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SEM-24-022: SEMOpx Revised Regulatory Revenue Recovery Framework consultation paper.

Kevin, Akshant

EirGrid plc and SONI Ltd, in their respective capacities as Nominated Electricity Market Operators (NEMOs), together operating as SEMOpx welcome the opportunity to respond to the SEM Committees (SEMC) consultation paper on SEMOpx Revised Regulatory Revenue Recovery Framework, SEM-24-022, (the 'Consultation Paper'). The proposed streamlined revenue framework for SEMOpx stands to support the operation of SEMOpx in an efficient manner, while providing the Regulatory Authorities with ongoing oversight.

SEMOpx welcome the SEMC's recognition of the benefits of moving from a multi-annual price control process to a more agile approach for revenue recovery, as outlined in the Consultation paper. We note, however, that the SEMC's minded to position is to continue with an approach that provides that capital expenditure is added to the SEMOpx Regulatory Asset Base (RAB) only when a project/asset has been commissioned. This is of notable concern to SEMOpx in the context of the growing scale of investment required. SEMOpx maintain the position that capital expenditure should be added to its RAB as costs are incurred.

It is our view that the approach put forward by the SEMC presents a number of weaknesses in the process and is not in keeping with the streamlined nature of the proposal. There is currently a mismatch between when expenditure is incurred and when it is added to the RAB. This means that, in this case, SEMOpx has no revenue stream to support investment in critical IT systems and programmes until a project is completed, which in turn increases the financing requirement of SEMOpx. Without the ability to add projects to the RAB as costs are incurred, the expectation is that SEMOpx will carry the debt, without remuneration (no recognition of time value of money) until a project is commissioned. The appropriateness of such an approach where, in increasing cases, there can be a number of years between project initiation and completion which creates cashflow problems and funding challenges for SEMOpx, must be reviewed. It is vital that SEMOpx is in a position to finance its activities.

Similar to SEMO, increased expenditure needs over the coming tariff years and the anticipated extended delivery timeframes for IT projects, will lead to significant shortfalls in revenue. It may also result in the need for SEMOpx to postpone future investment activity until the completion of ongoing projects, impacting on service improvements for customers and market participants.

A RAB 'on-completion' approach exhibits significant step changes as projects are commissioned and capitalised. The multi-annual nature of projects, together with the low asset base and accelerated 5 year IT asset depreciation, leads to a 'saw-tooth' RAB profile, where the RAB shows significant variability over short

periods. Such 'saw-tooth' RAB profiles in turn lead to volatility in the SEMOpx charges. This RAB pattern can be mitigated if additions to the RAB are smoother over time, which arises where expenditure is added as incurred, and which in turn can lead to smoother tariff profiles.

SEMOpx's proposal to move to a RAB 'as incurred' model is not new or out of keeping with wider industry practice. Indeed, the SEMC's minded to position differs to the position of the respective RAs for other utilities they regulate across Ireland and Northern Ireland respectively, including EirGrid TSO, SONI TSO, GNI, Irish Water, BGTL, and GNI UK. All of these licensees operate under the RAB 'as-incurred' model. Such inconsistency will be exacerbated during the delivery of all-island projects being advanced by EirGrid and SONI in their respective roles (e.g. SMP), which would see multiple licensees contributing to delivery while only the TSOs will RAB their allocation of costs as incurred, leaving SEMOpx to carry a debt for a number of years, until the projects are commissioned. Whilst we recognise the need to deliver projects in a timely manner, it is difficult to see how such an approach, only applicable to SEMOpx, and currently SEMO, would expedite the overall delivery of projects.

The RAs state in the consultation paper that "*the SEM Committee is of the view that the approach of adding capital expenditure to SEMOpx's RAB only when an asset is commissioned would give an incentive to SEMOpx to get projects / assets commissioned at a quick pace..*", however the SEMC fails to recognise that a number of projects and particularly those of scale are not solely within the control of SEMOpx, rather the costs to be borne by SEMOpx are subject to allocation arrangements (some of which are to be finalised) of larger cross licensee costs, the scope of some such projects are yet to be fully determined and for which the timeframe for completion is driven not only by the licensees implementation but by future decisions of the RAs and the timeframes associated with same. In addition, the proposal to maintain a RAB 'on completion' approach, in effect, may create a perverse incentive on SEMOpx to implement projects quickly regardless of whether the solution is the best for the market and consumers. There should be no connection between appropriate remuneration of SEMOpx through RAB related funding and regulatory incentives on SEMOpx to deliver projects. Continuing to conflate the two into the framework for SEMOpx risks the financial stability of SEMOpx.

We strongly urge the RAs to move to a RAB 'as-incurred' model for SEMOpx. It will allow funding, through the depreciation charge and the allowed return at WACC, during the construction phase of the project, thereby reducing cash-flow volatility for the licensee. It will also lead to a smoother tariff profile than would otherwise be the case under the current RAB 'on-completion' approach. It will also ensure uniformity of approach across the licensees in EirGrid and SONI, and indeed across the wider utility environment on the island. We believe that it is ultimately both in the best interest of the customers, market participants and the financial stability of SEMOpx for the RAs to incorporate this proposal into their final decision on the SEMOpx regulatory framework.

We welcome any further engagement the RAs wish to have in respect of our feedback. SEMOpx notes that this response and the above comments are premised on the content of the Consultation Paper. Should the RAs intend, based on the feedback from other parties, to make significant changes to the proposals set out in the Consultation Paper, and in particular to core framework elements, as part of the final decision, SEMOpx requests that the RAs provide SEMOpx with an opportunity to discuss such changes and provide comment, if required.

A robust and clear Regulatory Revenue Recovery Framework is essential to enable SEMOpx to carry out its functions and we look forward to working with the RAs to finalise and implement same.

Yours sincerely,

[Sent by email therefore bears no signature.]

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