

Revenue Recovery Principles for SEMO and Designated NEMO (SEMOpX) from I-SEM go-live

Decision Paper

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Contents

1. EXECUTIVE SUMMARY	3
2. Introduction	5
2.1 Overview of consultation paper and decisions on revenue recovery principles for SEMOpx and SEMO.....	5
3 SEMO px Price control decisions.....	8
Price Control Decisions and Rationale	8
3.1.1 Will a Price control apply to SEMOpx?	8
3.1.2 How will the Setup costs of SEMOpx be recovered?	10
3.1.3 How will incremental Capex for SEMOpx be treated?.....	13
3.1.4 Should SEMOpx operate under a target or allowed revenue?	14
3.2 SEMOpx Tariffs.....	20
3.3 SEMOpx Incentives and KPIs.....	21
4 Roadmap for future considerations for SEMOpx.....	22
5 SEMO Price Control Decisions and future considerations	26
5.1 Scope of Price Control.....	26
5.2 How will the set-up costs of SEMO for I-SEM be treated?	27
5.3 Approach to Price Control.....	27
Operating Expenditure.....	28
Capital Expenditure.....	28
SEMO KPIs	29
Conclusions and next steps.....	30

1. EXECUTIVE SUMMARY

The Integrated Single Electricity Market (I-SEM) is a new wholesale electricity market arrangement for Ireland and Northern Ireland. The new market arrangements are designed to integrate the all-island electricity market with European electricity markets, enabling the free flow of energy across borders.

The introduction of the I-SEM requires the development and operation of a number of systems and processes that sit at the heart of the new market, to facilitate and settle trades between energy traders (typically Generators and Suppliers). These central systems are being developed and operated by two distinct types of Market Operator (MO):

NEMO: Nominated Electricity Market Operators (NEMOs) will provide a platform for trading electricity up to a short time ahead¹ of delivery, and will then settle those trades; and

SEMO: The Single Electricity Market Operator (SEMO) is a monopoly body that will be responsible for balancing market settlement. This “balancing market” ensures payments are made in respect of any difference between the quantities of electricity a Generator or Supplier may have traded through a NEMO, and that they are recorded to have delivered or consumed across their meters.

The Consultation Paper on the Revenue Recovery Principles of the NEMO and SEMO considered a range of issues related to the principles and operation of price controls for both entities. Seven responses to the Consultation Paper were received, from;

- EirGrid/SONI
- SSE Airtricity
- ESB
- PrePayPower
- Bord Gáis Energy
- Viridian (the response submitted by Viridian is an amalgamation of the individual business response from Energia, PPB and Power NI.)
- Gaelectric

These responses are published along with this Decision Paper.

This decision paper is split into three main sections;

1. Section one outlines the revenue principles decisions made in relation to SEMOpx.

¹ NEMOs are only able to enter into trades up to “Gate Closure”, which will initially be 1 hour ahead of physical delivery

2. Section two outlines the future roadmap for revenue regulation of SEMOpx to take account of changes in the NEMO landscape prior to 2nd October 2019.
3. Section three outlines the revenue regulation principles that will apply to SEMO as the Market Operator in I-SEM. The forthcoming price control papers will address how these revenue regulation principles, including the approach to financing the SEMO and SEMOpx businesses, will be considered in the context of the actual revenue submissions.

Section 1: Decisions for price regulation of SEMOpx for initial designation period	Section 2: Roadmap for future consultations and decisions for SEMOpx prior to 2 nd October 2019
Section 3: Decisions for price regulation of SEMO in I-SEM	

Table 1 – Decision Paper sections

2. INTRODUCTION

2.1 Overview of consultation paper and decisions on revenue recovery principles for SEMOpx and SEMO

On the 4th of April 2017, the RAs published a Consultation Paper on the Revenue Recovery Principles that would underpin both the NEMO (SEMOPx) and SEMO. This paper looked at the issues related to both entities and their price controls under I-SEM, as this will be the first price control of a NEMO and many of the functions of SEMO will change between SEM and I-SEM.

The main items consulted on for the NEMO and SEMO price controls are outlined below.

SEMOPx price Control

Will a Price Control Apply to SEMOPx?

The consultation paper proposed that a price control will apply to SEMOPx at least for the initial designation period, as it is currently the only designated NEMO for I-SEM and due to the licence conditions that have been imposed through the Market Operator licences.

This decision paper confirms the RAs intention to apply a price control for SEMOPx. The form of the Price Control that will apply is further detailed in this paper.

How will the Setup costs of SEMOPx be treated?

The consultation paper considered the provisions under CACM for the treatment of set-up costs, the licence conditions imposed on SEMOPx, the fact that it was the only applicant for initial designation and the one off nature of establishing market coupling. Based on these considerations, it was proposed that these costs go to the TSOs to be recovered on their RABs.

This decision paper confirms the RAs intention to have set-up costs of SEMOPx, which include market coupling costs, recovered via the TSO's RABs, in line with Article 76(2) of the CACM Regulation.

How will Incremental Capex for SEMOpx be treated?

It was proposed that any incremental Capex, separate to its set-up costs, would be recovered via SEMOpx's price control. This decision paper confirms this proposal. The treatment of Incremental Capex and form of the price control itself is considered below.

How should SEMOpx's Operating Expenditure be treated?

The consultation paper outlined two options for the treatment of SEMOpx's ongoing Operating Expenditure. However the consultation paper did not outline a minded to position on either approach.

The first option outlined was to provide an allowed revenue approach whereby SEMOpx's costs are underwritten with a correction applied under the allowed revenue approach. The second option, a target revenue approach, would involve the RAs approving tariffs set by SEMOpx, which is in line with CACM requirements.

The RAs have considered the merits of both approaches, in the short term (up to the end of the initial designation period in October 2019) and in the longer term. At this time, the RAs do not have visibility on how the market for NEMO services will develop. As such, the decisions outlined in this paper pertain to the operating expenditure for the period of designation and are without prejudice to any revenue regulatory decisions that may be considered in the longer term after the initial period of designation of SEMOpx. However, the RAs are cognisant of the need to ensure market clarity on such issues and Chapter 4 of this decision paper outlines the process by which the RAs will assess future revenue regulation of SEMOpx post 2019.

As such, for the initial period of designation, the RAs have decided to apply an allowed revenue approach to the SEMOpx Price Control.

Duration of Price Control

The duration of this price control is linked to the treatment of SEMOpx's Opex and any incremental Capex. The RAs have decided, as proposed in the consultation paper, to run this price control from I-SEM Go Live up to the end of the designation period. The options for next steps are outlined in Chapter 4.

SEMO Price Control

Scope of Price Control

The consultation paper outlined the 'business as usual' approach that would be taken to SEMO's price control for I-SEM as opposed to the 2016-19 price control which looks at the winding down of SEM.

The current 2016-19 price control will be extended separately to take account of the revised I-SEM Go-Live date on the 23rd May 2018, and will run concurrently to the 'I-SEM' SEMO price control. The first 'I-SEM' price control for SEMO will run from I-SEM Go-Live until 2021.

How will the set-up costs of SEMO be treated?

It was proposed that the set-up costs of SEMO (which are being borne through I-SEM implementation costs) would be recovered through the TSOs RAB on a 75:25 EirGrid/SONI basis consistent with the Agreed Approach Document². As with the SEMOpx price control, incremental Capex incurred will be considered separately and recovered through SEMO's price control.

Approach to Price Control

The consultation paper considered a margin-based approach to the regulation of SEMOpx along with a RAB-WACC approach as had been applied in previous price controls where an Opex + Cost of Capital approach is applied, which includes incentives. In their submission SEMO has requested that the RAs consider a margin-based approach to the entity. Feedback on this aspect indicated that respondents did not agree with SEMO's views on a margin approach and that the RAB-WACC approach should continue to apply. Although the RAs indicated in the consultation paper that in principle a RAB-WACC approach was appropriate for SEMO, the RAs are further considering submissions from the operators in this regard and will address them in the context of the forthcoming price controls.

² The I-SEM Agreed Approach Document can be found [here](#)

3 SEMO PX PRICE CONTROL DECISIONS

Price Control Decisions and Rationale

3.1.1 Will a Price control apply to SEMOpx?

The I-SEM market design is uniquely dependent on the day ahead market (DAM) and the intra-day market (IDM) as these will be the exclusive route to market. The provision of the I-SEM requirements for DAM and IDM services will also fulfil the CACM requirements in relation to NEMO services. SEMOpx applied for, and was granted, designation as NEMO in Northern Ireland and the Republic of Ireland (by virtue of the respective decisions of the UR and CER dated 3 October 2015)³. No other parties applied for NEMO designation in either or both of the SEM jurisdictions. SEMOpx is therefore currently the only designated NEMO for the I-SEM.

The Market Operator licences in Northern Ireland and Republic of Ireland have been modified to include specific obligations in relation to the performance by the respective Licensees of NEMO activities. The effect of such conditions is that SEMOpx is required (for as long as its designation remains in effect) to provide NEMO services. The provision of these NEMO services falls within the ambit of activities authorised by the MO licences. As such, the existing ‘price control’ arrangements for market operator activity can properly be applied to the licensee’s activities in the DAM and IDM (i.e. including the provision of NEMO services); at the very least during the initial NEMO designation period.

The requirements of CACM further support the oversight of the cost efficiency of NEMOs by the RAs. In particular, Article 76 (3) provides that NEMOs are only permitted to recover costs (over and above those borne by the TSOs) by means of fees or other appropriate mechanisms only if the costs are “reasonable and proportionate”. The RAs are of the view that CACM acknowledges the need for oversight by NRAs of the cost-efficiency of those carrying out NEMO activities, in particular noting that at the time of the designation there was no certainty that any other NEMO would offer I-SEM market participants a choice of service provider. This indicates a requirement for a revenue control model to be applied in the case of SEMOpx.

³ The RAs received one submission each for Northern Ireland and Ireland for initial designation; SONI Ltd for Northern Ireland and EirGrid Plc for Ireland. Both SONI Ltd and EirGrid Plc were successful in their application on the basis that they fulfilled the requirements of Article 6 of the Regulation. The SONI/EirGrid designation is based on establishing a joint venture (SEMOpx) to deliver the NEMO, with EPEX spot providing the required capabilities to interface with the Market Coupling Operator.

In addition, there is a need for a revenue control for the trading facilities offered by SEMOpx to ensure all market participants are assured of market certainty and continuity of service – at least until effective competition between NEMOs has been established.

In consideration of the significance of guaranteeing that a NEMO was designated and would be available to market participants from I-SEM go live and in light of the licence obligations imposed on the Market Operators, the RAs are of the view that revenue regulation offers the most suitable form of regulation of SEMOpx as it takes account of the specific circumstances related to the establishment of SEMOpx and its importance in terms of providing a route to access the day ahead and intraday markets in I-SEM.

In reaching decisions in relation to the SEMOpx price controls, the SEMC is acting in accordance with its relevant statutory duties. Annex 1 to this paper details the statutory framework governing decision making by the SEMC in this context.

Respondent's comments:

- In their response to the RA's consultation paper, SSE Airtricity agreed with the application of a price control to SEMOpx given the level of interest in the initial NEMO designation, however SSE Airtricity noted that regulatory oversight may no longer be necessary in future.
- Bord Gáis Energy agrees with the RAs view that they are at a minimum responsible for reviewing the costs associated with the establishment of NEMO functions for I-SEM. In their response, BGE highlighted the importance of reviewing costs in line with CACM to ensure that those that are reasonable, efficient and proportionate are recovered and the need for the RAs to provide confidence to participants in this regard.
- In their response, Viridian agreed with the RA proposal for an initial price control period running from I-SEM go live until the 2nd of October 2019. They further suggest that the second price control period should run from 2nd October 2019 until the end of the five year establishment cost recovery period.

Regulatory Authorities' Response:

The RAs have noted in their decision the general support from respondents for a price control being applicable to SEMOpx for the initial designation period. This includes the importance of ensuring that SEMOpx costs are being reviewed in line with CACM to ensure they are reasonable, efficient and proportionate. The RAs have also had regard to the requirement of Article 6 (1)(c) that the designated NEMO shall "be cost-efficient with respect to single day-ahead and intraday coupling and

shall in its internal accounting keep separate accounts for MCO functions and other activities in order to prevent cross-subsidisation.”

In terms of a second price control running after 2019, this aspect will be considered as part of the SEMOpx roadmap as per Section 4. This will consider, amongst other things whether SEMOpx will continue to operate under a price control regime given the extent of competition in the provision of NEMO services at the end of this price control period. While these considerations are outside the scope of this paper a number of scenarios are outlined in Section 4, taking into account respondent’s comments in relation to future revenue regulation of SEMOpx.

Decision 1: A price control will apply to SEMOpx for the initial designation period, from I-SEM Go Live until October 2019.

3.1.2 How will the Setup costs of SEMOpx be recovered?

The recovery of SEMOpx set-up costs will be consistent with the requirements of CACM and consider the licence obligations placed on the Market Operators to provide NEMO services and the one-off nature of the costs associated with establishing market coupling for the first time in the I-SEM bidding zone. The RAs are of the view that recovery of the capitalised set up costs of SEMOpx should be attributed to the TSOs, and depreciated over a five year period. The RAs consider that this is also consistent with the Agreed Approach Document of 9 January 2015 which set out that all costs once approved by the RAs would be subject to the principles of the relevant price controls.

The Licensee shall at all times charge in respect of its NEMO Activity in accordance with its NEMO Statement of Charges and with the requirements of the CACM Regulation. As per condition 3A of the Eirgrid Market Operator licence and condition 15A of the SONI Market Operator licence the RAs shall specify from time to time by direction the form of the NEMO Statement of Charges, which shall include a price list.

The RAs have come to this position regarding the recovery of set-up costs as a result of the absolute need for at least one designated NEMO to be available for the I-SEM go-live, the limited interest in providing that role in response to the public request made by the RAs in June 2015, as well as the licence obligation imposed on SEMO in its capacity as holder of the designation through the MO licences to fulfil its obligations as NEMO at all times during which the Designation is in effect.

Respondent's comments:

- In its response to the consultation paper, PrePayPower agreed with the proposal for some project capital costs to be recovered through TUoS tariffs, but queried all capital costs being recovered through TUoS tariffs and whether this might represent a barrier to entry or cross-subsidisation between SEMO and SEMOpx.
- SSE Airtricity supports the proposal to recover establishment costs through the TSOs over a 5 year period in the interest of transparency, simplicity and minimal regulatory intervention.
- Gaelectric supports this proposal and the necessity of the RAs underwriting the establishment costs of SEMOpx through the TSO charging basis.
- BGE supports the option for capitalised set up costs to be recovered through the TSO's RAB. BGE is of the view that if these costs were recovered through SEMOpx tariffs it would front-load the costs of I-SEM on consumers, especially considering the short depreciation timeline of 18 months.
- In their response, Viridian requested confirmation from the RAs that the treatment of SEMOpx is not unduly discriminatory to other NEMOs, and not in contravention of any EU directives, rules or regulations. They also requested further detail on the breakdown of SEMOpx's establishment costs. Overall, Viridian supports in principle the RA proposal of spreading the establishment costs of SEMOpx over a period of 5 years, but proposed that the RAs designate SEMOpx as a NEMO for a five year period as a minimum.
- In their response, ESB support the proposal for establishment costs to be recovered via the TSOs on the basis that such costs have been assessed by the RAs as being appropriate. They also propose that any costs associated with being a proxy 'NEMO of last resort' should be recoverable outside of the NEMO fees.

Regulatory Authorities' Response:

Responses to the RA's proposal to recover capitalised 'Day 1' SEMOpx set up costs via the TUoS and SSS tariffs over a longer five year period were generally supportive, however the RAs note respondent's points about transparency of costs and ensuring the treatment of SEMOpx is not discriminatory to other NEMOs.

Viridian proposed that the RAs designate SEMOpx as a NEMO for a five year period in order to spread the establishment costs of SEMOpx over this period. Under CACM, NEMOs are designated for

an initial term of four years⁴. However, the arrangements that follow this initial designation period are not set out. In SEM-15-073 and SEM-15-073b (Decision on NEMO Designation for Ireland under Article 4 of the European Commission Regulation on Capacity Allocation and Congestion Management) it was stated that the ‘RAs consider that at least twelve months prior to the expiry of this initial period the designated NEMO in Ireland and Northern Ireland should confirm to the RAs if it wishes to continue to be a designated NEMO in Ireland and Northern Ireland together with evidence it continues to comply with the designation criteria.’ As the time period for recovery of revenues until the end of the first designation for SEMOpx is 16 months, the RAs cannot assume designation beyond this period. The regulatory regime for SEMOpx will need to be reconsidered based on future market conditions at this time.

PrePayPower also queried all capital costs being recovered through TUoS tariffs. Capitalised setup costs refer to the costs being incurred to establish the functions of the NEMO before it is operational and are currently being borne by the TSOs as part of the overall I-SEM implementation project. Such costs include resources focused on readiness, operational capability, central systems and services and costs incurred in order for market coupling to go live. Any additional Capex incurred by SEMOpx, separate to establishment costs, would not be recovered via TUoS tariffs.

The establishment costs for SEMOpx are part of the overall I-SEM implementation costs being incurred by EirGrid and SONI in their capacity as TSOs/MOs/NEMOs for I-SEM. These costs are being tracked by the RAs and are reviewed on an ongoing basis to ensure that they meet the following criteria;

- That they are being efficiently incurred;
- That they are demonstrably necessary for the progression of I-SEM;
- That they are incremental to existing price controls and capable of being robustly validated.

The establishment costs for SEMOpx are not detailed in the Consultation or Decision papers on the revenue recovery principles for SEMOpx and SEMO. However, the establishment costs associated with I-SEM implementation costs (including SEMOpx Set-up Costs) will be outlined in a separate Information Paper. With regards the treatment of SEMOpx’s setup costs (the costs associated with the establishment of SEMOpx and getting the market coupling systems in place), the RAs were cognisant of the scope of CACM which permits such setup costs to be recovered via the TSOs. Article 76 of CACM states that *“Subject to agreement with the NEMOs concerned, TSOs may make a contribution to the costs provided for in paragraph 1 subject to approval by the relevant regulatory*

⁴ Article 4.2 of the CACM regulation

authorities.” This relates to both PrePayPower and Viridian’s responses and on this basis the RAs are not of the view that this treatment of setup costs represents a barrier to entry or cross-subsidisation.

In addition, it should be noted that in order to ensure that a NEMO was available to market participants, the RAs imposed a licence condition on the Market Operator to undertake the functions of a NEMO. Such obligations would not be imposed on any other NEMOS passporting into the I-SEM.

Decision 2: The Setup costs of SEMOpx will be recovered via the TSOs RAB as part of TUoS and SSS tariffs

3.1.3 How will incremental Capex for SEMOpx be treated?

While significant incremental Capex is not expected within the period of this price control, this will be considered as part of the revenue submission to the RAs and subsequent decision and consultation papers on SEMOpx’s revenue. Any incremental Capex would be recovered in principle, through the SEMOpx price control rather than through the TSOs. The form of recovery of such incremental Capex along with SEMOpx’s Opex is discussed below.

Notwithstanding this, due to the nature of NEMO costs which may be driven by pan European developments, certain decisions on cost recovery may require the input not only of the CER and UR, but also consideration of fellow NRA arrangements both regionally and at a pan EU level, as outlined in the CACM Regulation. As such, there may be ad hoc decisions required that relate to the treatment of capex that would be influenced by such factors.

Respondent’s comments:

- SSE Airtricity support the proposal that incremental Capex should be considered separately and addressed in subsequent revenue periods.
- BGE has proposed that any incremental Capex should be minimised given the short timeline for this price control.

Regulatory Authorities' Response:

The RAs agree with the responses received that given the short timeline (16 months) for this price control, any incremental Capex should be minimal. Any proposals received by SEMOpx related to incremental Capex will be reviewed by the RAs as part of the price control process. However, it should be noted that the depreciation of such incremental capex (if any) will be maintained as part of SEMOpx's revenue requirements, noting that the depreciation profile would be expected to be longer than the price control under consideration. If any incremental capex was incurred during the period of this price control, the treatment of its depreciation (for example if it was depreciated over 5 years) would need to be considered in line with the treatment of over or under recovery by SEMOpx at the end of this price control as outlined in section 3.1.4.

Decision 3: Any approved Incremental Capex will be recovered via the SEMOpx Price Control, notwithstanding any decisions regarding regional or national cost recovery principles, under CACM.

3.1.4 Should SEMOpx operate under a target or allowed revenue?

The RAs have considered both an allowed revenue and a target revenue approach in detail. Both approaches and the merits of each approach are discussed below.

Allowed Revenue Approach

Under an allowed revenue approach, the RAs would underwrite the efficient costs associated with SEMOpx.

At the end of this price control in October 2019, any revenue differences would be recovered through a correction factor mechanism. Where this correction factor would be applied would depend on whether SEMOpx continued to operate beyond October 2019. There are three different scenarios to consider here;

1. Over or under recovery by SEMOpx, where they continue in the market beyond the end of this Price Control period under a revenue regulated regime.
2. Over or under recovery by SEMOpx, where they continue in the market without revenue regulation.

3. Over or under recovery by SEMOpx, where market exit has occurred.

In scenario one, the correction factor would be applied to SEMOpx and would be corrected via future regulated revenue streams. For example, if SEMOpx over-recovered or under-recovered its revenues as set out in the revenue control final determination to be published in November 2017 and it was decided that a second revenue control would apply, a correction factor would be applied to the revenue control for SEMOpx.

In scenario 2, where SEMOpx continues in the market but where sufficient competition has developed and it is decided that a revenue regulated regime will not apply, the treatment of any correction factor would need to be considered carefully in order to ensure that there is no distortion to a level playing field for competition. This correction factor could either apply to SEMOpx or to SEMO given that the licence conditions pertaining to the NEMO are ascribed to the Market Operator licences. However, the RAs will make a decision on this aspect of the treatment of any correction factor once the market conditions at the time are better known.

In scenario 3, where SEMOpx exits the market, any correction factor would be attributed to SEMO as the licence conditions pertaining to the NEMO are ascribed to the Market Operator licences.

The RAs are of the view that these methods of correcting any correction factor that may arise provides both certainty for the current price control and allows for delineation between the market circumstances pertaining to I-SEM go-live and the relevant articles in CACM relating to a competitive NEMO environment.

In addition, the RAs note that a number of respondents to the consultation paper were in favour of an approach whereby the RA's role in revenue regulation could cease in a clear manner based on future market conditions. The treatment of any correction factor as outlined here is intended to provide this.

Allowed Revenue Approach			
Revenue	k-factor	Tariffs	Incentives
Efficiently incurred costs are underwritten through regulatory controls.	Will apply.	Tariffs will be developed in order for SEMOpx to recover its costs, with consideration of access for smaller market participants.	As is practice in regulated revenue regimes, Key Performance Indicators will apply

Table 2 –Allowed Revenue Approach

Target Revenue Approach

In contrast to the guaranteed revenue approach, under a target revenue approach the RAs would have a role in the approval of costs and tariffs but these would be set by SEMOpx with no guarantee of their revenue. This approach may, in general be considered to require a higher level of risk reward via the return afforded to the entity.

Target Revenue Approach			
Revenue	k-factor	Tariffs	Incentives
Target Revenue without guaranteed recovery in a competitive market	Does not apply.	Tariffs would be approved within a certain range, with a cap and floor applied.	Incentives are not generally applied to target regimes, as there is no incentive to outperform.

Table 3 – Target Revenue Approach

If SEMOpx did not recover its target revenue, no correction factor would be applied by the RAs. An advantage of this approach is that it allows revenue regulation to end at any time as there is no ongoing obligation to correct under or over recoveries, as noted by a number of respondents to this consultation paper. A disadvantage is that such an approach does not return any over-recoveries to the market, and may also result in risk being transferred to SEMOpx; an entity which carries out a function that is integral to the I-SEM design.

Respondent's comments:

- SSE Airtricity's preference is for a target revenue model (with a cap and floor) to be introduced in order to allow for SEMOpx to cease its operations as a NEMO in a clear, defined manner should it be necessary.
- BGE supports the option of a target revenue approach, potentially with a cap and floor option. BGE states that a cap and floor would enable SEMOpx to react to market conditions and allow for recouping of *efficiently incurred* costs established in the Price Control. A relatively level NEMO playing field would also be made possible with such an approach and should SEMOpx exit the market as a NEMO in October 2019, a correction factor would not need to be applied as in the 'allowed' revenue approach.
- In their response to the consultation paper, Viridian support the allowed revenue regime approach and propose that this is reviewed after the 2nd of October 2019.
- Gaelectric are of the view that a cap and collar should be applied to this revenue collection method and the price control should remain cognisant of the potential for NEMO competitors to enter the market and increase competition in this area.
- ESB recommends an approach where SEMOpx does not have its fees approved by the RAs based on an allowed revenue given the complexities of the coexistence of a regulated NEMO and competitive NEMOs.

Regulatory Authorities' Response:

The RAs have carefully considered the options available in terms of an allowed vs. target revenue regime. The RAs note that SSE Airtricity, Bord Gáis Energy and Gaelectric support a target revenue approach while Viridian and ESB support an allowed revenue regime approach. One of the main reasons respondents gave in relation to a target revenue approach was that it would allow SEMOpx to exit the market without a correction factor being applied as in the allowed revenue approach. While recognising this advantage to such an approach, on balance the RAs have concluded that there are a number of reasons as to why SEMOpx's efficiently incurred costs will be subject to regulatory oversight via an allowed revenue approach.

This aspect of revenue regulation and the decision of the RAs to underwrite the initial period of designation should be seen in the context of the immediate requirements of I-SEM, and as such the RAs have come to the conclusion that an allowed revenue approach will apply for the period of designation.

- CACM requires that at least one NEMO is designated. This is significant as the I-SEM design requires NEMO services to be available to market participants (OTCs and bilateral physical trading not being part of market design). Without a NEMO in place, all actions would take place in the Balancing market. As such, the RAs imposed a licence condition on the MOs to fulfil the functions of a NEMO so as to ensure that such services were available.
- The RAs are also of the view, that given the scale of changes to the Single Electricity Market under I-SEM it is important to consider potential impacts on market participants. Under an allowed revenue approach, SEMOpx's revenue regime would be aimed at cost recovery, including financing requirements that are reflective of the risk associated with a regulated entity. In addition where SEMOpx over or under recovers within this price control, k-factors would be returned to customers thereby ensuring that they are only recovering necessary efficient operating costs. This allows full scrutiny of SEMOpx costs by the RAs to the benefit of market participants.
- Under an allowed revenue approach the RAs would have a direct role in terms of developing the range and balance between fixed vs. variable components of tariffs, a factor which a number of participants referred to as critical to ensure the full range of market participants are facilitated.
- In addition, an allowed revenue approach facilitates the development of Key Performance Indicators (KPIs) for market participants as the performance of the entity is tied to an incentive mechanism. Following the feedback received on this aspect, the RAs intend to include an element of KPIs as part of the revenue control consultation paper. In contrast, a target revenue approach would not involve the RAs having a specific role in terms of incentives.

In summary the RAs have considered that on balance the allowed revenue approach is to be preferred as a proportionate approach that ensures the provision of NEMO services for the initial designation period and does not distort the market through presenting either a barrier to entry into the market or undue discrimination. However, the RAs are of the view that this allowed revenue regime may not be required on an enduring basis should NEMO market conditions change, and will need to be reviewed following the initial period of designation, details of which are included in Section four.

The RAs are currently considering a number of aspects related to SEMOpX's price control including financeability which will be outlined in more detail in the forthcoming price control decision.

Decision 4: The operating expenditure of the NEMO will be based on an allowed revenue approach for the period of designation.

3.2 SEMOpx Tariffs

As outlined in the Consultation Paper, the focus of this Decision Paper is the revenue principles that will underpin SEMOpx and SEMO in I-SEM, with indicative tariffs to be published with the consultation paper on SEMOpx's price control in July 2017. However, the RAs outlined some initial thoughts on the forms of tariffs that could be applied, such as costs on a 'per user', 'per MWh' and 'per transaction' basis.

It should be noted that SEMOpx, through the requirements of the relevant MO licence conditions, shall at all times charge in respect of its NEMO Activity in accordance with its NEMO Statement of Charges and with the requirements of the CACM Regulation. The RAs shall specify from time to time by direction the form of the NEMO Statement of Charges, which shall include a price list. These charges shall be arrived at through the SEMOpx price control.

Stakeholder feedback was requested on SEMOpx's tariffs ahead of the consultation paper on SEMOpx's price control. While the RAs will not be deciding on the form of tariffs to apply until further analysis of costs has been conducted based on SEMOpx's price control submissions, a summary of the responses received is outlined below and will be considered as part of the tariff development.

On this basis the RAs will be conducting sensitivity analysis of a number of different tariff scenarios and their impact on market participants as part of the consultation paper on SEMOpx's price control which will include an indicative tariff statement.

Respondent's Comments:

- PrePayPower is of the view that a lower fixed cost, higher transaction cost tariff structure is more in line with the market design and the smaller size of market participants in the SEM, rather than a high fixed cost, low transaction cost tariff structure.
- SSE Airtricity considers that the establishment of an appropriate tariff mechanism will have a direct impact on liquidity in the market. Variable transaction or volume based tariffs will prevent the development of liquidity through disincentivising small volumes being posted and traded. Based on this, SSE has proposed that per transaction fees are avoided and volume fees are kept to a minimum. SSE has also set out a proposed tariff structure with a combination of an initial access fee, annual subscription fee and IT service element.
- In their response, Gaelectric highlighted the difficulty market participants may face related to increased fixed costs to participate in I-SEM.

- BGE believes that an appropriate balance must be struck between fixed and variable (floating) charges in order that all sizes of market participants can access market timeframes. In this context BGE is in favour of applying variable fees on a per MWh basis.
- Viridian support tariffs based on a cost 'per MWh' charging structure.
- ESB noted that if different fee structures for different classes of participants are developed to ensure that costs of participation are not overly prohibitive, any extra cost associated with this should not be levied within the 'pot' of SEMOpx fees as it may make SEMOpx less competitive compared to other competing NEMOs.

3.3 SEMOpx Incentives and KPIs

As with tariffs, the incentives and KPIs that will be applied in the SEMOpx price control will be considered more fully in the consultation paper in July but the range of responses received will be considered as part of the development of these KPIs. Below summarises the range of responses received with regard to KPIs.

Respondent's Comments:

- In their response to the consultation, SSE Airtricity provided a number of proposals for incentives. They have proposed that the provision of accurate and timely information is incentivised for; Market Results, Trade Confirmations, ETS bid files, Block Bid Order files and Buy and Sell curves.
- SSE Airtricity also proposed that a KPI based on platform reliability should be considered following the 'bedding in' period for the platform. It was proposed that the reliability of the platform is particularly important given that the SEMOpx platforms are the only route to market for physical power in I-SEM.
- BGE believes that to ensure compliance with CACM on the efficient recovery of costs by SEMOpx, that explicit obligations and related KPIs for SEMOpx are necessary. BGE is of the view that the publication of certain data within particular timelines is also critical to efficient market functioning. This data includes for example early ex-post prices. Other KPIs should include the need for system availability and resolution of queries within usefully narrow timelines. Credit cover and invoicing are also relevant parameters.
- Viridian believe data transparency from NEMOs should be a licence obligation, and proposed a consultation by the RAs on what data should be provided to the market. They suggested that once data requirements are in place, the market should be allowed to operate for a time, after which a review of performance against targets should be completed.

4 ROADMAP FOR FUTURE CONSIDERATIONS FOR SEMOPX

The NEMO provides a critical function in the ex-ante markets and the RAs are required to ensure that at least one NEMO is always available in I-SEM. Therefore, the RAs consider it important that there is consideration given to the longer term views of NEMO regulation in I-SEM, in particular by balancing the requirements that NEMOs can compete to offer services in the market but also that the existence of at least one NEMO is critical to the I-SEM design.

From a revenue principles perspective, the future development of the competitive market will determine the longer term view on what level of regulatory oversight and control is required for SEMOpx. Although this paper is focused on the revenue principles that will underpin SEMOpx up until the end of the current designation period, the RAs note the range of options that may require consideration when I-SEM goes live, so as to give market certainty.

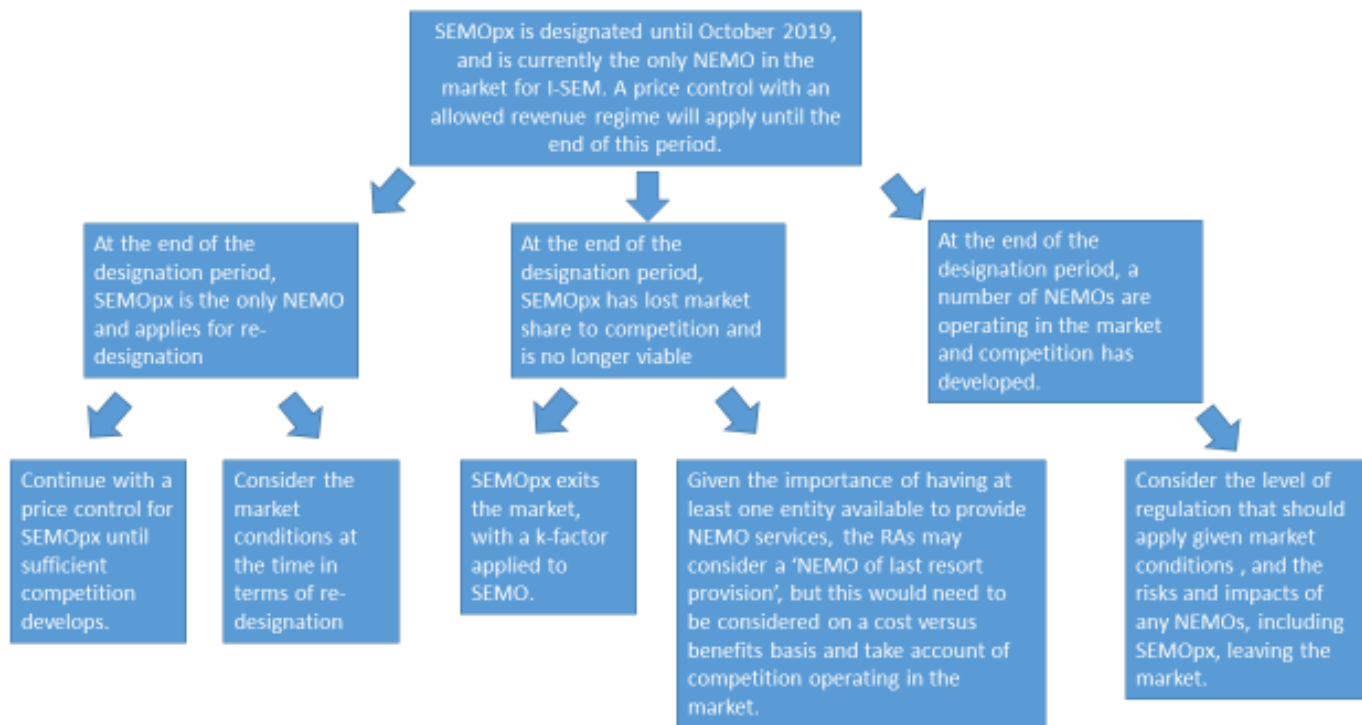
Respondent's Comments:

- BGE agrees that the length of the SEMOpx price control should continue until the expiration of its initial designation as NEMO, i.e. October 2019. However, should SEMOpx re-apply for designation (which re-application should occur by October 2018), BGE is of the view that the RAs should undertake a full review of the extent of price control required in the context of the non-commercial nature of SEMOpx, its status as one entity in a Group of companies and the need to avoid potential conflict of interests.
- BGE also proposes that the treatment of SEMOpx now and going forward should not in any way disadvantage other NEMOs or deter their entry to the market so that a competitive NEMO market is facilitated.
- In their response, Gaelectric stated that they look forward to the effect of competition and alternative routes to market for participants.
- In their response to the consultation, Viridian highlighted the fact that the consultation paper made reference to the possibility that any NEMO (including SEMOpx) can decide to exit the market at any time, and requested clarity on what steps SEMC will take to ensure there is a NEMO available to the market at all times in I-SEM as an exclusive route to market. Viridian also requested details around the criteria that will be used to define when 'effective competition' in the NEMO market has occurred.

The RAs acknowledge that the longer term view of NEMOs is important to market participants. However, for the purposes of this paper, the decision making scope is limited to the revenue control that will apply to SEMOPx for the duration of its designation period, alongside the SEMO revenue principles.

However, the RAs consider that there are a range of potential options available concerning future revenue regulation, depending on market conditions at the time. Consideration of these matters will take place alongside the analysis that will be undertaken as part of the re-designation in 2019. At this time, the RAs will have more visibility on market conditions.

The diagram below indicates the options that the RAs may consider on this question regarding an enduring NEMO revenue regulation regime.



Scenario for NEMO price regulation			
Scenario:	SEMOpx applies for re-designation and remains the only provider in the I-SEM market/has majority market share and can recover its costs.	SEMOpx decides for commercial reasons to exit the market at the end of the designation period.	More than one NEMO applies for designation in 2019, or multiple NEMOs are operating in the market following the initial designation period.
Risks:	<p>Price regulation would be required as long as SEMOpx is the only service provider or until sufficient competition has developed, in order to ensure that prices are fair and reasonable.</p> <p>The same risks for future developments in the market as per today would apply.</p>	<p>There is no longer an obligation for a NEMO to be in the market, a critical function for I-SEM.</p> <p>If there is no entity providing NEMO services, participants could not trade in the day ahead or intraday markets, and this would negatively impact the market and consumers.</p> <p>The AoLR licence condition would not be sufficient in a scenario where there is no NEMO in the I-SEM market</p>	The same risks as for the second scenario would apply, in terms of the potential of having no entity available to provide NEMO services.
Potential Options:	<ul style="list-style-type: none"> ➤ Continue with the current form of price regulation. ➤ At the end of the initial designation period, the RAs carry out a designation process for a NEMO with an open process for applications. ➤ At the end of the initial designation 	<ul style="list-style-type: none"> ➤ At the end of the initial designation period, the RAs carry out a designation process with an open process for applications. ➤ At the end of the initial designation period, allow SEMOpx to exit the market and recover any k-factor via SEMO's price control. ➤ At the end of the initial designation period, introduce a 'NEMO of last resort' provision to ensure there is always a NEMO in the market, either 	<ul style="list-style-type: none"> ➤ At the end of the initial designation period, introduce a 'NEMO of last resort' provision to ensure there is always a NEMO in the market, either through a licence condition or change in legislation. ➤ Review the regulatory

	<p>period, introduce a 'NEMO of last resort' provision to ensure there is always a NEMO in the market, either through a licence condition or change in legislation.</p>	<p>through a licence condition or change in legislation. This 'NEMO of last resort' provision could potentially be made available to any NEMO through a competitive process.</p>	<p>framework at the time while considering the risks involved.</p>
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Table 4 – Risks for NEMO Price Regulation

5 SEMO PRICE CONTROL DECISIONS AND FUTURE CONSIDERATIONS

5.1 Scope of Price Control

Under the Single Electricity Market, SEMO carries out certain functions in the wholesale market. The responsibilities of SEMO are set out in the SEM Trading and Settlement Code and defined in Section 1.3 of the Code which states that the role of SEMO is to;

“Facilitate the efficient, economic and coordinated operation, administration and development of the Single Electricity Market in a financially secure manner”.

With the introduction of differing functions in the I-SEM, the functions of SEMO will change. For example, under I-SEM SEMO will be responsible for Imbalance Settlement Operator functions and Settlement of Capacity Payments and Charges. As there will be a change in the responsibilities the Price Control for the functions carried out by SEMO will inevitably also change.

SEMO’s operational and capital costs are recovered through Market Operator tariffs and fees, which are levied on market participants. To date, the revenue requirements have been set as one, and have been apportioned based on comparative levels of energy consumption in Republic of Ireland and Northern Ireland on a 75% and 25% split.

In terms of the scope of this price control, it will run from May 2018 to September 2021, a period of 3 years and 4 months. The 2016-2019 price control will be extended on a pro-rata basis to take account of the revised Go-Live date for I-SEM.

I-SEM SEMO Price Control: May 2018 – September 2021	SEM SEMO Price Control – to be extended on a pro-rata basis to take account of the revised Go-Live date for I-SEM
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Participant Comments:

- SSE Airtricity agrees with the RAs proposals for tariffs and the duration of the price control for SEMO, and notes that once the new market is established there may be scope for extending the price control to five years.
- BGE supports a straight line 5 year based depreciation period and that any RAB additions are subject to the same depreciation policy. Capex developments during the year with any costs that impact on the original Price Control settings should be simply and transparently reported in annual tariff reviews related to the price control.

- EirGrid and SONI support the continuation of a revenue control approach for SEMO in I-SEM, with ex ante regulatory scrutiny, an approved tariff and adjustment through a k-factor. In addition, they support the proposal for the revenue control to run from May 2018 to 30th September 2021, with the caveat that there should be mechanisms to manage uncertain costs and a level of re-openers available.
- ESB supports the continuation of the current regulatory regime and sees it as important that SEMO is well resourced to carry out its functions and provide a high level of service to its customers.

5.2 How will the set-up costs of SEMO for I-SEM be treated?

It was proposed that the set-up costs of SEMO be recovered through the TSOs RABs via TUoS and SSS tariffs as part of the overall I-SEM implementation costs, as detailed in the Agreed Approach Document for I-SEM. As with the SEMOpX price control, any additional Capex incurred will be considered separately and recovered through SEMO's price control.

These set up costs are being reviewed by the RAs to ensure that they are reasonable, efficient and proportionate, and will be detailed in an information paper on I-SEM implementation costs in August 2017.

5.3 Approach to Price Control

A key aspect of the revenue control is the financing approach to SEMO. As part of the consultation, the RAS considered the merits of the RAB WACC approach vs. a margin approach which has been proposed by SEMO. In that consultation paper, the RAS undertook analysis on the applicability of either approach but concluded that the RAB WACC approach continued to be applicable.

Participants broadly agreed with this approach, with the exception of SEMO.

The RAs are of the view that the WACC RAB approach to SEMO is robust and quantifiable. This is because the respective WACCs of the parent companies can be verified using market data and therefore is transparent for end customers.

However, with the change in overall market design there are a number of aspects that need to be considered in the context of the Price Control, including aspects pertaining to the financeability of SEMO in the context of its licence obligations under I-SEM. The RAs are considering these aspects at present and decisions relating to these will be included in forthcoming price control decisions.

Operating Expenditure

It is envisaged that Opex will be subject to Revenue Cap (RPI-x) Regulation. The efficiency rate (x) will be established in the Price Control paper. Any efficiency and price savings are retained by SEMO; overspends must conversely be absorbed by SEMO.

Capital Expenditure

As per the consultation paper the RAs were minded to continue to apply rate of return regulation (i.e. a RAB, depreciation, WACC approach) to SEMO. With this method of regulation the actual historical cost is included in the Regulated Asset Base (RAB) and depreciated straight line over five years. In addition, the RAB value is indexed each year and a return (representing compensation for risk and the opportunity cost of the capital) is given. This return is referred to as a Weighted Average Cost of Capital (WACC) and is directly derived from blending the WACCs applicable for EirGrid and SONI in line with the specified proportions (75% / 25% respectively).

This RAs have engaged with financial consultants to review the continued applicability of this approach. This analysis is ongoing and will be outlined in detail in the revenue decision pertaining to SEMO.

Participant Comments:

- SSE Airtricity agree that retaining the RAB WACC approach is the most appropriate option for SEMO, with retention of the RPI-X approach.
- BGE agree with the application of the RAB-WACC approach, however BGE requests that full, line by line account for the RAB base and related depreciation and WACC is provided for in the Price Control and in subsequent related annual tariff reviews.
Viridian state that there is insufficient detail provided in the consultation paper to allow respondents to make informed comments on the proposed 'business as usual' approach, and a lack of detail around the overlap of the SEMO price control in SEM and price control beginning at the start of I-SEM. Viridian is of the view that the current RAB-WACC approach and RPI-X approach the RAs have used to date in regulating the Capex costs should continue.
- EirGrid and SONI disagree with the consultation paper's statement that 'As SEMO's Opex is relatively stable over a Price Control Period, the RAs are of the view that the scale of SEMO does not justify an RPE approach' and are of the view that the *ex ante* revenue cap for SEMO should be adjusted for general inflation (RPI/CPI), Real Price Effects (RPEs) and efficiency (X).

- EirGrid and SONI have raised concerns over the RAB WACC approach in their response, however they do not go into detail in their response on the limitations of this approach and how this is different to SEMO's price controls in SEM.
- EirGrid/SONI also raise concerns several times regarding their financeability. This is a matter where the RAs are engaging with the TSOs and undertaking ongoing financial analysis.

SEMO KPIs

As discussed in the consultation paper, Key Performance Indicators (KPIs) are currently applied to SEMO in the current SEM market to improve performance, promote customer service and increase efficiencies, with the incentives pot set at a maximum of 4% of total Opex revenues for each year.

As the roles and responsibilities of SEMO will change in I-SEM, the RAs will review the incentives placed on SEMO as part of its upcoming price control, and a decision on these will be included in the Decision Paper on SEMO revenues.

Participant Comments:

- SSE Airtricity would welcome an adjustment to the weighting for credit cover increase notices and general queries. SSE Airtricity would like to have an extension of the time period for notices in addition to a higher weighting on this KPI.
- SSE Airtricity has also proposed KPIs related to the production and issuance of the following information; Forecast Imbalance, Four Day Rolling Wind Power Unit Forecast by Unit, Net Imbalance Volume Forecast, Accepted Bid Quantity, Accepted Offer Quantity, Anonymised Inc/Dec Price Quantity Pairs and Daily Load Forecasts.
- ESB sees merit in the continuation of relevant KPIs, focusing on; Timely publication of the imbalance price with use of the back-up price kept to a minimum, Dealing with SEMO Helpdesk queries in a timely manner, timely publication of invoices, credit cover management, availability of systems and website and customer satisfactions.

CONCLUSIONS AND NEXT STEPS

This paper outlines the approach that the RAs will take to the revenue regulation approach of both SEMOpx and SEMO as well as outlining a roadmap for the future revenue regulation of SEMOpx. However, there are a number of considerations ongoing;

- Financeability in I-SEM;
- Implementation costs and,
- The revenue controls outlining the revenue allowances for both SEMOpx and SEMO.

In addition, there is also a requirement to consider the current “SEM active” revenue for SEMO in the SEM given that the I-SEM go live date of 23rd May 2018 is beyond what was initially envisaged in the 2013-2016 SEMO Price Control, where a go live date of October 2016 was envisaged.

In terms of next steps, the RAS will be publishing the following papers relating to SEM ongoing revenues and I-SEM revenues.

Subject	Output	Publication date	Period of application
Revenue requirements for SEM SEMO between October 2017-May 2018 (“SEM active revenue”)	Information Note Tariff Schedule	August 2017	Oct '17-May '18
Revenue requirements of SEMOpx	Draft determination for consultation	July 2017	–
Revenue requirements of SEMO	Draft determination for consultation	September 2017	–
I-SEM implementation costs	Information Paper	August 2017	TBC
Final revenue requirements for SEMOpx	Final Determination Tariff Schedule	November 2017	May '18-Oct'19
Final revenue requirements for SEMO	Final Determination	December 2017	May '18 –Sep'21
Tariffs set for I-SEM SEMO *	Tariff schedule	February 2017	May '18 –Oct '19

*SEMO tariffs will be set after the capacity auctions in early 2017

ANNEX 1

STATUTORY FRAMEWORK FOR DECISION MAKING

Republic of Ireland

1. In terms of s.9BC(1) of the Electricity Regulation Act 1999 (the 1999 Act), the principal objective of the Commission (in giving effect to any decision of the SEM Committee) and of the SEM Committee (in carrying out its functions under section 8A(4)), is to protect the interests of consumers of electricity in the State and Northern Ireland supplied by the holders of licences or exemptions under a provision of the 1999 Act relating to electricity or under any corresponding provision of the law of Northern Ireland (Authorised Persons), wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale or purchase of electricity through the Single Electricity Market.

2. In terms of s.9BC(2) of the 1999 Act, the Commission and the SEM Committee must carry out their respective functions referred to above (Relevant Functions) in the manner which each considers is best calculated to further the principal objective, having regard to:

(a) the need to secure that all reasonable demands for electricity in the State and Northern Ireland are met;

(b) the need to secure that Authorised Persons are able to finance the activities which are the subject of conditions or obligations imposed by or under this Act or the Internal Market Regulations or any corresponding provision of the law of Northern Ireland;

(c) the need to secure that the functions of the Minister, the Commission, the Authority, and the Department in relation to the Single Electricity Market are exercised in a coordinated manner;

(d) the need to ensure transparent pricing in the Single Electricity Market; and

(e) the need to avoid unfair discrimination between consumers in the State and consumers in Northern Ireland.

3. Subject to s.9BC(2), the Commission and the SEM Committee must (according to s.9BC(4)) carry out Relevant Functions in the manner which each of them consider is best calculated:

(a) to promote efficiency and economy on the part of Authorised Persons;

(b) to secure a diverse, viable and environmentally sustainable long-term energy supply in the State and Northern Ireland; and

(c) to promote research into, and the development and use of (i) new techniques by or on behalf of Authorised Persons, and (ii) methods of increasing efficiency in the use and generation of electricity.

4. Subject again to s.9BC(2), the Commission and the SEM Committee must (according to s.9BC(5)), in carrying out any Relevant Functions, have regard to:

(a) the effect on the environment in the State and Northern Ireland of the activities of Authorised Persons; and

(b) the need, where appropriate, to promote the use of energy from renewable energy sources.

5. According to s.9BC(6) of the 1999 Act, in carrying out any Relevant Functions, the Commission and the SEM Committee must not discriminate unfairly as regards terms and conditions (a) between Authorised Persons, or (b) between persons who are applying to become Authorised Persons.

6. Finally, according to s.9BD of the 1999 Act, the Commission and the SEM Committee must have regard to the objective that the performance of any of their respective functions in relation to the Single Electricity Market should, to the extent that the person exercising the function believes is practical in the circumstances, be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed.

Northern Ireland

1. In terms of Article 9(1) of the Electricity (Single Wholesale Market) (Northern Ireland) Order 2007 (the 2007 Order), the principal objective of the Authority (in giving effect to any decision of the SEM Committee) and of the SEM Committee (in carrying out its functions under section Article 6(2)), is to protect the interests of consumers of electricity in Northern Ireland and Ireland supplied by authorised persons, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the sale or purchase of electricity through the SEM.

2. In terms of Article 9(2) of the 2007 Order, the Authority and the SEM Committee must carry out their respective functions referred to above (Relevant Functions) in the manner which each considers is best calculated to further the principal objective, having regard to:

(a) the need to secure that all reasonable demands for electricity in Northern Ireland and Ireland are met;

(b) the need to secure that authorised persons are able to finance the activities which are the subject of conditions or obligations imposed by or under Part II of the Electricity Order or the Energy Order or any corresponding provision of the law of Ireland;

(c) the need to secure that the functions of the Department, the Authority, the Irish Minister and CER in relation to the SEM are exercised in a coordinated manner;

(d) the need to ensure transparent pricing in the Single Electricity Market; and

(e) the need to avoid unfair discrimination between consumers in Northern Ireland and consumers in Ireland.

3. Subject to Article 9(2), the Authority and the SEM Committee must (in accordance with Article 9(4)) carry out Relevant Functions in the manner which each of them consider is best calculated:

(a) to promote efficiency and economy on the part of authorised persons;

(b) to secure a diverse, viable and environmentally sustainable long-term energy supply in Northern Ireland and Ireland; and

(c).to promote research into, and the development and use of (i) new techniques by or on behalf of authorised persons, and (ii) methods of increasing efficiency in the use and generation of electricity.

4.Subject again to Article 9(2), the Authority and the SEM Committee must (according to Article 9(5)), in carrying out any Relevant Functions, have regard to:

(a) the effect on the environment in Northern Ireland and Ireland of the activities of authorised persons; and

(b) the need, where appropriate, to promote the use of energy from renewable energy sources.

5.According to Article 9(6) of the 2007 Order, in carrying out any Relevant Functions, the Authority and the SEM Committee must not discriminate unfairly as regards terms and conditions (a) between authorised persons, or (b) between persons who are applying to become authorised persons.

6.Finally, according to Article 9(7), the Authority and the SEM Committee must have regard to a) the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed and b) any other principles appearing to it to represent best regulatory practice.