SEMO Revenue Requirements for 2017/18

Information Paper

SEM-17-054

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Contents

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).

The introduction of I-SEM will require major changes to the roles and responsibilities of certain entities in the market, including the SEMO in its capacity as market operator. So as to allow SEMO the necessary revenues to carry out its functions the Regulatory Authorities (RAs) have set out a Price Control which runs from 2016 to 2019. This Price Control covers the transitional period as the all-island market moves from the SEM to the Integrated Single Electricity Market (I-SEM) and relates to SEM related costs only. A separate price control will run for SEMO in I-SEM from May 2018 to September 2021 and is the subject of a separate consultation process.

As a result of a stocktake exercise taken in November 2016, the RAs decided to extend the I-SEM go live date from October 2017 to May 2018, which represents an additional 8 months for the ‘active’ period of the 2016-2019 SEMO price control. The 2016-19 Price Control was designed to cover a period spanning over three tariff years 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">Decommisioning</td></tr>
<tr><td colspan="2">SEM</td><td colspan="4">SEM Resettlement</td><td colspan="3">SEM Decommissioning</td></tr>
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Figure 1

This extension of the SEM active period necessitates an adjustment of the revenue requirement for the 2017/18 tariff period. In addition, this Information Paper accounts for correction factors applying to SEMO’s revenues for 2015/16 where an under recovery of €2.016m occurred, primarily driven by currency exchange differences.

2. Introduction

2.1 Introduction to 2017/18 revenue adjustment

In August 2016, the SEM Committee published its final determination on the revenue requirements for SEMO. 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.
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.
3. The 'SEM decommissioning period' of 3 months.

The 2016-19 Price Control set out the revenue requirements to apply to the active, resettlement and decommissioning of SEMO under SEM. Under the currently active Price Control it was anticipated that I-SEM would "go live" for October 2017. However, in November 2016 the SEM Committee undertook a stock take exercise of I-SEM go live. This resulted in a change to the Go Live date from October 2017 to May 2018. This extended the period of application of the SEM active period by 8 months, and consequently the resettlement and decommissioning periods will now occur later than originally envisaged. The revised timeframe is set out below.

- SEM active and settlement period (October '17 to June '18)
- SEM Resettlement period (July '18 – September '19)
- SEM decommissioning period (September '19- Nov '19)

As part of the I-SEM stocktake, the SEM Committee noted that the SEMO Price Control "*will be adjusted on a proportionate basis to take account of any movements in the I-SEM commencement date"* and stated that "*SEMO's revenue allowance is to be rolled forward (adjusted for inflation) on a proportionate basis in the event of any delay".*

For 2017/18 there are two SEM periods under consideration; continuing SEM active + SEM resettlement. There will be an additional 8 months of the SEM active period and a further 4 months of the SEM resettlement period. As such, in line with the approach established in the I-SEM stocktake, the revenue requirements will be adjusted based on a pro rata basis of 8 months revenue requirements for SEM active revenues plus 4 months of SEM resettlement revenue requirements. This approach takes account of the ramping down requirements that will occur from May 2018 onwards when SEM resettlement occurs.

2.2 Revenue requirements for 2017/18

The revenue requirements for 2017/18 are made up of a number of aspects. These include;

1. Operating Expenditure
2. Cost of Capital (Depreciation, WACC)
3. Parental Company Guarantee

Each of these aspects is detailed below.

Operating Expenditure

Opex consists primarily of payroll and to a lesser extent IT, professional fees, corporate services etc. To derive a pro rata basis between SEM active and resettlement a ratio of 8:4 months of Opex has been applied between active and resettlement revenue using the 2016/17 and 2017/18 Price Control allowances.

For example, for payroll the calculation applied is €2.92m/12*8 + €1.19m/12*4 which results in a payroll allowance of €2.34m. The same pro rata calculation has been applied to all Opex requirements. This results in a pre-adjusted Opex requirement of €6.58m for 2017/18.

	Tariff Year 2016/17 (SEM Active) €m	Tariff year 2017/18 (SEM Resettlement) €m	**Final Tariff Year 2017/18[1] €m**
Payroll	€2.92	€1.19	**€2.34**
IT & Communications	€2.92	€2.72	**€2.85**
Facilities & Insurance	€0.65	€0.26	**€0.52**
Professional Fees	€0.31	€0.15	**€0.26**
General and Administrative	€0.22	€0.08	**€0.17**
Corporate Services	€0.45	€0.39	**€0.43**
Total Opex	€7.47	€4.79	**€6.58**

SEMC Decision: Operating Expenditure for 2017/18 to be based on a pro-rata calculation of SEM active and SEM resettlement revenues, resulting in an Opex allowance of €6.58m.

[1] SEM Active 8 months and 4 months resettlement

Return of Capital –Depreciation

The Cost of Capital consists of return of and on the Capital assets on SEMOs Regulated Asset Base (RAB). The return of capital is captured through straight line depreciation over a five year period. During 2017/18 there are no new assets being added to SEMOs RAB and as such, the depreciation profile and amount applicable in the 2016 Price Control decision continues to apply. This results in depreciation of €1.349m applying for 2017/18.

	Tariff Year 2016/17 (SEM Active) €m	Final Tariff Year 2017/18 €m
Depreciation Charge (€ million)	€3.236	€1.349

Return on Capital- WACC

In the SEMO Price Control Decision Paper the SEM Committee decided to continue to apply the blended WACC approach. This approach incorporates the WACC that prevails for the System Operators in Ireland and Northern Ireland i.e. EirGrid and SONI, and blends them in accordance with a specified proportion of 75% for EirGrid and 25% for SONI[2].

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. The currently prevailing WACC for EirGrid is 4.95% and 5.42% for SONI. This results in a blended WACC of 5.07% for SEMO. For 2017, the estimated residual RAB value is €2.645m. Using the applicable blended WACC this results in a return of Capital of €0.134m for 2017/18.

WACC Amount (€ million)	Tariff Year 2016/17 (SEM Active)	Final Tariff Year 2017/18
Estimated RAB	4.467	2.645
Blended WACC Rate	5.07%	5.07%
RAs Estimated WACC amount	0.226	0.134

[2] Per the Market Operator Agreement between SONI and EirGrid

Parental Company Guarantee (PCG)

The SEMO business is unique in that it is a contractual joint venture between the System Operator in Ireland (EirGrid) and Northern Ireland (SONI). The SONI MO licence contains a requirement that SONI must have a PCG in place from EirGrid PLC as the legal and beneficial owner of the business. As part of the decision for the SEMO Price Control the RAs decided that the PCG allowance would fall as SEMO's working capital risk reduced.

As the SEM continues to be active, the PCG requirement continues to be required. In accordance with the pro rata approach of 8 months active and 4 months resettlement this results in a PCG requirement of €0.22m for 2017/18.

SEMC Decision: Applying the pro-rata approach a PCG requirement of €0.22m will apply for 2017/18.

Revenue allowances for 2017/18

Taking into account the Opex requirements, depreciation, WACC and PCG the total revenue allowance for 2017/18 is €8.28m in 2016 monies. SEMO's revenue is corrected year by year by the outturn rate of inflation. These monies are indexed according to a blended out-turn inflation figure based on the RPI and CPI. The RPI (Retail Price Index[3]) and CPI (Consumer Price Index[4]) are different measures for calculating inflation. The former is used in Northern Ireland while the latter is used in Ireland, thus a blended measure is applied for the SEMO price control on a 25% to 75% basis.

Between March 2015 and March 2017 the RPI was 1.19% while the CPI was 0.30%. The combined figure on a 25:75 basis is 1.48%.

As per SEM-16-043, an efficiency factor of 0.3% (Inflation -X) is applied to this outturn inflation figure for the SEM period, leading to a final indexation figure of 1.18%.

SEMC Decision: Taking account of the blended out-turn inflation figure, based on the Consumer Price Index and the Retail Price Index and an X-factor of 0.3, the indexation figure for this tariff year is 1.18% This equates to an adjusted revenue allowance of €8.378m.

Correction Factors

As SEMO operates under an Allowed Revenue regime, correction factors apply. Where SEMO recover in excess of their allowed revenues then a positive correction factors applies which reduces future revenue requirements, where SEMO under recover the allowed revenues within a year then a negative correction applies thereby increasing revenue requirements. Correction Factors are settled in KT-1, meaning 1 year after settlement. For 2017/18 correction factors for 2015/16 revenues apply.

In 2015/16 the total allowed revenues was €18.485 million, while the total amount recovered through tariffs was €16.469 million. This leaves €2.016million in under-recovery to be applied as a correction factor. The main drivers behind this under-recovery were exchange rate losses and adjustment[5]. In addition, incentive factors for efficient capex spend have also been applied. Details of these incentive out turns can be found in the SEMO Incentives Report published on the SEMO website[6].

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[3] Based on publication by the Office for National Statistics, UK
[4] Based on publication by the Central Statistics Office, Ireland
[5] FX loss was €1,392,000 and the capital incentive reward was €723,000
[6] SEMO Performance Report

Revenue Summary

In total, the 2017/18 revenue allowance for SEMO is €10.394 million, comprised of both the adjusted revenue allowances and the application of correction factors from 2015/16.