



**Viridian response to ISEM consultation on  
Revenue Recovery Principles for  
SEMO and Designated NEMO (SEMOpX)  
for I-SEM Go-Live**

*Consultation 17-018*

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## **1. Introduction**

This response submitted by Viridian is an amalgamation of the individual business response from Energia, PPB and Power NI. Viridian welcomes the opportunity to respond to the Regulatory Authorities (RAs) consultation paper (SEM-17-018) on Revenue Recovery Principles for SEMO and Designated NEMO (SEMOpX) from I-SEM go-live. Viridian has actively and constructively engaged in all aspects of the I-SEM project and related consultation process as it is essential to ensure the new and complex I-SEM market is fit for purpose for the years ahead.

Given the SEMO will have additional responsibilities under I-SEM, and SEMOpX is the designated NEMO (until Oct 2019), there is a requirement to ensure the activities of these entities are regulated in a manner that complements the functioning of the I-SEM market design. However, as ultimately the costs of these entities are borne by end users, it is imperative that the RAs ensure any costs which they allow recovery of under the tariffs, are proportionate, appropriate and necessarily incurred for the sole purpose of the activities for which the entity is licenced and thus regulated. Further, given the likelihood that there will be other NEMOs operating in the I-SEM market, it would be illegal and contrary to State aid guidelines if the regulatory treatment of the Designated NEMO, in any way provided them with unfair support or a unique position or advantage over other NEMOs, and thus care should be exercised to ensure this does not occur.

This response makes some general comments in relation to points raised in the consultation paper, in addition to responding to the specific questions raised for which feedback was sought, and finally some we provide some concluding comments.

## **2. General Comments**

### ***2.1 Insufficient detail to make informed comments;***

While it is appreciated that the SEMC has asked for comments on the principles related to how the revenues of SEMO and the designated NEMO (SEMOpX) will be regulated, there is a lack of sufficient detail contained in the consultation paper to allow respondents to make truly informed comments on many of the suggestions being made and the questions being asked. As such the value of this consultation is limited in the absence of such data, in particular economic details related to SEMO and designated NEMO potential costs. Give this Viridian reserve the right to vary any comments it makes in relation to this consultation paper pending further detail assumed to be

provided in the planned consultation dealing with SEMO and designated NEMO price control during the summer of 2017.

### ***2.2 Treatment of the Designated NEMO***

It is illegal and contrary to State aid guidelines for the regulatory treatment of the Designated NEMO to provide them with unfair support or a unique position or advantage over other NEMOs, and thus extreme care should be exercised to ensure this does not occur, . If as hoped, other NEMO providers enter the I-SEM market, they will do so at their sole commercial risk. As such, the designated NEMO who alone made its decision to offer designated NEMO services in I-SEM, should see the same commercial risks as any other NEMO providers.

### ***2.3 Absolute need for a NEMO at all times***

The paper outlines that there is an absolute need to ensure there is a NEMO available at all times to allow participants to trade. This need gave rise to the appointment of SEMOpx as Designated NEMO until Oct 2019. However the paper also makes reference to the fact that a NEMO can decide to leave the market at any time. Given the possibility that any NEMO (including SEMOpx) can decide to vacate the market at any time, the SEMC are asked to advise what steps they will take to ensure there is a NEMO available to the market at all times in I-SEM which is critical given the I-SEM design that requires this as the exclusive route to market.

### ***2.4 Costs of Market Coupling***

This consultation proposes that the costs associated with getting market coupling systems in place will be allowed and capitalised via the TSOs. Given this, the RAs are asked to confirm that any new NEMO will not have to incur any specific costs associated with getting set up to utilise, or to utilise on an on-going basis, the market coupling systems created by this allowed TSO expense.

The I-SEM design does not permit bilateral contracts or OTC trading as a route to market for the Day Ahead Market and Intra-Day Market. Instead the I-SEM design prescribes one exclusive route to these markets, and in so doing, creates additional costs for the market given incremental cost impact of linking to a pan-european market. Such costs should be clear to the market, and the I-SEM design decision reviewed on a regular basis to ensure it represents the most economical solution.

### ***2.5 Clarity on the SEMOpx business***

The designated NEMO until Oct 2019 is SEMOpx. SEMC should ensure that market participants are provided sufficient detail on matters such as how SEMOpx will be regulated; what their licence obligations are; are their employees a team of people separate from the TSOs and SEMO, and what

ring-fencing and demarcation is in place. Details should also be provided as to what premises, facilities, systems SEMOpx will use and the extent to which these, and other shared services, are proposed to be leased or procured from the TSOs, and what security measures are in place to ensure correct access and rights.

## **2.6 Recovery of SEMO costs in I-SEM**

Clause 5.1 of the consultation paper dealing with SEMO “Tariffs” suggests that the SEMO tariffs will be recovered based on “forecasted market demand”. Clarity is requested as to what “forecast market demand” is. For instance is it the total actual market demand expected to occur, or it is in some way referring to demand in each of the various I-SEM markets of Day Ahead, Intro-Day, and Balancing?

Nothing in the SEMO tariff regime should act as a deterrent for market participants to act in a balance responsible manner. However charging on a basis of volumes in each market as opposed to net volume may risk such an outcome in the scenario where a market participant who is making every effort to be balance responsible trades material volumes in several markets, and thus trades more volume than their net requirement. The SEMC are asked to confirm that SEMO charges will not be charged on the actual volumes more than once.

Further nothing in the way charges are recovered should encourage participants to avoid or favour certain markets as this may bring about inefficient outcomes in the market. For this reason, and in the interests of customer information transparency, the SEMC and RAs are asked to consider the potential of the application of one consolidated tariff. This may appear as an option in the expected Price Control consultations this summer. Such a consolidated tariff would facilitate a better understanding by end customers of where such costs are incurred, and the potential scale of same.

## **3. Price Regulation of the Designated NEMO**

In the following section Viridian provide responses to the specific questions raised in the consultation paper itself related to the treatment of the designated NEMO (SEMOPx).

### **3.1 Licence obligations on SEMO to provide NEMO services.**

Given the RA’s interpretation of CACM, the fact that only one NEMO applied and was designated and the importance of having an operational NEMO for go-live of the I-SEM, licence obligations have been placed on SEMO to provide NEMO services.

No comment.

### **3.2 Options for SEMOpx to recover capitalised establishment costs.**

At this time the RAs are proposing options for the recovery of SEMOpx's capitalised establishment costs, whilst being cognisant of the fact that the Price Control period is relatively short.

Any costs which the RAs are proposing to allow the TSOs to recover through their RAB should be fully consulted upon in advance of any final decision, to allow stakeholder to comment. As no detail in this regard has been provided in this paper, the RAs are requested to provide this in sufficient detail to industry seeking their views on same, before any final determination is made on the level of SEMOpx costs to be allowed.

Details should be provided in the planned Price Control consultation this summer in relation to how SEMC defined "establishments costs" and thus how it decided what costs constituted establishment costs required for I-SEM go-live, and what were in fact day two I-SEM costs. Any Capex costs not required for I-SEM go-live (for example enhancement changes to the original design proposed for I-SEM) should not be included in the establishment costs, but as suggested in the consultation paper should be considered separately during the relevant price control period.

Given the RAs have not stated any plans to allow the recovery of the establishment costs of any other NEMO who might enter the I-SEM market, the RAs are asked to confirm that the unique treatment they propose for SEMOpx in this regard is not unduly discriminatory to other NEMOs, and that such unique treatment of SEMOpx is not in contravention of any EU directives, rules or regulations (Including State Aid).

While Eirgrid/SONI may have been the sole bidders for the role of designed NEMO when the RAs tendered for the service in 2015, and thus the RAs selected them as designed NEMO, given their unique position in the market the RAs must ensure in how they regulate the designated NEMO that:

- (i) All allowed establishment costs are appropriate, solely as a result of the establishment of the designated NEMO service, and that the costs are proportionate and necessarily incurred.
- (ii) A key aim is to minimise the costs borne by end customers
- (iii) Nothing is the way the designated NEMO is treated under regulation should confer any unique advantage on the designated NEMO over any other existing, or potential, NEMO.

There is insufficient detail provided in the consultation paper to determine if the criteria outlined above will be met in relation to SEMOpx, and so market

participants will have to rely on the RAs to ensure this criteria is met. Clear detail needs to be provided to the market as to the Capex establishment costs which will be recovered in this regulated manner, such that market participant can assure themselves that appropriate controls are in place, and such costs are reasonable and appropriate.

Viridian supports in principle the RA proposal of spreading of the establishment costs of SEMOpX over a period of 5 years. This is more in line with industry norms for such expenditure compared to the stated shorter 18 month alternative period to Oct 2019, but has the added benefit of reducing the day-to-day costs to market participants of using the Designated NEMO service.

By allowing the establishment costs to be spread over a 5 year period via the TSOs RAB the RAs should designate SEMOpX as the Designated NEMO for this same five (5) period as a minimum. If SEMOpX does not provide designated NEMO services for this 5 year period this should result in a revocation of their ability to recoup some/all of their establishment costs and the application of early exit fees. Such an arrangement brings many positives to the market as a whole including giving certainty to the TSOs on their establishment cost recovery, to SEMOpX as to their longer term operations, to the RAs on having at least one NEMO in the market for a longer period of time, and to the markets as to the NEMO arrangements going forward. Further there appears little or no negatives to such an arrangement at this time.

### **3.3 SEMOpX Opex based on a target or allowed revenue regime.**

Opex will either be based on a target revenue or allowed revenue regime, taking account of fostering a competitive environment and licence conditions.

In a truly competitive NEMO market there should not be any requirement for regulating the Opex of any NEMO, designated or otherwise. The consultation paper makes this point by suggesting that revenue regulation is appropriate “at least until effective competition between NEMOs has been established”. The RAs are requested to provide details as to the criteria they will use to define when “effective competition” in the NEMO market has occurred, at which time regulation of the Opex of SEMOpX should cease.

Viridian supports the Opex for SEMOpX being regulated using an Allowed Revenue regime. This appropriately encourages efficiency and facilitates benchmarking of costs. This should be reviewed at the end of the initial price control period ending 2nd October 2019 to ensure that SEMOpX are operating as would be expected, and are facilitating the functioning of an efficient market.

Any costs which the RAs are proposing to allow SEMOpx to recover under a price control must be fully consulted upon in advance of any final decision, to allow stakeholders to comment. As insufficient detail in this regard has been provided in this paper, the RAs are requested to provide this in sufficient detail to industry seeking their views on same, before any final determination is made on the level of SEMOpx costs to be allowed, and provide details of any redistribution between TSO, SEMO and SEMOpx price controls.

The SEMC are requested to confirm what control they, the RAs, or other authority have, over the tariff structure that will be applied by SEMOpx? For example does this include approving the format of the tariff, the customer cost allocation method, and the actual tariff monetary values? Further the SEMC are asked to outline how they will assure market participants and themselves that the cost of SEMOpx providing NEMO services to the I-SEM market will be cost effective.

### **3.4 Incentives for additional obligations on SEMOpx.**

Obligations on SEMOpx regarding data transparency and service standards otherwise incremental to CACM may be appropriate. Views on the need or benefit of having these tied to an incentive mechanism using Key Performance Indicators are being sought.

Viridian believe data transparency from NEMOs should be a licence obligation, and thus not optional nor requiring additional incentives in order to deliver what the market by necessity requires in order to operate effectively and efficiently. The RAs could initiate a consultation process in which they outline what data can be provided to the market, in what granularity, to what accuracy and in what timeframe, while specifying clearly the minimum requirements under CACM. Market participants should then be encouraged to provide feedback as to what data they would value, and the details in relation to same. All reasonable requests for data transparency for which respondents have outlined strong arguments for, should be facilitated to the extent possible. Once this minimum data set is in place, the market should be allowed to operate for a time, after which a review of performance against targets should be completed. Where there are gaps, views should be sought from the market as to the value related to addressing such gaps. At this point in time it seems reasonable that potential incentives could then be considered, reflecting on the experience of a period of market operation.



### **3.5 Options for SEMOpx's pricing.**

The framework and content of SEMOpx's pricing will require public consultation through the price control process. A number of pricing options are currently being considered with the aim of facilitating participation by the full range of market participants (including smaller participants) in the I-SEM.

Viridian support the proposal for SEMOpx tariffs which are based on a cost "per MWh". This methodology should strike the right balance in terms of cost allocation for all types of user, from large to small users.

In deciding how the tariffs for SEMOpx will be priced the RAs are asked to carefully consider the following. Regardless of the nature or scale of the costs the Designated NEMO claims to have incurred in establishing or operating its NEMO service, if the price of the resulting tariffs, imposed on participants in the intra-day market, are of a sufficient scale, they will provide an economic disincentive for players to trade in the intra-day market. This will force more volume into the Balancing market, and may create more price uncertainty in the I-SEM market, increase price volatility, and perhaps force the TSO's to take more balancing actions than would be normal for a market operating efficiently and effectively. Such a situation is unlikely to be in the best interests of the market as a whole, either economically or otherwise. Thus the RAs are asked to ensure the tariffs to be imposed by SEMOpx in the Intraday market are as low as they can reasonably be, taking account of all the various factors including the costs and volatility likely in the Balancing Market, and the market price differences between the various markets. Further it is suggested that similar tariffs/charges in the Intra-day and Balancing markets should be considered, as this would greatly assist in guarding against the aforementioned possibility.

### **3.6 Proposal for SEMOpx price control until the 2nd of October 2019.**

It is proposed that the price control will run until the 2nd of October 2019. At this point a decision will be made on the RA's role in revenue regulation of SEMOpx.

The RA's proposal for an initial price control period running from I-SEM go live until 2<sup>nd</sup> Oct 2019 is reasonable.

Further to the comments made concerning question 3.2 above, assuming the RAs decide to allow a 5 year period to recover the SEMOpx establishment costs through the TSO RAB's, regardless of whether the RA's decide to obligate SEMOpx to provide NEMO services for 5 years as argued in the response to question 3.2, the second price control period for SEMOpx should run from 2<sup>nd</sup> October 2019 until the end of the 5 year establishment cost recovery period.

## **4. Price Regulation of SEMO**

In the following section Viridian provide responses to the specific questions raised in the consultation paper itself related to the treatment of SEMO.

### **4.1 A 'business as usual' approach to this SEMO price control.**

*This price control will be the first such control under I-SEM and will include provisions for the new market. It is envisaged that the following price control will take a 'business as usual' approach as opposed to the 2016-19 price control which looks at the winding down of the SEM.*

There is insufficient detail provided in the consultation paper to allow respondents make informed comments on this broad proposal for a "business as usual" approach, given business as usual for SEMO in SEM is not the same as business as usual in I-SEM. Further the overlapping of the two markets, and the lack of details of how this complexity will be managed, adds greater uncertainty to the business as usual proposal

### **4.2 Regulation of SEMO CAPEX by rate of return regulation**

*It is proposed that CAPEX is regulated by rate of return regulation as in previous SEMO price controls*

It is important that a regulated entity such as SEMO is regulated in a manner that encourages it to seek efficiencies so as to reduce its Capex costs. Viridian expects that the current RAB WACC approach the RAs have used to date in regulating the Capex costs of SEMO will continue.

### **4.3 SEMO Opex to be subject to RPI-X efficiency regulation**

*It is proposed that Opex is subject to RPI-X efficiency regulation*

It is important that a regulated entity such as SEMO is regulated in a manner that encourages it to seek efficiencies so as to reduce its Opex costs. Viridian expects that the current RPI-X (Revenue Cap Regulation) approach which the RAs have used to date in regulating the OPEX for SEMO will continue.

#### **4.4 Potential approaches for SEMO incentives**

A number of approaches are being considered in relation to incentives, and feedback is requested on suitable metrics

In general Viridian are open to incentives which deliver real value to the market, and are efficient and effective in how they are applied and operated. However, at this time without some operational experience of the I-SEM market it is not possible to make informed comments on the appropriate incentives to be used, and how these might work best for the market. .

#### **4.5 Proposal for a three year Price Control for SEMO**

It is proposed that a three year Price Control is to be put in place, for the purposes of reviewing efficiency gains between Price Controls

Given I-SEM is a new market to SEM, and more complex, and given the fact SEMO has new obligations under I-SEM, many of which are key to the effective and efficient operation of the market and the network system, a price control period of less than that normally applied would be prudent. As such Viridian proposes a two (2) year price control period for SEMO which is more aligned with the initial price control of SEMOpX. At that time market participants will be in a better position to comment on the SEMO price control having had some experience of SEMO operating in the I-SEM market.

### **5. Conclusion**

It is very difficult to comment on high level principles for regulated revenue recovery in the absence of sufficient detailed information of the costs being proposed. If the level of cost is small, a view might be that the method can be one of several options, and the most convenient or least cost approach may be selected. However if the cost being considered is in fact material, and the various options yield dramatically different impacts on consumers, then it is likely respondents will have strong views on the issue and push for one method over another for specific reasons. Given the aforementioned, Viridian reserves the right to vary its views when the full details in relation to costs are known, along with the potential impacts each option may yield on how these costs are recovered.

In relation to the main issues raised in this consultation paper Viridian;

- (i) Agrees that there is a need to have a NEMO in the I-SEM market at all times and asks the RAs to ensure there is an established process in place to ensure this is always the case

- (ii) supports the proposal that the establishment costs for the Designated NEMO (SEMOpX) are recouped over 5 years via the TSO's RAB's provided the designed NEMO is obliged to provide NEMO services for the same 5 years and this does not unduly favour SEMOpX over new entrant NEMOs in the future.
- (iii) Supports the use of an Allowed Revenue approach for the Designated NEMO Opex revenue regulation.
- (iv) Supports the RAs proposal for an initial price control period for SEMOpX to run from I-SEM Go-Live until 2<sup>nd</sup> Oct 2019, but also advocate that the second price control period should run from 2<sup>nd</sup> Oct 2019 to the fifth anniversary of I-SEM Go-Live (when the establishment costs of SEMOpX will have been fully recouped); and
- (v) Supports a two (2) year price control for SEMO post I-SEM go-live.