode, as set out in the Central Market Systems Roadmap Options and Recommendations report (the 'CMS Roadmap Report'), endorsed by the RAs[13].

SEMO do not anticipate a reduction in any of the activities carried out, relative to current levels, for the remainder of the SEM. SEMO envisage that, with the ageing of systems, there is in fact likely to be an increase in the level of generator queries. The level of both queries and

[13] http://www.sem-o.com/Publications/General/MOST%20-%20November%202015%20-%20CMS%20Roadmap%201.0.pdf SEMO consulted on whether an upgrade or maintenance approach should be adopted in relation to their Central Market Systems on 25 November 2016 and in line with market participant feedback the RAs endorsed the maintenance mode of operation in January 2016.

registration is at a consistent high level and SEMO expect this to continue for the foreseeable future.

At a meeting with the RAs, SEMO advised that achieving efficiency gains, in terms of new processes and better ways of doing things takes time to achieve and often has an associated cost. At this late stage in the SEM, SEMO are not in a position to seek additional funding to invest in new efficiency improving techniques.

SEMC DECISION

SEMO have provided detailed reasoning behind the 2016/17 FTE requirement and the SEMC has decided that SEMO have provided sufficient evidence to justify an increase in the number of FTE's, relative to that proposed by the RAs in the Consultation Paper.

Based on the justification provided by SEMO, in their response to the Consultation Paper, the SEMC has decided to provide an allowance for 42 FTEs in the 2016/17 tariff year. SEMO will still be incentivised to enhance efficiency levels under the revenue cap (inflation-X) regulation in place for the remainder of the SEM.

SEMC Decision: SEMO to be provided with an allowance for 42 FTEs for the 2016/17 tariff year in accordance with table 4 below.

Tariff Year 2017/18

SEMO proposed that there will be a need for 15 FTEs in the 2017/18 tariff year. The RAs agreed with SEMO that there is significant uncertainty surrounding this period but felt that SEMO had not provided sufficient evidence to justify the inclusion of 15 FTEs. In the Consultation Paper the RAs requested that SEMO provide reasoning and further logic behind this FTE requirement. The RAs argued that the level of staffing in areas such as credit risk management, funds transfer, customer service, stakeholder management, formal and adhoc queries, market reporting, security cover and change management should be minimal.

RESPONSE

In their response to the Consultation Paper SEMO discussed the requirement for an average of 15 FTEs for the 2017/18 tariff year. SEMO advised that this is an average figure that reflects the phased 'wind down' of many of SEMO's activities between month one and 12 of the 2017/18 tariff year. SEMO confirmed that funds transfer activities and final bank closure will be required to close the market up to and within the decommissioning period. Credit risk management activities will continue up to 100 days after the I-SEM Go-Live and it is assumed that registration activities can be wound down within a month of I-SEM Go-Live. Furthermore, SEMO asserted that customer service and requests for operational and market analysis are likely to remain at a high level, in particular from suppliers as they will be keen to ensure their close out position is correct. SEMO further argued that a capability for re-pricing will have to be maintained during this period, in the event of queries and/or disputes, as set out in the TSC. In terms of finance and legal resourcing, the level of activities in this area will broadly be the same as for 2016/17. Additional work around the preparation for a final market audit, participant account reconciliations and any VAT, legal or regulatory compliance issues may arise during this period.

SEMC DECISION

Based on the detailed information provided by SEMO, in relation to the average FTE requirement for the 2017/18 tariff year, the SEMC has decided to endorse SEMO's request for 15 FTEs. As stated previously, all costs in this period are on a cost pass-through basis.

> SEMC Decision: SEMO to be provided with an allowance for 15 FTEs in the 2017/18 tariff year in accordance with table 4 below.

Tariff Year 2018/19

In the Consultation Paper the RAs required that SEMO make a proposal on how they will conduct data archiving activities within the decommissioning period. The RAs requested that SEMO ensure SEM data is available to interested stakeholders on request, until the RAs advise it is no longer required. Additionally, the RAs required that SEMO keep the SEMO website fully functional until the end of the two year dispute window, following the cessation of the SEM.

The RAs proposed reducing the number of FTEs in the decommissioning period, from SEMO's proposal of seven, to four. SEMO have included an allowance of €60k for contractors in this period and the RAs felt that four FTE's on top of an allowance of €60k for contractors should be sufficient to finalise the decommissioning of the SEM. The RAs asked that SEMO provide detailed evidence on the required amount of FTEs to carry out the necessary decommissioning activities.

RESPONSE

SEMO stated that until such time as the decommissioning period and the requirements of the RAs are better understood that they are not in a position to develop a decommissioning plan. In their response SEMO confirmed that they will work to develop a plan with input from the RAs over the coming months. Despite the fact no plan is yet in place SEMO advised as to the likely activities that will need to be undertaken within the decommissioning period. These activities are detailed in their response and include the final resettlement of the market, inventory of all files and paperwork for filing and storage, and any review and follow-up actions from a final market audit. As well as the CMS, the decommissioning period will include back-ups, power down, equipment removal and recycling. The decommissioning approach and execution for the production systems should be independently audit approved and certified for which SEMO have included a provision for Professional (Contractor) fees during this period. The decommissioning phase will also need to include a contractual/commercial ‘wind down’ work stream where contracts with suppliers and vendors are reconciled and terminated.

SEMO revised the estimated length of the decommissioning period downwards from a period of 12 months to three months. SEMO have made an updated submission on this basis, meaning the 2018/19 tariff year allowance is based on a six month period in total, as discussed in section 5.5 above. SEMO’s payroll (and other OPEX) in the 2018/19 tariff year has been reduced by 50% to reflect this six month period.

SEMO asserted that the RAs’ requirement for retention of the existing SEM website for two years post cessation of the SEM was not envisaged at the time of their submission. SEMO considered that keeping the website active will incur an additional vendor OPEX cost of €20k per annum plus a requirement for additional support (monitoring, patching, maintaining firewalls etc).

Further to the above, SEMO noted the RAs’ assertions in regard to the provision of FTEs ‘on top of’ allowances for contractor costs. SEMO confirmed that, where professional costs have been sought, these are required to carry out functions outside of the skill set maintained within the SEM teams or for activities where independent assurance is mandated, such as for audit requirements.

SEMC DECISION

Based on the information provided by SEMO, the SEMC has decided to endorse SEMO’s request for an average of seven FTEs for six months of the 2018/19 tariff year. As stated previously, all costs in this period are on a cost pass-through basis. In coming to this conclusion the SEMC has considered the fact that SEMO have revised the estimated length of the decommissioning period, from a 12 month to a three month period. This change to the length of the decommissioning period means costs in the 2018/19 tariff year run to 31 March 2019, rather than to 30 November 2019, as detailed in the Consultation Paper. This has a direct impact on OPEX costs and also on the depreciation and WACC allowance for the 2018/19 tariff year.

SEMO have not submitted a decommissioning plan as part of their response to the Consultation Paper. The SEMC require that SEMO engage with the RAs within three months from the publication date of this decision paper to discuss decommissioning requirements, most notably around the enduring presentation and administration of SEM data. The SEMC require that SEMO consults on the options available, including costs, in order to gain market participant feedback on the best option to pursue. The SEMC requires that this consultation process is finalised and a decommissioning plan agreed upon by no later than 31 July 2017. Once the details around any additional decommissioning requirements are confirmed any monies approved by the RAs will be recovered through an appropriate tariff mechanism in the I-SEM, as described in section 5.3 above. Any additional monies sought will have to be clearly separable from the allowance already provided to SEMO for the decommissioning period, under this Price Control.

The RAs requested that SEMO maintain their website for two years post the cessation of the SEM and the SEMC has decided to allow for an additional vendor OPEX cost of €20k per annum to enable continuation of the website. This allowance is provided for in the total IT and communications allowance, discussed in section 7.3 below.

SEMC Decision: SEMO to be provided with an allowance for 7 FTEs for six months of the 2018/19 tariff year, to 31 March 2019, in accordance with table 4 below.

SEMO to develop a SEM decommissioning plan by no later than 31 July 2017, having previously consulted on the options available.

SEMO to be provided with €20k per annum to maintain the SEMO website for two years post the cessation of the SEM period to 31 October 2019.

RESPONSE

PPB commented on the average per FTE cost and questioned why it had risen by 14% between 2016/17 and 2017/18, with a further 22% increase between 2017/18 and 2018/19. PPB further argued that they do not believe an allowance for contractors should be built into a three year price control but where it is demonstrated that such resources are needed to deliver specific projects that are not part of the 'normal' business activity of SEMO, then such costs should be considered and approved as pass through costs at that time in relation to that specific project. As SEMO are moving to an operate and maintain market model PPB find it difficult to see any need for such specific projects.

SEMC DECISION

The SEMC questioned SEMO on the increase to their average per FTE cost and SEMO advised that the increase can be explained by the higher percentage of more experienced staff being used in the latter periods of the Price Control. The SEMC considers that it is important that the SEM resettlement and decommissioning period is finalised effectively and accepts that more experienced staff may be required to enable this to happen. Furthermore, the SEMC notes that although average cost per FTE increases over the duration of the price control, the absolute amounts of payroll costs fall significantly from €2.92 million in 2016/17 to €0.33 million in 2018/19 (see table 4).

In relation to SEMO's allowance for contractors SEMO informed the SEMC that where contractor costs have been sought, these are required to carry out function outside of the skill set maintained within the SEM teams or for activities where independent assurance is mandated, such as for audit requirements.

SEMC Decision: SEMO's increase in average FTE payroll costs and contract costs of €0.17m to be provided for under the Price Control.

7.2 CONCLUSION ON PAYROLL

The SEMC has decided to allow a total payroll allowance of €4.44 million in the 2016-19 Price Control, per table 4 below. The allowance is 7% lower than that originally requested by SEMO and 20% higher than that proposed in the Consultation Paper. The increase in allowance from that proposed in the Consultation Paper is largely due to the justifications and substantiation provided in SEMO's response to the Consultation Paper.

	RAs Proposal				SEMC Decision			
€ million	**Forecast**	**Forecast**	**Forecast**		**Forecast**	**Forecast**	**Forecast**	
	2016-17	**2017-18**	**2018-19**	**Total**	**2016-17**	**2017-18**	**2018-19**	**Total**
No. of FTEs	35	10	4		42	15	7*	
Salaries	1.67	0.55	0.26	2.48	2.00	0.83	0.22	3.06
Bonus	0.12	0.05	0.02	0.19	0.14	0.07	0.02	0.23
Employer's PRSI	0.24	0.07	0.03	0.34	0.29	0.10	0.03	0.42
Employer's Pension Contribution	0.27	0.08	0.04	0.39	0.32	0.12	0.03	0.48
On Call / Shift / Overtime	-	-	-	-	-	-	-	-
Car Other Benefits	0.06	0.01	0.01	0.08	0.07	0.02	0.01	0.10
Contractors/Agency costs	0.09	0.05	0.05	0.19	0.09	0.05	0.03	0.17
Other	0.01	-	-	0.01	0.01	-	-	0.01
Total Payroll	**2.46**	**0.81**	**0.41**	**3.68**	**2.92**	**1.19**	**0.33**	**4.44**

Table 4: SEMC Payroll Decision

*7 FTEs for a period of 6 months

7.3 IT & TELECOMMUNICATIONS

IT & Telecommunications represents the largest category of OPEX for the 2016-19 Price Control. SEMO's submission proposed an allowance of €5.62 million for IT & Communications, broken down as follows:

	2013-16 Price Control				SEMO's Submission			
€ million	**Actual**	**Actual**	**Estimate**		**Forecast**	**Forecast**	**Forecast**	
	2013-14	**2014-15**	**2015-16**	**Total**	**2016-17**	**2017-18**	**2018-19**	**Total**
Telecommunications	0.19	0.25	0.14	0.58	0.17	0.17	-	0.34
IT Support & Maintenance	2.20	2.36	2.39	6.95	2.75	2.53	-	5.28
IT Opex Support for Capex	-	-	-	-	-	-	-	-
Total IT & Communications	**2.39**	**2.61**	**2.53**	**7.53**	**2.92**	**2.70**	**-**	**5.62**

Table 5: Summary of IT & Communications proposed by SEMO

SEMO predicted that total IT & Communications costs would increase by €0.39m between the current tariff year and the 2016/17 tariff year. The majority of this cost increase is accounted for by the increase in IT Support & Maintenance.

As mentioned previously, the RAs approved a CMS maintenance approach over a CMS upgrade, that ordinarily would be necessary given that some of the CMS assets are approaching the end of their useful economic lives. This maintenance mode avoids the significant CAPEX requirement associated with an upgrade mode but it will incur additional OPEX costs to provide for the additional support requirements to ensure the life of the system can be extended effectively. The maintenance mode approach will take the operational lifetime of the SEMO CMS and corporate systems beyond standard/recommended operational timeframes. SEMO advised that due to this, additional risk management measures to provide greater protection against system outages and/or failure are required, leading to additional IT & Communication costs. SEMO stated that as warranties expire and usage timeframes extend, that additional costs will be incurred.

SEMO's CMS Roadmap submission advised that there would be an expected increase in operating costs of approximately €250k, specifically related to the adoption of the maintenance mode option. SEMO have advised that the remainder of the increase in costs, relative to the current year, relates to the structure of the extended Brady contract, which was approved by the SEMC in December 2015. For these reasons the RAs proposed endorsing SEMO's IT and communications submission.

RESPONSE

SEMO responded to the Consultation Paper by advising that maintenance of their website would cost an additional €20k+ per annum.

PPB responded to the Consultation Paper and asserted that such IT and telecom costs should be relatively predictable and therefore the expected costs should be capable of evidential demonstration. Such costs should be allowed otherwise SEMO would not be able to provide the services required.

SEMC DECISION

Per section 7.1 above on payroll, the SEMC has decided to provide SEMO with an additional allowance, over and above their original submission, in order to maintain the SEMO website for two years post the cessation of the SEM. The SEMC has decided to provide SEMO with an allowance of €20k per annum to enable continuation of this facility. On this basis SEMO's IT and communications allowance has increased by €20k in tariff year 2017/18 and again by €20k in tariff year 2018/19, with website maintenance coming to an end on 31 October 2019, given the current I-SEM Go-live date of 1 October 2017.

SEMC Decision: SEMO to be provided with a total IT and communications allowance of €5.66 million, per the table below.

	RAs Proposal				SEMC Decision			
€ million	**Forecast**	**Forecast**	**Forecast**		**Forecast**	**Forecast**	**Forecast**	
	2016-17	**2017-18**	**2018-19**	**Total**	**2016-17**	**2017-18**	**2018-19**	**Total**
Telecommunications	0.17	0.17	-	0.34	0.17	0.17	-	0.34
IT Support & Maintenance	2.75	2.53	-	5.28	2.75	2.55	0.02	5.32
IT support for CAPEX	-	-	-	-	-	-	-	-
Total IT & Communications	**2.92**	**2.70**	**-**	**5.62**	**2.92**	**2.72**	**0.02**	**5.66**

Table 6: SEMC Decision IT & Communications

7.4 FACILITIES & INSURANCE

SEMO has office space in both jurisdictions and will continue to co-locate on property provided by both parent organisations. Facilities costs cover rent, rates, insurance, utilities and also include cleaning services, maintenance, car parking, security, mail service, copy bureau, switch board and catering and canteen services.

In the Consultation Paper, the RAs proposed that no allowance should be allowed for facilities and insurance costs in the SEMO 2016-19 Price Control. This was the RAs position as in the previous Eirgrid System Operator price control[14] a specific amount of facility costs were apportioned to Eirgrid, in its capacity as Market Operator. Whereas it appeared that in the current Eirgrid System Operator Price control[15] that there had been no reductions in relation to SEMO premises costs.

RESPONSE

In their response SEMO stated that Eirgrid has confirmed that the current Eirgrid System Operator price control does not provide for Eirgrid's facility costs in its capacity as Market Operator. Information on this was provided in an appendix to the Eirgrid System Operator price control and SEMO have contacted CER to resolve this matter. CER have advised that Eirgrid's facility costs will be reinstated in this Price Control as a result.

SEMC DECISION

Given the evidence provided in the appendix of the current Eirgrid System Operator price control, the SEMC has decided to include an allowance for facilities and insurance costs within the 2016-19 Price Control. SEMO will be provided with an allowance of €0.97 million, to reflect the shortening in the length of the decommissioning period.

SEMC Decision: SEMO to be provided with a total facilities and insurance allowance of €0.97 million for the 2016-19 Price Control as shown in table 7 below.

---

[14] http://www.cer.ie/docs/000085/cer10206.pdf pg 123

[15] http://www.cer.ie/docs/001043/CER15296%20Decision%20on%20TSO%20and%20TAO%20Transmission%20Revenue%20for%202016%20to%202020%20(1).pdf

7.5 OPEX CONCLUSIONS

The RAs analysed the following cost categories within SEMO's OPEX submission:

- Payroll
- IT & Communications
- Facilities and Insurance
- Other OPEX (including professional fees, general and administrative costs, corporate services)

Compared to SEMO's submission for a total of €13.28 million of OPEX, the SEMC has decided to approve an allowance of €12.78 million (a 4% reduction). The increase to the Consultation Paper OPEX proposals is largely due to SEMO's provision of further information and reasoning behind their allowance requests, relative to that provided at the time of drafting the Consultation Paper. The table below summarises the SEMC's decisions for OPEX.

	RAs Proposal				SEMC Decision			
€ million	**Forecast**	**Forecast**	**Forecast**		**Forecast**	**Forecast**	**Forecast**	
	2016-17	**2017-18**	**2018-19**	**Total**	**2016-17**	**2017-18**	**2018-19***	**Total**
No. Of FTEs	35	10	4		42	15	7*	
OPEX								
Total Payroll	2.46	0.81	0.41	3.68	2.92	1.19	0.33	4.44
Total IT & Communications	2.92	2.70	-	5.62	2.92	2.72	0.02	5.66**
Total Facilities and Insurance	-	-	-	-	0.65	0.26	0.06	0.97
Total Professional Fees	0.31	0.15	0.10	0.56	0.31	0.15	0.05	0.51
Total General and Administrative	0.22	0.09	0.03	0.35	0.22	0.08	0.01	0.31
Total Corporate Services	0.45	0.39	0.10	0.94	0.45	0.39	0.05	0.89
Total	**6.36**	**4.14**	**0.64**	**11.15**	**7.47**	**4.79**	**0.52**	**12.78**

Table 7: SEMC Decision OPEX

*Based on 6 month period
** Includes €20k per annum for maintenance of SEMO website for two years post the cessation of the SEM in October 2017

8. CAPITAL EXPENDITURE (CAPEX)

SEMO requested a CAPEX allowance of €1.64 million as part of their price control submission. This compares to an estimated outturn CAPEX spend of €5.38 million in the current price control period. As with SEMO's OPEX request, the reduced values sought reflect the fact that the 2016-19 Price Control only contains one year's worth of SEM operations. Furthermore, the lower CAPEX amounts reflect the decision to implement a maintenance rather than an upgrade mode which was favoured by market participants and endorsed by the RAs. Market participants did not deem it cost effective to upgrade SEMO systems at the final stages of the SEM.

Four categories of CAPEX have been identified as part of SEMO's submission:

1. Biannual IT Market Release CAPEX;
2. Biannual IT Market Release Support CAPEX;
3. Predictable Business CAPEX;
4. Unpredictable Business CAPEX.

The table below shows a breakdown of SEMO's CAPEX submission and expected outturn for the current price control period.

	2013–16 Price Control				**SEMO's Submission**			
€ million	**Actual**	**Actual**	**Estimate**	**Total**	**Forecast**	**Forecast**	**Forecast**	**Total**
	2013-14	**2014-15**	**2015-16**		**2016-17**	**2017-18**	**2018-19**	
Biannual Release Capex	1.28	0.55	0.71	2.53	0.25	0.15	-	0.4
Biannual IT Market Release Support Capex	0.13	0.08	0.21	0.42	0.02	-	-	0.02
Predictable business Capex	0.69	0.40	0.31	1.40	0.59	0.19	0.06	0.84
Additional Business Capex	0.95	-	-	0.95	-	-	-	-
Unpredictable business capex	-	-	0.08	0.08	0.15	0.15	0.08	0.38
Total CAPEX	**3.05**	**1.02**	**1.31**	**5.38**	**1.01**	**0.49**	**0.14**	**1.64**

Table 8: Summary of SEMO's CAPEX submission

The following paragraphs consider each of the CAPEX components.

8.1 BIANNUAL IT MARKET RELEASE CAPEX

The bi-annual IT market release CAPEX allows SEMO to deliver market modifications, non TSC changes, system fixes and operational efficiencies to their CMS.

The bi-annual release process will come to an end in the current price control period and will not exist in the next price control period. Despite this, in their submission, SEMO included an allowance in relation to a single adhoc release in both the 2016/17 and 2017/18 tariff years. This provision caters for adhoc releases including any emerging functional requirements that may be obligatory (e.g. Revenue, REMIT etc) or urgent technical requirements (security updates) that need to be provided for. A small amount of €20k was included in the submission to support any adhoc releases.

In the Consultation Paper the RAs proposed disallowing the amounts in relation to these adhoc releases, as currently there is no requirement for such releases. If the need for an adhoc release does arise then SEMO can seek RA approval for the additional costs associated with the release.

RESPONSE

SEMO noted the RAs' statements that in the event that ad hoc releases arise then SEMO can seek additional costs for same and that they are content to proceed on this basis.

PPB agree that SEMO should seek RA approval for costs associated with an ad-hoc release when they occur and that no provision should be included in this price control.

SEMC DECISION

The SEMC has decided to include zero allowance for bi-annual IT market release CAPEX and the associated support costs, in line with the Consultation Paper proposals.

SEMC Decision: Zero allowance to be provided for biannual market release CAPEX and associated support CAPEX.

8.2 PREDICTABLE CAPITAL EXPENDITURE

A predictable CAPEX allowance enables SEMO to plan for hardware and software upgrades and the implementation of additional operational support systems.

Predictable CAPEX makes up the majority of SEMO's CAPEX submission, totalling €0.84 million over the 2016-19 Price Control. The predictable CAPEX is made up of the following components:

- CMS and Corporate Infrastructure (€0.55m)
- Network Equipment (€0.08m)
- Non CMS applications (€0.15m)
- Decommissioning (€0.06m)

The costs for the CMS and corporate infrastructure relate to SEMO's CMS maintenance mode approach. These costs are included to allow for the replacement of hardware assets should they become unmaintainable. SEMO have advised that every effort will be made to prolong the operational life of assets (by repairs etc) but that this may not be practical or cost-effective. The provision for predictable CAPEX will fund replacement hardware for both the CMS and corporate systems, if required.

SEMO advised that the network equipment allowance is included to cover the cost of a set of spare switches should some have to be replaced if they cannot be repaired. The network equipment allowance is also in place to cover the CMS internal firewalls, incase repair is no longer cost effective and replacement is required. The non CMS applications provision covers upgrades to corporate systems required by SEMO for operational purposes.

Lastly, SEMO included a provision for decommissioning in the 2018/19 tariff year. SEMO propose that this cost should cover the proper disposal and recycling of all equipment related to the current SEM. Backups will be taken of all environments after which hard drives and other storage devices will be wiped and shredded.

The RAs proposed endorsing SEMO's predictable CAPEX submission in the Consultation Paper.

RESPONSE

SEMO welcomed the RAs' endorsement of its predictable CAPEX submission.

PPB agreed with the proposals in relation to predictable CAPEX.

SEMC DECISION

This decision paper allows SEMO to recover 100% of their residual RAB, as documented in section 9 below. This represents a shift from that proposed in the Consultation Paper. The SEMC have made the decision to disallow SEMO's predictable CAPEX decommissioning costs, of €60k, on the basis that consumers will pay for the RAB in full. Furthermore, the SEMC feel that SEMO should be able to realise some value from their residual RAB that could be used to fund the cost of disposing of any remaining assets. The SEMC feel that the assets being disposed off such as server racks and cabling will contain some value. The realisation of value from the residual RAB is discussed further in section 9 below.

SEMC Decision: SEMO to be provided with €0.78 million of predictable CAPEX for the 2016-19 Price Control, per table 9 below.

8.3 UNPREDICTABLE BUSINESS CAPEX

The unpredictable business CAPEX is a discretionary fund requested by SEMO to cover the costs of unexpected business CAPEX.

SEMO requested an allowance of €0.150 million per annum for unpredictable CAPEX in both the 2016/17 and 2017/18 tariff years, with an allowance of €0.08 million requested for tariff year 2018/19. In the Consultation Paper, the RAs proposed reducing the unpredictable CAPEX allowance, to bring it in line with the estimate for the current tariff year and provide SEMO with an unpredictable CAPEX allowance of €0.08 million in each of the tariff years.

RESPONSE

PPB agree with the proposals in relation to unpredictable CAPEX.

SEMC DECISION

The SEMC has decided to endorse the position advocated by the RAs in the Consultation Paper.

SEMC DECISION: SEMO to be provided with a total allowance of €0.24m for unpredictable CAPEX for the 2016/19 Price Control, per table 9 below.

8.4 CAPEX CONCLUSIONS

The table overleaf details the SEMC's decision on SEMO's CAPEX allowance. Only amounts in relation to the decommissioning period's predictable business CAPEX have changed from that proposed in the Consultation Paper. SEMO's CAPEX allowance is 38% lower than that requested in SEMO's submission. The SEMC feels that this reduced CAPEX allowance provided still affords SEMO with the necessary flexibility to deal with unexpected CAPEX costs, given the unpredictable CAPEX allowance and the 'just in case' nature of the predictable business CAPEX provision.

	RAs Proposal				SEMC Decision			
€ million	**Forecast**	**Forecast**	**Forecast**		**Forecast**	**Forecast**	**Forecast**	
	2016-17	**2017-18**	**2018-19**	**Total**	**2016-17**	**2017-18**	**2018-19**	**Total**
Biannual Release Capex	-	-	-	-	-	-	-	-
Biannual IT Market Release Support Capex	-	-	-	-	-	-	-	-
Predictable business Capex	0.59	0.19	0.06	0.84	0.59	0.19	-	0.78
Additional Business Capex	-	-	-	-	-	-	-	-
Unpredictable business capex	0.08	0.08	0.08	0.24	0.08	0.08	0.08	0.24
Total CAPEX	**0.67**	**0.27**	**0.14**	**1.08**	**0.67**	**0.27**	**0.08**	**1.02**

Table 9: SEMC CAPEX Decision

The SEMC requires that SEMO continue to provide an annual capital update in the form of an End of Year Capital Report.

9. REGULATED ASSET BASE (RAB)

In the Consultation Paper the RAs proposed that SEMO should be allowed to recover depreciation on their RAB for the duration of the 2016-19 Price Control with any under or over recovery being captured as part of the k-factor mechanism within an I-SEM tariff.

The RAs proposed that SEMO reuse their residual RAB or dispose of it as they see fit. It was proposed that SEMO would not be remunerated for their residual RAB once SEM related activities cease.

RESPONSE

SEMO expressed concerned that the RAs' proposal would introduce regulatory uncertainty. In their response they considered that the RAB is a regulatory concept which provides for a store or recovery of value from future customers rather than an accounting concept. It is a promise for customers to repay that value and cannot be disposed of or reused. SEMO asserted that the Consultation Paper proposals appear to provide certainty in regard to the recovery of capital spend while on the other hand they negate their ability to recover costs.

In a meeting held with the RAs, they argued against the proposal as they considered that their residual RAB has no value, in that there is no secondary market for it and no possibility of using it within the I-SEM. SEMO further asserted that not all of the RAB items have a five year life and that the use of a five year depreciation policy is arbitrary for many of the CAPEX items and simply a method of spreading the costs to consumers over a longer period. SEMO considered that adoption of the proposals within the Consultation Paper would constitute a fundamental change to regulatory principles.

SEMO forecast that there will be a residual RAB value of €1.725 million at the end of the 2016-19 Price Control[16]. Subsequent to issuance of the Consultation Paper, they provided analysis to show that 86% of the residual RAB value relates to capital expenditure on software updates and market releases. SEMO asserted that these residual RAB components have no realisable value beyond the SEM as they are designed specifically for use within the SEM. They further stated that €0.247 million of the forecasted residual RAB (€1.725m) relates to expenditure on hardware and that this is the only element that has the potential to contain any value. SEMO argued that any value that could be realised from the disposal of second hand hardware that is a number of years old is likely to be negligible.

[16] Forecast residual RAB has changed due to the change in length of the decommissioning period

SEMO proposed that the residual RAB be recovered in tandem with the recovery of other amounts such as the k factor, potentially through the TUOS and SSS tariffs.

PPB agree with SEMO's position and commented that they do not see any reason why provision cannot be made to allow any outstanding RAB (including new expenditure) to be carried forward and recovered in the I-SEM.

SEMC DECISION

Given the analysis provided the SEMC feel that SEMO should be remunerated for its residual RAB as it stands at the end of the 2016-19 Price Control. The SEMC consider that there should be some small value in the hardware element of the residual RAB (€0.247m), and any monies realised from this can be used to fund any disposal costs (see predictable CAPEX section above). It should be noted that remuneration for SEMO's residual RAB does not impact the amounts provided for in this decision paper as amounts in relation to the residual RAB will be recouped in an appropriate tariff within the I-SEM.

SEMC Decision: SEMO to be remunerated for 100% of their residual RAB value as at the end of the SEM decommissioning period, through an appropriate tariff mechanism in the I-SEM.

10. WEIGHTED AVERAGE COST OF CAPITAL & DEPRECIATION

10.1 WACC

In the Consultation Paper the RAs proposed to continue with the current WACC mechanism, which blends the two System Operator WACCs in accordance with the specified proportions, currently 75% for EirGrid and 25% for SONI[17]. The table below highlights the WACC applied, in the current price controls, for both SONI and EirGrid in their capacity as System Operators for NI and ROI respectively. SONI's System Operator price control runs from October 2015 to September 2020 and Eirgrid's is applicable between January 2016 and December 2020.

WACC Rate	Specified Proportion	2016-17	2017-18	2018-19
EirGrid Transmission System Operator	75%	4.95%[18]	4.95%	4.95%
SONI Transmission System Operator	25%	5.90%[19]	5.90%	5.90%
Blended Rate for SEMO WACC		**5.19%**	**5.19%**	**5.19%**

Table 10: RAs Proposed WACC Rate

RESPONSE

SEMO agreed with the RAs' proposal to continue with the current WACC mechanism which blends the two System Operator WACCs in accordance with the specified proportions; however they proposed using a different SONI WACC rate, in turn resulting in a lower blended WACC rate to that used in the Consultation Paper. SEMO commented that the SONI rate used by the RAs, taken from the SONI Price Control 2015-2020, is not valid as the licence modifications necessary to codify this price control have not yet been implemented. SEMO instead proposed to use a SONI WACC rate of 5.42%, which represents the most recently codified SONI WACC rate.

SEMC DECISION

The SEMC has decided to use the SONI WACC figure of 5.42% for the SEMO Price Control. This creates a blended WACC rate of 5.07%, based on the specified proportions of 25/75 between SONI and Eirgrid respectively. SEMO's WACC will be adjusted in line with the WACC decisions

[17] Per the Market Operator Agreement between SONI and Eirgrid

[18] Pre-tax WACC as defined in Decision on EirGrid TSO transmission revenue for 2016 to 2020

[19] Pre-tax WACC as defined in SONI Price Control 2015 – 2020 Decision Paper

reached by the RAs, so that SEMO's WACC will track the prevailing WACC of both Eirgrid and SONI in their capacity as System Operators.

The SEMC has decided on a WACC amount based on the CAPEX additions detailed in Table 9 above and the shorter decommissioning period as follows:

WACC Amount	**2016-17**	**2017-18**	**2018-19***	**Total**
€ million				
Estimated RAB**	4.467	2.645	1.885	
Blended WACC Rate	5.07%	5.07%	5.07%	
RAs Estimated WACC amount	0.226	0.134	0.048	0.408

Table 11: SEMC Decision WACC Allowance

*Based on 6 month period and removal of predictable CAPEX in the decommissioning period
**Based on average of opening and closing RAB and assuming CAPEX additions are made at beginning of the year, as advised in SEMO's CAPEX submission

SEMC Decision: SEMO WACC to be calculated in line with the specified proportions (25/75) using a SONI WACC figure of 5.42% and an Eirgrid WACC figure of 4.95%, to give a blended WACC figure of 5.07%. SEMO's WACC figure will track the WACC of Eirgrid and SONI in their capacity as System Operators.

10.2 DEPRECIATION

In the Consultation Paper the RAs proposed to continue to depreciate SEMO's assets, on a straight-line basis, over a five year period.

RESPONSE

In their response to the Consultation Paper SEMO provided an estimated annual depreciation charge, based on both SEMO's CAPEX submission and on the RAs' proposed CAPEX allowances. Following a request from the RAs, SEMO subsequently updated this allowance to reflect the reduced duration of the decommissioning period and provided the following estimate of depreciation over the 2016-19 Price Control, based on SEMO's proposed CAPEX allowance of €1.64 million.

€ million	2016-17	2017-18	2018-19*	Total
Depreciation Charge	3.244	1.469	0.580	5.293

Table 12: SEMO's Updated Depreciation Amount

*Based on 6 month period

SEMC DECISION

Based on CAPEX additions of €1.02 million, as detailed in Table 9 above, the SEMC endorses the following depreciation allowance over each of the Price Control's tariff years.

€ million	2016-17	2017-18	2018-19*	Total
Depreciation Charge**	3.236	1.349	0.520	5.105

Table 13: SEMC Decision Depreciation

*Based on 6 month period

**Assuming CAPEX additions are made at beginning of the year, as advised in SEMO's CAPEX submission

SEMC Decision: Depreciation to be calculated based on the SEMC's allowed CAPEX additions of €1.02 million, providing the depreciation charges shown in table 13 above.

11. KEY PERFORMANCE INDICATORS

As part of the current price control framework SEMO are incentivised to manage performance through KPIs. The KPIs currently in place are aimed at improving performance, promoting customer service, increasing efficiencies and delivering value to customers. The KPI incentive pot is currently set at a maximum of 4% of total OPEX revenue for each year. SEMO are assessed on the following KPIs, on a quarterly basis:

	Weightings	Target	Upper Bound
Ex-ante pricing report	0.15	99%	100%
Ex-post initial pricing report	0.10	99%	100%
Invoicing	0.20	97%	100%
Credit Cover Increase Notices	0.10	99%	100%
SEMO related resettlement queries	0.20	<9[20]	<5[21]
General Queries	0.15	97%[22]	99%[23]
System Availability (7am to 5pm Mon-Sun)	0.10	99.5%[24]	99.9%[25]

Table 14: Current KPIs

In the Consultation Paper the RAs recommended maintaining the quarterly assessment, based on an average value of each KPI over that period. The RAs believe this incentivises SEMO to maintain good performance over a longer period, to the benefit of participants, in the form of a consistent good service. The SEMC requires that this quarterly assessment is continued for the relevant periods in the 2016-19 Price Control.

11.1 KPIS IN THE REMAINDER OF THE SEM

SEMO proposed fixing the allowance incentive pot at €400k for Period 1 and 2 of the 2016-19 Price Control. In the Consultation Paper the RAs disagreed with this proposal, arguing that the current arrangements, of 4% of annual OPEX, should be carried forward into Period 1 and 2 of the 2016-19 Price Control.

[20] 9 or less upheld queries incidents per quarter
[21] 5 upheld queries incidents per quarter
[22] 97% of Queries answered within 20 business days
[23] 99% of Queries answered within 20 business days
[24] 99.5% System availability between 7am and 5pm Monday to Sunday excluding planned outages
[25] 99.9% System availability between 7am and 5pm Monday to Sunday excluding planned outages

SEMO suggested a minor adjustment to the Systems Availability KPI range from “99.5% to 99.9% availability” to “99.4% to 99.8% availability” for Period 1 of the 2016-19 Price Control and the RAs proposed that this amendment should be endorsed given the ageing of the systems.

RESPONSE

SEMO agreed with the RAs’ view that incentives should continue within Period 1 of the Price Control. SEMO requested that the SEMC decision includes provision for the KPI target to be reviewed and revised in the event that there is a delay to the I-SEM Go-Live date. They added that such a provision reflects the reality that the longer the SEM is operated in maintenance mode the higher the uncertainty and risk to continuous system operation becomes.

PPB agree that the incentive allowance pot should not be fixed but should remain a percentage of OPEX costs.

In their response Brookfield commented on the transparency of SEMO’s KPIs and SEMO’s accountability to the same. Brookfield believe that there has been inadequate consideration given to the potential commercial impacts to market participants or subsequent SEMO accountability for failure to reach these targets. As interconnector participants in the SEM, Brookfield are reliant on the timely publication by SEMO of pricing reports and have a direct commercial exposure as a result of delays ex-ante price publication. Interconnector users are particularly exposed to delays to the publication of MIUNs. However, delays to MIUN publication are not considered in the KPIs. Brookfield request that MIUN publication is included as a KPI or incorporated into EA1 pricing such that a delay to the MIUNs are considered a delay to this pricing report.

Additionally, in Brookfield’s view, the existing one-way incentive that seeks to reward satisfactory performance without penalty for substandard performance is inadequate. Brookfield further requested that other power exchange services should be consulted so that global benchmarks can be used to measure performance for the timely and accurate publication of price reports.

Brookfield considered that the target time of 20 business days to respond to general queries is inappropriate and it should be significantly reduced to reflect the business needs of market participants who rely on such information for their day to day activities.

SEMC DECISION

In line with that proposed in the Consultation Paper, the SEMC has decided to allow for the amendment to the Systems Availability KPI range from “99.5% to 99.9% availability” to “99.4% to 99.8% availability” for the SEM period. This amendment has been deemed reasonable by the SEMC given the ageing of some systems that would ordinarily be due for replacement but instead are being maintained. Additionally the SEMC endorse the RAs’ position that the KPI incentive pot should be set at 4% of OPEX, in line with current practice.

The SEMC also agrees that in the event that the I-SEM commencement date is significantly delayed that KPI targets may have to be revisited.

In response to Brookfield’s comments, the SEMC requires that SEMO publish their annual KPI performance reports to aid transparency around the process[26]. The SEMC considers that it may be worth considering a two way incentive scheme to enable SEMO to be penalised for poor performance, however feels this would be better considered in an I-SEM context.

In response to Brookfield’s proposals around the inclusion of a MIUN target, SEMO asserted that the costs associated with providing the necessary vendor support and resources to reduce any further potential delays in publication on the MIUNs and/or meet KPIs would likely significantly outweigh and potential benefit. As a result SEMO would not support the introduction of a KPI on MIUN publication for the remainder of the SEM. The SEMC have decided that a KPI should be added to reflect the publication of MIUNs on a timely basis for the remainder of the SEM. The SEMC feels that it would be unnecessarily discriminatory to exclude MIUNs from being subject to a KPI. The SEMC requires that the publication of MIUNs is held to account in the same manner as the ex-ante pricing report, in that at least 99% of MIUN reports are to be published on time i.e. by 11am every day, seven days a week in order for SEMO to receive the KPI payment.

The table below summarises the SEMC’s decisions for the KPIs to apply for the SEM period.

[26] These can be found at the following link http://www.sem-o.com/MarketMessages/Pages/SEMOKPIOutturnReportsPublished.aspx

	Weightings	Target	Upper Bound
Ex-ante pricing report	0.10	99%	100%
MIUN publication	0.05	99%	100%
Ex-post initial pricing report	0.10	99%	100%
Invoicing	0.20	97%	100%
Credit Cover Increase Notices	0.10	99%	100%
SEMO related resettlement queries	0.20	<9[27]	<5[28]
General Queries	0.15	97%[29]	99%[30]
System Availability (7am to 5pm Mon-Sun)	0.10	99.4%[31]	99.8%[32]

Table 15: SEMC Decision KPIs for SEM

SEMC Decision: KPI's for the remainder of the SEM to be based on the parameters in the above table, with a total incentive amount of 4% of OPEX in the period.

[27] 9 or less upheld queries incidents per quarter

[28] 5 upheld queries incidents per quarter

[29] 97% of Queries answered within 20 business days

[30] 99% of Queries answered within 20 business days

[31] 99.4% System availability between 7am and 5pm Monday to Sunday excluding planned outages

[32] 99.8% System availability between 7am and 5pm Monday to Sunday excluding planned outages

11.2 KPIS IN THE SEM RESETTLEMENT PERIOD

The RAs proposed that the following KPIs applied to Period 2 of the 2016-19 Price Control.

	RAs Proposed Weightings
Invoicing	0.20
Credit Cover Increase Notices	0.20
SEMO related resettlement queries	0.20
General Queries	0.20
System Availability (7am to 5pm Mon-Sun)	0.20

Table 16: RAs proposed KPI weightings in SEM resettlement

Again the RAs proposed that the total KPI fund available for meeting KPIs in Period 2 be fixed at 4% of the allowable OPEX in the corresponding period, rather than at €400k as suggested by SEMO. Furthermore the RAs recommended allowing for the amendment to the System Availability target range from “99.5% to 99.9% availability” to “99.4% to 99.8% availability” in this period.

RESPONSE

SEMO highlighted that the System Availability KPI as currently proposed by the RAs would not be workable as post I-SEM Go-Live SEM operations will no longer operate on a 365 day a year basis. SEMO further stated that as a result the System Availability targets would need to change to reflect Monday to Friday operation (excluding planned outages). In addition the time period of 7am to 5pm may also need to be revised.

SEMC DECISION

In line with the decision made for the remainder of the SEM, the SEMC has decided to allow for the amendment to the System Availability target range from“99.5% to 99.9% availability” to “99.4% to 99.8% availability” and to continue with the use of an incentive pot based on 4% of OPEX.

The SEMC agrees with SEMO’s comments in that the System Availability KPI as currently set would not be workable and has decided to amend the KPI to reflect a standard working week i.e. the target will be applied on a Monday to Friday, 9am to 5pm basis and exclude public holidays. The table below details the SEMC’s decision on the KPIs for the SEM resettlement period.

	Weightings	Target	Upper Bound
Invoicing	0.20	97%	100%
Credit Cover Increase Notices	0.20	99%	100%
SEMO related resettlement queries	0.20	<9[33]	<5[34]
General Queries	0.20	97%[35]	99%[36]
System Availability (9am to 5pm Mon-Fri)	0.20	99.4%[37]	99.8%[38]

Table 17: SEMC Decision KPIs SEM resettlement

SEMC Decision: KPIs for the SEM resettlement period to be based on the parameters in the above table with an incentive pot of 4% of OPEX in the period.

11.3 SEM DECOMMISSIONING KPIS

SEMO proposed that a decommissioning KPI should be implemented, to include all SEM decommissioning activities e.g. the shortening of resettlement timelines, archiving of data, decommissioning of systems, closure of bank accounts etc.

In the Consultation Paper, the RAs required that SEMO submit a proposal to detail decommissioning activities within the SEM to include the archiving of all data and maintenance of the current SEMO website for the two year dispute window, post cessation of the SEM.

[33] 9 or less upheld queries incidents per quarter

[34] 5 upheld queries incidents per quarter

[35] 97% of Queries answered within 20 business days

[36] 99% of Queries answered within 20 business days

[37] 99.4% System availability between 9am and 5pm Monday to Friday excluding planned outages and public holidays

[38] 99.8% System availability between 9am and 5pm Monday to Friday excluding planned outages and public holidays

RESPONSE

In their response SEMO asserted that until such time as the decommissioning period and the requirements of the RAs are better understood, they are not in a position to develop a decommissioning plan. SEMO stated that they would work to develop a plan with input from the RAs over the coming months.

SEMC DECISION

As discussed in the payroll section above, the SEMC require that SEMO consults on the options available for successful decommissioning of the SEM. The SEMC requires that this consultation, which should include costs for each option, is finalised and a decommissioning plan agreed upon by no later than 31 July 2017. Once the details around any additional decommissioning requirements are confirmed, any monies approved by the RAs will be recovered through an appropriate mechanism in the I-SEM.

> SEMC Decision: SEMO to engage with the RAs within three months from the publication of this decision paper and to consult on available decommissioning options in order to have a plan agreed upon by no later than 31 July 2017. Any additional monies sought and approved by the RAs in relation to this decommissioning plan are to be recovered through an appropriate tariff in the I-SEM.

12. K FACTOR

An annual adjustment to SEMO's revenue allowance is necessary when setting the MO tariffs for the forthcoming tariff year. Such an adjustment is referred to as a 'k-factor adjustment'. K-factor adjustments manage specific areas of SEMO's business which are exposed to risk and outside of SEMO's control. Use of a k-factor adjustment mechanism reduces SEMO's overall risk profile.

In general, the management of costs is largely a matter for SEMO, unless specifically identified as an appropriate k-factor adjusting item. In the Consultation Paper the RAs stated that they were minded to allow the following as k-factor adjustments within the 2016-19 Price Control:

- Uncertain costs that cannot be reasonably foreseen by SEMO should be dealt on a cost pass-through basis via 'k' factor adjustment. These costs could include:
  - Changes in legislation or regulation that impose unforeseen costs to SEMO's operations and capital investments;
  - Restructuring costs driven by changes in legislation.

In addition, the k-factor adjustment should cater for the following:

- Adjustment to allowed revenues to reflect any over or under recovery of revenue in comparison with the revenue allowance (i.e. adjust for market demand);
- Foreign exchange gains or losses catered on a cost pass-through basis;
- Interest on funding from the parent company, EirGrid Group;
- Interest received on surplus funds;
- Market audit adjustment to reflect actual expense;
- Depreciation and WACC will require a separate k-factor adjustment. This specific treatment is required given that the timing of the capital expenditure could deviate from the initial expectations and therefore will have a resulting impact on the depreciation and WACC costs;
- KPI reward will be recovered through an adjustment of the k-factor;

- Any actual net outturn tax loss relating to accelerated recovery of CAPEX and any other adjustments necessary, specific to accelerated CAPEX recovery applied in the 2010-2013 price control.

The RAs continue to require an ex-post review report, outlining separately the market operator tariff adjustments, with detail and backup calculations provided on a line-by-line basis. The RAs requested that the ex-post review report be submitted by SEMO in May each year, to facilitate the annual tariff process. In line with current practice, this report will detail the k-factor for the most recent full tariff year.

On receipt of this report the RAs will carry out a review of the figures and engage with SEMO to discuss any areas requiring clarification. Once all issues are closed, the RAs will seek approval from the SEMC for the k-factor adjustments, as part of the overall MO tariff approval process.

RESPONSE

SEMO have raised concerns as to the applicability of the k-factor model once the SEM ceases to operate in October 2017.

SEMC DECISION

SEMC Decision: The SEMC endorses the k-factor proposals detailed above and also reiterates that any CAPEX or OPEX underspend during the cost pass-through periods will be returned to consumers via the k-factor mechanism, in accordance with section 5.2 of this decision paper.

As stated previously, any outstanding k-factor amounts are to be recovered through a tariff to be developed in the I-SEM.

The SEMC continues to require that SEMO provide an ex-post review report detailing the k-factor for the most recent full tariff year, in May each year.

12.1 MANAGING UNCERTAINTY AND RISK

As with any business there is an element of inherent business risk within SEMO. The SEMO business is unique in that it is a contractual joint venture between the System Operator in ROI (EirGrid) and the System Operator for NI (SONI). Some aspects of the current SEMO price control are designed to reflect this risk e.g. SONI's Parent Company Guarantee (PCG) and the inclusion of an allowance for SEMO's WACC.

The SONI MO licence contains a requirement on SONI to have in place a PCG from EirGrid Plc (the legal and beneficial owner), which includes a requirement to ensure at all times the licencee shall have adequate financial and non financial resources in order that it may perform its obligations.

SONI's PCG is directly linked to their exposure to risk and is in place to cover any working capital deficits that may arise. As SEM operations will significantly reduce, once the SEM ceases, this working capital risk will reduce significantly. For this reason the RAs proposed including an allowance for €300k for the remainder of the SEM, as requested by SEMO and as provided for in the current price control. However, the RAs further suggested that this PCG allowance be removed once the SEM ceases, as a consequence of SEMO's working capital risk falling to an immaterial level.

RESPONSE

SEMO welcomed the RAs' proposal to continue to provide an allowance of €300k for the remainder of the SEM, however they questioned the removal of this amount once the SEM ceases and asked whether this would involve the obligation being removed from the SONI MO licence. SEMO argued that whilst this is a licence requirement it represents a capital committed to the business and therefore must be remunerated to enable the licensee to continue to finance their operations.

PPB agree with the RAs proposals in relation to the allowance for maintaining the PCG facility.

SEMC DECISION

The SEMC have decided that some level of facility should be kept in place to ensure any working capital fluctuations can be dealt with effectively. Nevertheless, the SEMC considers that such working capital risks will fall to an immaterial during the three month SEM decommissioning period. The current PCG allowance is based on SEMO being remunerated for the cost of maintaining a facility to the value of £10 million. The SEMC feel that the size of the facility should reduce significantly in line with the lower cashflows that will be experienced once the SEM period ceases. The RAs requested that SEMO make a submission detailing the size of the facility that would be required to effectively mitigate any potential working capital risks once the SEM comes to an end. SEMO advised that a facility of £2 million would be necessary to manage their working capital risks in both the SEM resettlement and SEM decommissioning periods. SEMO's request equates to an allowance of €300k for the 2016/17 tariff year, an amount of €80k for the 2017/18 tariff year and €30k for the 2018/19 tariff year (total of €410k based on the blending of periods in each tariff year).

The SEMC has decided to include an allowance to maintain a £2m facility during the resettlement period, given the likely resettling of amounts that will occur in this period. However, the SEMC have decided that zero allowance should be provided to cover the decommissioning period as levels of working capital risk will fall to an immaterial level during this period. SEMO have not provided any evidence to negate this assumption.

SEMC Decision: SEMO to be provided with a PCG allowance of €300k for the 2016/17 tariff year, €80k for the 2017/18 tariff year and €15k for the 2018/19 tariff year, based on the current blending of periods, described in Figure 1. These amounts are provided to maintain a PCG facility of £10 million for the remainder of the SEM, £2 million for the SEM resettlement period and zero in the SEM decommissioning period.

13. FORM AND MAGNITUDE OF CHARGES

As part of its role in the administration of the market there are charges which SEMO must levy in order to recover its allowed costs. These charges consist of:

- Energy and capacity charges
- The accession fee
- The participation fee
- The Imperfections charge
- Market operator charges

The TSC allows for allocation of SEMO's costs to a number of fees and charges. In the Consultation Paper the RAs were minded to continue with the current mechanism for calculating each of the fees and charges. As stated previously, once the SEM ceases, any approved amounts yet to be recovered will be reimbursed via an appropriate tariff mechanism in the I-SEM.

13.1 ENERGY AND CAPACITY CHARGES

The structure and detail of charges for energy purchased from the 'pool' is defined in the TSC. Energy is charged on a per MWh basis, on a half hourly basis.

13.2 ACCESSION FEES

The TSC states that the accession fee will be paid to SEMO by each applicant for accession to the TSC, to cover the costs incurred in assessing the application. Currently these fees are netted off overall SEMO costs.

13.3 PARTICIPATION FEES

In the TSC the participation fee is defined as "the fee payable with an application to register and become a participant in respect of any unit". Currently these fees are netted off overall SEMO costs.

13.4 MARKET OPERATOR CHARGES

The TSC states that the Market Operator Charge shall comprise of:

- A Fixed Market Operator Generator Charge, which may be different for each Generator Unit;
- A Fixed Market Operator Supplier Charge, which may be different for each Supplier Unit; and
- A Variable Market Operator Charge applicable to all Participants in respect of their Supplier Units, expressed in €/MWh.

During each tariff year, these charges will recover SEMO's operational costs and the appropriate amount of depreciation and WACC associated with SEM related capital costs.

In the Consultation Paper the RAs proposed that 95% of these costs be recovered through the Variable MO Charge with Fixed MO Charges to Generators and Suppliers recovering the remaining 5% of costs.

RESPONSE

No responses were received in relation to the form and magnitude of SEMO's charges.

SEMC DECISION

SEMC Decision: SEMO's charges to be recovered in line with Consultation Paper proposals and details provided above.