



Single Electricity Market

Response to

SEMO Revenue and Tariffs Consultation Paper

October 2009 – September 2010

issued by the Regulators July 20th

14th August 2009

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1 INTRODUCTION

SEMO has considered the Regulators feedback and are submitting this document to further support its proposal for an appropriate allowance to enable SEMO to operate the business in the forthcoming year. The Single Electricity Market requires SEMO to maintain the level of customer service achieved to date and to meet its licence obligations. This response follows various meetings with the Regulators to discuss their consultation documentation, "SEMO Revenue and Tariffs Consultation Paper, October 2009 – September 2010", issued by the Regulators on July 20th.

SEMO welcomes the opportunity to comment on the consultation paper and specifically on the appropriateness of the revenue control for the SEMO business for the tariff period 2009/10. The successful performance of the Market Operator business to date has been acknowledged in the SEM Committee's first annual report. SEM itself was delivered on time and on budget; the market has operated successfully for the first 18 months; this is testament to our commitment to deliver a high quality service to the ultimate benefit of participants and consumers. We remain committed to doing so and to adding further value as the market continues to develop.

Nonetheless it must be recognised that the Market Operator business is still embryonic in nature and continues to grow and evolve. This is evident with further developments in policy areas such as renewables integration, market coupling and global aggregation but also as both the extent of our obligations and performance targets in administering them increase. The tariff year 2008/09 has seen, with the support of the Regulatory Authorities and market participants, both a ramping in the level of resources employed and performance attained and our baseline is now somewhat higher than at 1 October 2008. Part of our response to the consultation, requests this be recognised, as the same level of obligation and service level will be expected.

1.1 THE ECONOMIC ENVIRONMENT

These are difficult times for both market participants and consumers alike. Recognising this EirGrid and SONI, the holders of the Market Operator licences, are committed to reducing costs wherever possible. It is for this reason that EirGrid implemented a wage freeze in relation to the payment of the National Wage Agreement for 2009, including to its staff working in SEMO. SONI is also currently proposing a wage freeze and is in negotiation with the trade union representatives. The underlying indexation applied to Transmission System Operator controls for both EirGrid and SONI also implies significant decreases in nominal revenues to these businesses in both 2009 and 2010.

While EirGrid and SONI have demonstrated their commitment to reducing costs where possible, they have concerns with the Regulatory Authorities' proposals outlined in the consultation and in particular whether the level of revenue proposed for the SEMO business is sufficient to cover the operating costs of the business and to provide for a reasonable rate of return on its investments. This is particularly so given the small scale of SEMO, the absence of a cost pass through regime of any retained profits, the limited day to day flexibility, its labour intensity and the short lived nature of the assets.

1.2 OUTLINE OF THE SUBMISSION

The remainder of SEMO's response is structured in two parts.

Part 1

The first part of the document supports our position for a level of operating costs sufficient to operate our business and meet our ongoing obligations to satisfactory performance standards

Part 2

Part 2 outlines our arguments as to the necessary components for the provision of a reasonable rate of return for the business.

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Part 1 Level of Operating Costs

2 FORM OF CONTROL

SEMO believe that the line by line approach proposed in the regulatory consultation paper does not allow SEMO to be flexible and efficient at allocating resources to addressing the demands of the business. SEMO are therefore looking for an overall Operating cost amount which can be flexibly managed by SEMO. As has been the practice to date SEMO costs would be subject to the scrutiny of the regulators through the *ex post* review and a k factor for under or over recovery. SEMO therefore believes the provision of an overall allowable revenue should be preserved as a general regulatory principle and applied here to SEMO'

The current economic uncertainty is reflected in the Regulatory Authorities' decision to proceed at this juncture with a further one year control and to continue to provide that all costs reasonably incurred by the business in carrying out its activities will be allowed. SEMO accepts this and looks forward to further engagement with the Authorities on bringing forward a multi-annual control with more traditional incentive based regulation in the next control period. SEMO is, however, disappointed that the Authorities believe that line by line regulation is appropriate for the SEMO business. The principle of the application of an allowable revenue rather than line by line regulation is well established, and allows management the scope to leverage its resources without a level of micro-management imposed by the Regulatory Authorities.

As has been the practice to date SEMO costs would be subject to the scrutiny of the regulators through the *ex post* review and a 'k factor' for under or over recovery. SEMO therefore believes the provision of an overall allowable revenue should be preserved as a principle.

SEMO also welcomes the introduction for the first time of some limited incentivisation for the business and are open to incentives which, in the context of the overall arrangements, reasonably balance risk and reward. However, such incentives must be meaningful and attainable. We further develop in our response proposals which we believe will meet this.

PROPOSAL 1

It is proposed that SEMO manages its operational costs within an overall Regulatory approved allowance.

3 APPROPRIATE BASELINE

The Regulators have proposed the March 2008 baseline figure of €4.032m for payroll costs, appropriately adjusted for inflation / deflation. SEMO believes that this figure should now be adjusted to reflect the additional roles, responsibilities and obligations which SEMO now fulfils and will continue to fulfil in the forthcoming period Oct 2009 / Sept 2010. The baseline figure of €4.032m proposed by the Regulators should be revised upwards to reflect the end of tariff year position and incorporate the following:

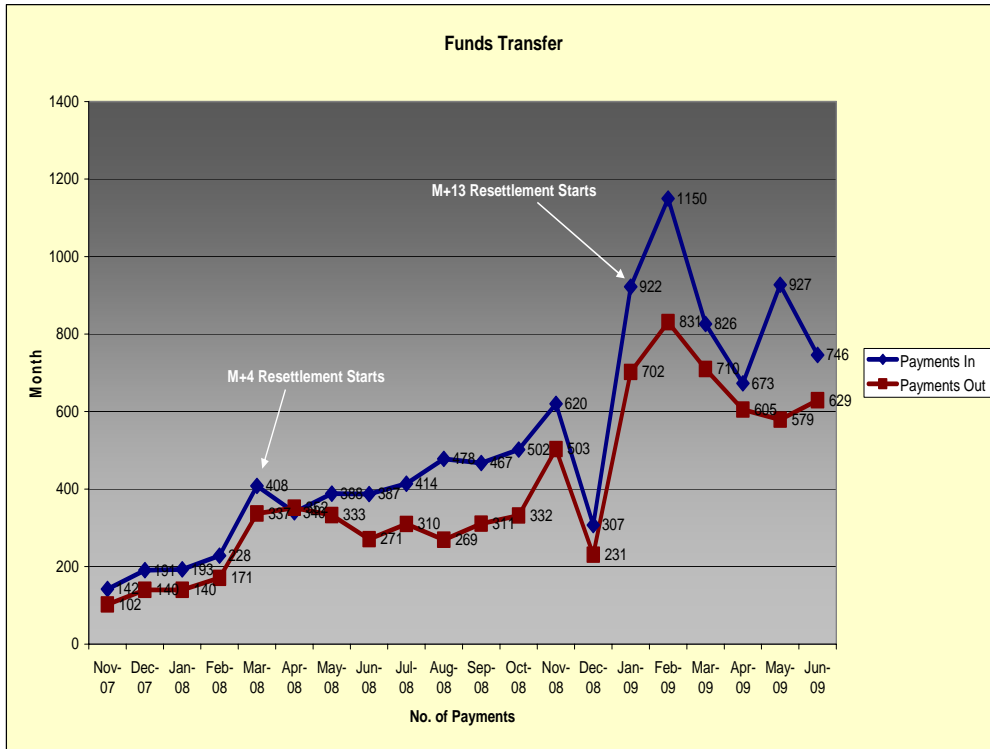
- (a) €258k additional annualised recruitment based on the additional obligations which SEMO now fulfils (see Table 1 below) and for the additional Modifications resource of €48k recruited following approval from the RAs.
- (b) Payment of the NWA @2.5% in April 2008 (ROI only) (€81k)

SEMO therefore proposes that a total amount of €4.371m in mid 2009 terms is the appropriate amount which should be allowed for the period Oct 2009 / Sept 2010 to enable SEMO to continue it's current level of administration and management of the market for participants. The table below details the additional and enduring obligations and the underlying resources employed to meet these which SEMO now support. There is also a general although non linear relationship between the number of participants in the market and the level of quality assurance, transactions and payments SEMO must make.

Additional recruitment required to meet the new and enduring obligations and to maintain current service levels	Annualised costs 2009
M+13: 1 additional controller hired. This should be included in the baseline.	84k
Registration: The number of unit applications has more than doubled from 16 in 2008 to 36 year to date in 2009 due to the increased amount of renewable generators registering in the market. At the start of the year we had forecast ½ a resource but in actual fact now have needed a full time resource on registration and expect yet increased registration in the coming year due to increased wind connections.	42k
Funds Transfer: Two to three times the amount of funds are now being transferred than was originally anticipated (see funds transfer graph page 7). This has increased the level of manual checking by the controllers and finance team. The increased transfer of funds has also resulted in an increased number of defaults from participants (33 for the whole of 2008, 47 in the first 6 months of 2009). This has led to an increase in workload requiring extra resources to manage and resolve the associated issues. Even though SEMO has introduced efficiencies through the bid to bank process it has been necessary to hire an extra temporary resource in funds transfer in the last quarter of this tariff year. SEMO believe that this resource will continue to be required in the forthcoming tariff year.	84k
Modifications Secretariat: SEMO recruited, with the support of the RAs, a full time resource to assist the Modifications secretariat. This additional resource had been approved by the RAs during the year to assist the modifications secretariat but has yet been included in the baseline.	48k
Additional Cost to the Baseline as a result of additional Obligations	258k

Table 1 New and enduring service obligations which required additional recruitment

It should be noted that these figures do not cover any extra obligations anticipated for the forthcoming tariff year. SEMO understands that any other upcoming obligations and corresponding resource requirements will necessitate separate approval from the RAs. See Section 3 Forward Work Plan.



Graph 1 The rising volumes of Fund Transfers since market opening.

PROPOSAL 2

The 2009 baseline figure for Payroll costs for SEMO should amount to **€4,371k**

3.1 INCREASED EFFICIENCIES

SEMO has made additional efficiency savings totalling €154k through leveraging existing resources and increased productivity levels. These additional efficiency savings have not been included in the calculation of the revised cost baseline. Table 2 below outlines where efficiencies have been made and the resulting cost savings. The Regulators contend be an additional cut of 1% should be in the payroll allowance over and above the deflation figure (page 16 paragraph 2 o f the consultation document). SEMO would argue that SEMO has demonstrated that they have delivered above and beyond the requested service levels. This equates to

savings of €154k (see table 2) and a +3.86%¹ increase in efficiency in real terms and should not be subjected to a -1% payroll cut.

Increased efficiencies delivered to the market	Annualised costs 2009
Audits: Absorbed at least 1 FTE ² in Market audits which will be a continuing obligation in 09/10. The audit process is much more intrusive than anticipated and there is an onerous amount of personnel time and market data required by the auditors.	84k
The Blended VAT issue was not envisaged and SEMO do not have the systems to perform the work automatically. This takes one month of person days to perform every year. (SEMO have attempted to get the blended VAT Systems change included in the April 2010 release – this will require a resource for user testing).	7k
Formal queries: 1010 formal queries have been lodged since go live, 437 of these have been upheld and 53 have required repricing. In addition there are 45 MDP issues which have required repricing, whereas SEMO had only anticipated 5. This has a direct resource impact of ~ 6 extra person months.	42k
Working group analysis for Modifications group for 2 mods was at least 65 person days. This is likely to be an enduring level of activity. The probability is high that this level of involvement by SEMO in producing analysis for modifications working groups is likely to continue into the future.	21k
Efficiencies introduced to the market at <u>no</u> extra cost	154k

Table 2: Efficiencies introduced to the market at no extra cost.

PROPOSAL 3

The proposed reduction of -1% to Payroll (approx 43k) should not apply as SEMO have demonstrated efficiencies equating to **€154k** (i.e. an **increased efficiency of +3.86%**)

3.2 CONCLUSION

¹ Efficiencies of 156k /Payroll baseline in 2008 of 4032k = 3.86%

² Full Time Equivalent

SEMO has reasonably and flexibly resourced at the appropriate time in correspondence with T&SC obligations and required service levels given the allowance provided (€4.032m indexed to €4.228m) e.g. temporary contractors as opposed to full time positions until it could be determined that we would need these staff on a permanent basis. This allowed us to significantly increase our performance levels for market participants in 2009 as demonstrated by the KPIs being monitored by the RAs. It is our understanding that these service levels and obligations are required into the next tariff year and therefore we need to include the cost for these resources. The baseline proposed in the Regulators consultation paper as it currently stands will not enable us to deliver this. SEMO has a payroll cost of €4.371m in mid 2009 terms. Payroll costs for SEMO should be on an actual annualised basis reflecting the existing service levels and expectations and continuing obligations placed upon us.

In addition to the underlying payroll costs there is a broadly linear relationship with other aspects of overhead including General & Administrative charges which need to be adjusted accordingly.

4 OPERATING FUNDING TO SUPPORT THE DEVELOPMENT OF SEM

A sizable number of significant market changes will be developed and implemented by SEMO over the coming year. Capex funding for systems changes and Opex funding in the form of additional payroll are required to enable SEMO to meet its obligations and commitments and the requirements of all energy stakeholders.

SEMO recognises that development of policy in relation to SEM falls primarily under the remit of the RAs. SEMO is also aware of the important policy initiatives currently under consideration by the RAs as defined in European legislation and the respective forward work programs of the Departments and Regulators. These include, among others, policies in relation to renewables, interconnection and capacity payments. SEMO regards these areas as some of the most complex, multifaceted aspects of SEM with highly detailed rules and extensive systems.

To respond with an appropriate level of urgency to any forthcoming policy decisions, SEMO needs to undertake significant analysis to determine the most suitable cost efficient route.

The following sections outline the key initiatives currently under consideration. Failure to deliver on the resourcing requirements will put increasing pressure on current resources that may result in lower quality solutions and less opportunity to investigate solutions that will deliver real cost savings to participants and ultimately to consumers.

4.1 SEMO FORWARD WORK PLAN

This funding needs to be sufficient to support the following key initiatives which are necessary to the SEM:

- Interconnection
- Wind in the SEM
- Capacity Payments Mechanism
- Market Coupling and Congestion Management
- Global Aggregation
- Establishment of the SEMO Design Authority (SDA)
- Internal and External Audits

4.1.1 INTERCONNECTION

Under EU Directive 2003/54/EC – “concerning common rules for the internal market in electricity...”- and EU Regulation 1228/2003 - “on conditions for access to the network for cross-border exchanges in electricity”, SEMO sees a requirement in the short to medium term to facilitate the regional market initiatives and to facilitate the introduction of additional types of Interconnectors. SEMO are conscious of the RAs forward work programme in this regard and intend to support this work.

The proposed entry to the market of the IMERA and EirGrid Interconnectors in the period 2010 to 2012 will require:

- Examination of the trading on the existing Interconnector to ensure any modifications to Interconnector Rules facilitate optimum utilisation of Interconnection.

- Re-evaluation of the Rules pertaining to Interconnection, such as Interconnector Administrator function, calculation of MIUNs and timing of Interconnector transactions.
- Examination of the feasibility of intraday trading on Interconnectors in SEM.
- Ensuring compliance with congestion management guidelines.
- Implementation of any process and systems changes which may arise from the above.
- The support of the European, Northern Ireland, Republic of Ireland and the dual Regulatory strategies for the significant increases in renewable energies.

4.1.2 WIND IN THE SEM

EU Directive 2001/77/EC –“on the promotion of electricity from renewable energy sources in the internal electricity market.” sets out national indicative targets for electricity produced from renewable energy sources by 2010. The indicative target for Ireland for energy under this Directive is 13.2% by 2010. The UK has an electricity target of 10% from renewable generation. Gates 1 & 2 in RoI 1673MW and up to 800MW in NI will be in service by 2012. The sheer scale of this change will transform SEM and will introduce significant challenges for all parties.

Working in partnership with the SOs and RAs on ‘Wind in SEM’ and ‘Facilitation of Renewables’, SEMO intends to identify the implications of different policy changes on the processes and systems that may arise as a result of this work. Especially in relation to the upcoming decision on Dispatch and Scheduling policy, the impact on rules and systems could potentially be quite significant.

SEMO will seek to present options for the above that achieve a balance between cost of implementation and time to implementation.

4.1.3 CAPACITY PAYMENTS MECHANISM

With regard for EU Directive 2005/89/EC – “concerning measures to safeguard security of electricity supply and infrastructure investment” the CPM is the primary mechanism in SEM the Capacity Payment Mechanism forms an important component of a generators revenue and its ongoing development will affect investment decisions in SEM.

With the forthcoming review of the mechanism, SEMO will need to undertake extensive analysis of any outcome of this review and how it could contribute to it. The rules and systems associated with the capacity payment mechanism are arguably some of the most complex of the SEM. The potential savings through the manner in which changes are implemented could represent significant savings both in cost and complexity of implementation. SEMO intends to analyse the CPM to understand the specific system dependencies so that it can provide valuable input to the Mid Term Review of the CPM in relation to the implementation of any potential changes. SEMO have significant experience and knowledge of the CPM especially in some of the headings outlined in the current consultation paper including:

- Assessment of CPM in SEM (historical analysis)
- Incentives for Generators Capacity
- Payments when Capacity is needed
- Distribution of Capacity Payments
- Infra Marginal Rent & CPM

- Impact of Exchange Rate in CPM
- Treatment of Wind in CPM
- Treatment of Interconnector in CPM
- Relationship of CPM with Ancillary Services
- Impact on Diversity of Generation & Security of Supply

Implementing any recommendations from the review will likely involve significant system changes.

4.1.4 MARKET COUPLING AND CONGESTION MANAGEMENT

To ensure the value of the increasing amount of interconnection is fully realised for the benefit of participants and consumers, SEM will need to support the development of Market Coupling Solutions with the UK. This will be increasingly important to meet EU objectives and to further facilitate renewables.

With the treatment of interconnectors and market coupling their implications upon associated issues i.e. Renewables and Congestion Management are also noted. The impact of priority dispatch of renewables and awareness of congestion at borders through the use of interconnectors, SEMO believes that these requirements need to be understood and analysed as a way forward.

In relation to cross border congestion management, SEMO will continue to work with the TSOs and RAs to ensure that Interconnector Trades in SEM on both current and future interconnectors comply with EU Regulation 1228/2003. This may require rule changes and SEMO will need to ensure that any associated process and system changes are implemented expeditiously. For the medium term solution to congestion management and for further consideration of the implementation of the EU 3rd package.

4.1.5 GLOBAL AGGREGATION

As part of the Enduring Solution project in the retail market in Northern Ireland which arises from the Enduring Solution Options Study commissioned by NIAUR in April 2008, a solution for Global Aggregation is being proposed. The implementation of this will have impact on the treatment of the Error Supplier Unit in the SEM. Currently, the Error Supplier Unit's calculated volume is used as the settlement volume for the host energy supplier in each jurisdiction as Global Aggregation has not been implemented. To manage the Error Supplier Unit volumes post implementation of a Global Aggregation solution, modifications will be required to the SEM rules and further changes will be required to the SEM central market systems to implement these new rules.

4.1.6 SEMO DESIGN AUTHORITY

This area is intended to provide an overview of the role and key activities of an industry-wide Design Authority and to provide a rationale for the establishment of such a function known as the Design Authority within the Single Electricity Market (SEM). This subject has been raised by a number of participants and the high level overview is reflective of existing industry wide operations to date. The SDA would formalise the current process for change control management and implementation of system changes.

4.1.7 INTERNAL AND EXTERNAL AUDITS

SEMO have been subjected to 15 audits to date as per SEMO's license obligations and statutory requirements. Since SEMO have two parent companies there is an additional overhead in this area as SEMO need to fulfil the audit requirements of both parent companies.

4.1.8 2009-10 RESOURCE REQUIREMENTS

During the 2009-10 period four additional resources will be required. These resources are:

1. **SEMO IT Website Technical Analyst** – This resource is required to support and administer the new website which now has to be internally hosted due to the complexity of the interfaces between the Central Market Systems and the new website.
2. **SEMO IT Database Administrator** – There are 17 production and non production databases which require a high level of support and maintenance to ensure the high availability of the Central Market Systems. There are also an increasing number of data requests from the market which can only be provided by a DBA. This resource should reduce SEMO's exposure to issues such as security, archiving, alerts, performance, sizing, backups etc.
3. **SEMO IT Market Release Analysts x 2** – with the current resourcing levels (4 down from 20) the capacity for implementing market changes has been significantly reduced. Two resources are required to support the ongoing biannual Central Market System release strategy. Market participants are aware of SEMO's resource constraints and fully support increasing resources levels of this team (from the feedback of the MSDP consultation 2008-10).

4.1.9 WORK PROGRAMME CONCLUSION

The key initiatives outlined above are areas of genuine involvement for SEMO to be engaged in. Developing these robust solutions and managing the change to the market will be carried out in partnership with the SOs and RAs and in consultation with Market Participants. Taking the time to communicate constantly with participants ensures their support and ultimately their trust that SEMO has the interest of the efficient operation of the market at its core.

Without these resources increased pressure on the current limited resources may result in lower quality solutions and less opportunity to investigate solutions that will deliver real cost savings to participants and ultimately to consumers.

SEMO requests that the extra resources which are directly linked to the RAs own Work Programme be recruited in this tariff year and their costs recovered in this tariff year rather than approval on a case by case basis which SEMO believe to be highly inefficient and assumes that the money is available to fund them.

PROPOSAL 4

Additional baseline costs will be added to SEMOs operations budget as and when opex resources are required

5 ABILITY TO INVEST:

SEMO believes that it has reached a sufficient level of maturity to forecast our capex requirements e.g. IT releases, and we request that this be provided for and recovered through the tariff. This does not have any impact on the RAs ability to scrutinise the capital as the items come up and challenge again on an ex post basis. Not only is this method more process efficient but financially efficient too as we are not borrowing the money and are recovering this money through our tariff rather than through Interest During Construction (IDC).

5.1 IT RELEASE CAPITAL EXPENDITURE

SEMO IT have now moved to a biannual IT release strategy. Regular IT releases allows SEMO IT to co-ordinate its IT resources and retain vendor expertise and support for the Central Market System. This biannual release strategy should reduce development costs and focus Market Participants on the development of key market rules that will benefit the SEM.

SEMO are now looking for a total of €1,233,125 for 2009-10 which will cover 2 scheduled releases from our software vendors. The table below outlines the proposed amounts and releases for Year 2009-10.

IT Release Capex	Release 1 Oct 2009	Release 2 April 2010	Total
Scheduled Releases	€100,000	€1,133,125	€1,233,125

Table 3: Summary of the IT Release capex

5.2 BUSINESS CAPEX

SEMO have identified a number of Business Capex projects and systems that are required. Software upgrades are necessary for continued software vendor support. Additional systems are being proposed to increase operational efficiencies and aid better decision support. A summary of the Business Capex items can be seen in the table 4 below.

Business Capex Item	Business Justification	Proposed Amount
Axapta Upgrade	Current version of SEMO accounting system, Axapta, is out of support	100k
Upgrade Servers / Network	The current Storage Area Network (SAN) is rapidly running out of capacity and requires immediate replacement <i>Reduction in price forecast due to EirGrid public tender.</i>	600k
Upgrade Comms Links	The current Communication links connecting Belfast and Dublin have reached capacity and are starting to impact on market system performance	800k
SEMO Website	Website is required by market participants, SEMO and Regulators to provide prompt and accurate information.(Please note that this is the approved cost but excludes the ABB costs which are included in the April 2010 release capital sum).	571k
Printing / Enveloping Machine	Time saving of valuable resources, also reduces errors and potential repetitive stress injury.	50k
Administered Settlement System	Based on the AS review currently ongoing it appears very difficult to produce the schedules manually so a system is required.	100k
Treasury System	The treasury function in SEMO is vital. Given the volume of money flowing through the market, the seasonal variances in cash balances and the nature of a dual currency, a proper treasury system for SEMO is recommended.	50k
Electronic Fax Solution	Currently if there is a LCF or a GCF SEMO has to fax all market participants. Faxing is very manual and can be prone to errors, this solution would ensure that all data faxed is recorded and the resources utilised during a Communications failure could be utilised more efficiently	100k
Discretionary Fund	For small capital projects	250k
Hardware Replacement	Market participants have requested an on-line help desk system to facilitate readily available updates on logged calls	50k
TOTAL		2,671k

Table 4: Business Capex Items

SEMO have examined their Business Capex requirements and still believe the vast majority of these items need to be implemented and seek some provision for these items in this tariff year. SEMO therefore seeks a reasonable allowance (which will be subject to ex post review and individual capital approval) to be recovered in this tariff year. SEMO therefore propose a provision of €2 Million for Capital investment.

PROPOSAL 5

SEMO propose that a provision of **€2 million** should be allowed for Capital Expenditure.

5.3 INCENTIVE MECHANISM FOR MAJOR CAPEX PROJECTS

SEMO believe that the revised amount of 10% retained on CAPEX savings is too low and does not balance the risk of CAPEX overspend proposed by the Regulators. It should be recognised that any overspend of the regulatory approved project budget carries an unacceptable risk which SEMO should not be exposed to. SEMO are seeking assurance that any unforeseen or exceptional circumstance that is highlighted to the Regulators should be eligible for cost recovery through the appropriate mechanism.

PROPOSAL 6

SEMO propose that **20%** of the Capex savings be retained by SEMO.

SEMO propose that any unforeseen or exceptional Capex overspend can be recovered.

6

CH TO PRICING - INFLATION

SEMO acknowledge the current deflationary environment and ask that the RAs adopt a consistent approach in their pricing. The RAs consultation paper July 2009 sets out deflation in May 2009 terms, however the precedent in previous years has been to use mid tariff prices. SEMO therefore requests that the RAs are consistent in their approach and use mid tariff March 2009 prices and an appropriate forecast through to mid 2010. To adjust from March 08 (last years determination) requires a -2.05% change (Actual blended CPI/RPI for that period) and a forecasted change from March 09/10 of -2.5%³. The data sources and method used to derive these figures are contained in Appendix 1.

³ Unpublished data provided by the ESRI.

Furthermore SEMO believes that a consistent approach between setting baseline costs and forecasting inflation for the upcoming tariff period is adopted with March 2009 being the appropriate point.

PROPOSAL 7

1. All inflation calculations are to be based on Mid Tariff (March) blended annualised rates of CPI and RPI
2. The inflation figure to be applied to the 2009 baseline costs is **-2.05%**
3. The forecasted inflation figure for 2009/10 is **-2.5%**

7 SERVICE LEVELS

While SEMO welcome the fact that there is no penalty for not reaching the target KPIs, the RAs have set the KPI levels well in advance of SEMO’s present level of performance. There is little possibility of meeting these service targets outlined in the consultation paper with the resourcing levels proposed by the RAs. SEMO request a set of achievable KPI targets which would incentivise SEMO to improve performance.

SEMO made the following proposals outlined in the table 5 below to the Regulators in April. This proposal included an equal monetary risk and reward and weighted all KPIs equally.

Metric	Weighting	Lower Bound	Target	Upper Bound
Ex-Ante	0.25	95%	97%	99%
Ex-Post Initial	0.25	95%	97%	99%
Invoicing	0.25	85%	90%	95%
Credit Cover Increase Notices	0.25	94%	96%	98%

Table 5 SEMO’s initial KPI proposal April

The consultation paper makes a counter proposal of removing the risk element of the KPI and making the target levels very high (all 100%). While SEMO welcome the fact that there is no penalty for not reaching the target KPIs, the revised targets and upperbounds are difficult in the extreme with the current resource levels.

Metric	Weighting	Lower Bound	Target	Upper Bound
Ex-Ante	0.2	n/a	98%	100%
Ex-Post Initial	0.2	n/a	99%	100%
Invoicing	0.4	n/a	90%	100%
Credit Cover Increase Notices	0.2	n/a	99%	100%

Table 6 Consultation proposal July 2009

Based on the fact that the KPI risk has been removed SEMO would like to counter propose the following challenging KPIs. The initial target levels SEMO propose are high with the upper bound for three of the KPIs being 100%. SEMO propose that all the KPIs be weighted equally with the Invoicing KPI having a Target of 90%

and an Upper bound of 95% (based on a year to date figure of 87%). The Year to Date figures have been provided for comparison to give an indicator of how challenging the targets still are.

Metric	Weighting	Target	Upper Bound	Year to Date
Ex-Ante	0.25	98.5%	100%	99%
Ex-Post Initial	0.25	98.5%	100%	99%
Invoicing	0.25	90%	95%	87%
Credit Cover Increase Notices	0.25	98%	100%	98%

Table 7 SEMO Counter proposal August 2009

PROPOSAL 8

SEMO propose that:

1. All the KPIs be weighted equally.
2. The overall amount for the improved service levels should amount to be €250k

8 PROFESSIONAL FEES

The Professional fees category has been broken down into the following cost subcategories:

1. Committees
2. Regulatory Legal
3. Market Auditor
4. Internal Audit
5. Communications
6. Consultancy
7. Recruitment

SEMO contend that the subcategories 1 to 5 are fixed costs and cannot be indexed as proposed in the consultation paper. However SEMO agree that costs savings can be made for Consultancy services and Recruitment.

PROPOSAL 9

SEMO propose that:

1. The Professional Fee subcategories of Committees, Regulatory Legal, Market Auditor, Internal Audits and Communications are fixed costs and should not be indexed.
2. The Recruitment allowance of 45k is required for the current levels of staff turnover.
3. An overall Professional Fees allowance of **€690k** should be provided for.

9 ACCESSION AND PARTICIPATION FEES

The income associated with accession and participation fees is currently returned to the consumer. However these fees are to cover the costs of Registration administration. As the number of participants in the market increases, there is a marked and significant increase in the workload for SEMO. As discussed above, the number of unit applications has more than doubled from 16 in 2008 to 36 year to date due to the increased amount of renewable penetration in the market. At the start of the year we had forecast ½ a resource but in actual fact now have a full time resource on registration and expect yet increased registration in the coming year due to increased wind connection. Therefore, SEMO believes that retention of registration and accession fee income should be allowed as the person who performs this function is paid for through these fees. This is reasonable on the basis of it being an Activity based fee income (Ref SEMO document 1 April 2009).

PROPOSAL 10

SEMO propose retaining the Registration and Accession fees.

Part 2 Rate of Return

10 RATE OF RETURN REGULATION

As outlined in the Regulatory Authorities' decision paper AIP/02/08 the Regulatory Authorities accept as a principle that the regulated business must be able to finance its operations plus any necessary capital expenditure so it can continue to operate in the future to the ultimate benefit of customers. In addition the provision of a reasonable rate of return is also explicitly provided for in Section 36A of the Electricity Regulation Act, 1999, as amended.

Deflation impacts not only on the underlying indexation of operating costs but also on the current regulatory treatment of the Regulatory Asset Base and the means by inflation is rewarded – and nominal returns applied - as part of that model. To the extent nominal interest rates track the price base downwards – and therefore real interest rates remained unchanged this wouldn't be an issue. However, this is not the case we know that there is a floor of zero on nominal interest rates (for depositors) and that in reality as the price level decreases real interest rates rise.

The application of deflation to the Regulatory Asset Base results in an adjustment akin to a write down in value. Thus, the regulated business will not only receive lower returns in the year in which the asset is deflated but over the remaining life of the assets. The approach proposed by the Regulatory Authorities in relation to the SEM assets gives SEMO, and its parent companies, cause for concern not only in relation to new investment but also in relation to the investments already undertaken. Given the assumed real cost of debt the approach proposed assumes that SEMO is effectively able to source capital at either zero or negative nominal interest rates. The value of the Regulatory Asset base post adjustment is lower than the original cost at which the SEM assets were acquired.

The Regulatory Authorities have argued that the overall level of real return varies over time and effectively the regulated business must 'take the rough with the smooth'. SEMO accepts this argument where the WACC is set for a control based on a number of assumptions that are expected to hold on average throughout the control period. A real WACC has been applied to the EirGrid SO business and SONI SO business based upon a set of inflation expectations prevailing at the time - for EirGrid in 2005 and SONI in 2007. These do not match inflation expectations today and indeed real rates are considerably higher today.

SEMO believes that (1) the short (5yr) asset life of the SEMO assets, (2) the exceptional 1 in 50 year nature of the current deflationary environment and (3) the fact that the Regulatory Authorities are not continuing an existing control but rather specifically setting a SEMO control means that an alternative approach should be adopted.

PROPOSAL 11

SEMO believes that the underlying level of real rates today must be recognised by the Authority as part of their determination whether by amending the real WACC applicable or the basis of the application of indexation to the RAB, bearing in mind the particular situation and circumstances faced by SEMO.

APPENDIX 1 INFLATION CALCULATIONS

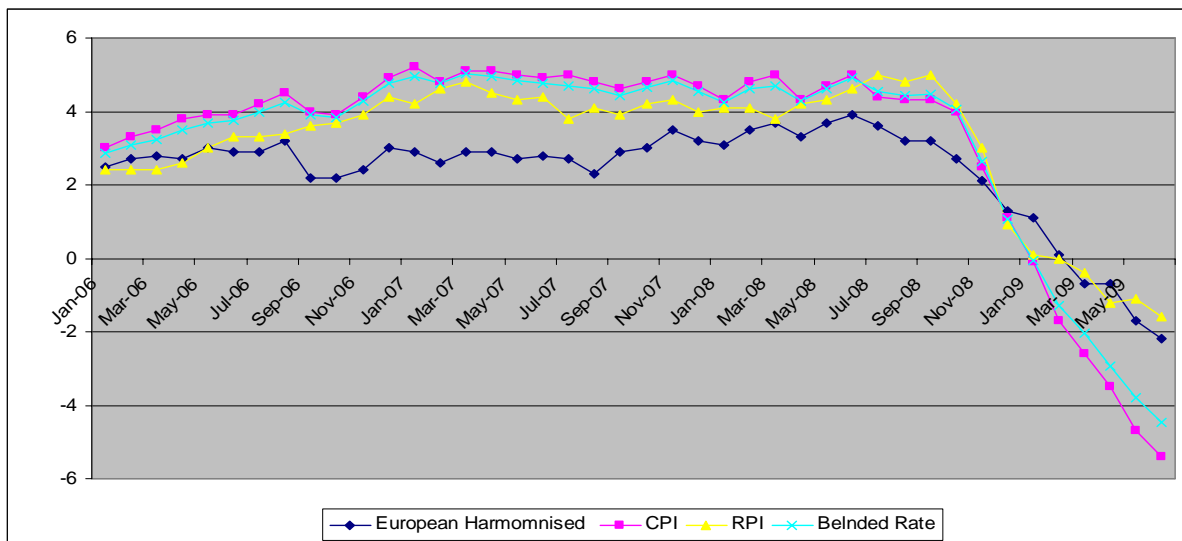
Find below the data used to calculate the actual Rate of Inflation for 2008-09 to be applied. This is a blended amount between CPI and RPI.

The second section contains the forecasted rate of inflation for 2009-10 produced by the ESRI. This is a CPI figure only.

ACTUAL RATE OF INFLATION MID TARIFF 2008-09

The CPI figure from the Central Statistics Office was blended with the RPI figure from the UK in a ratio of 3:1. The table below shows how the -2.05% figure was reached by SEMO. The graph below shows four lines indicating:

- European Harmonised rate of inflation
- The Consumer Price Index use by the Central Statistics Office in the Republic
- The Retail Price Index used in the UK and
- The Blended rate of inflation using a 75:25 weighting (75% CPI:25% RPI)



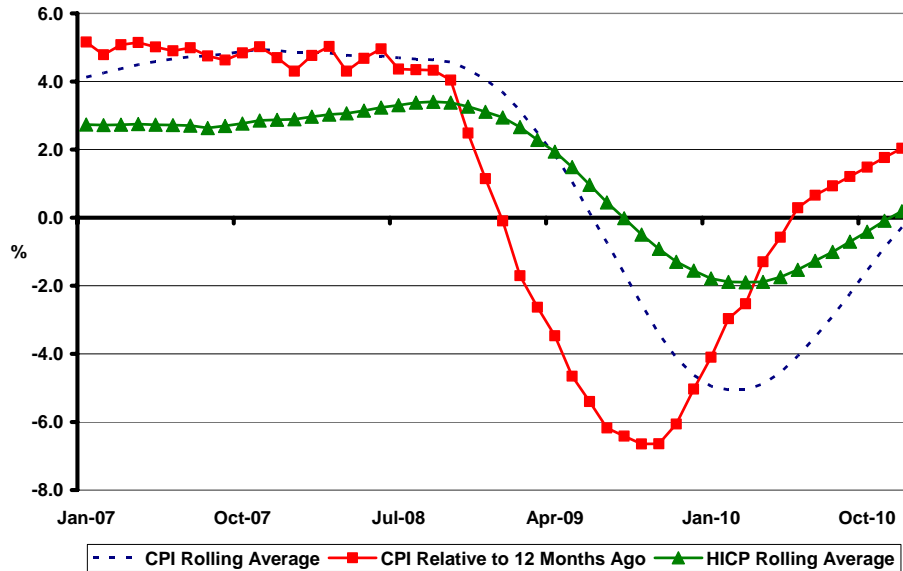
The table below shows the data used to plot the graph on the previous page. Please note that SEMO propose using the mid tariff blended rate of inflation of -2.05% as highlighted in the column in Red below.

Date	Jan 06	Feb 06	Mar 06	Apr 06	May 06	Jun 06	Jul 06	Aug 06	Sep 06	Oct 06	Nov 06	Dec 06
Euro Harmon	2.5	2.7	2.8	2.7	3	2.9	2.9	3.2	2.2	2.2	2.4	3
CPI	3	3.3	3.5	3.8	3.9	3.9	4.2	4.5	4	3.9	4.4	4.9
RPI	2.4	2.4	2.4	2.6	3	3.3	3.3	3.4	3.6	3.7	3.9	4.4
Belnded Rate	2.85	3.075	3.225	3.5	3.675	3.75	3.975	4.225	3.9	3.85	4.275	4.775
Date	Jan 07	Feb 07	Mar 07	Apr 07	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Euro Harmon	2.9	2.6	2.9	2.9	2.7	2.8	2.7	2.3	2.9	3	3.5	3.2
CPI	5.2	4.8	5.1	5.1	5	4.9	5	4.8	4.6	4.8	5	4.7
RPI	4.2	4.6	4.8	4.5	4.3	4.4	3.8	4.1	3.9	4.2	4.3	4
Belnded Rate	4.95	4.75	5.025	4.95	4.825	4.775	4.7	4.625	4.425	4.65	4.825	4.525
Date	Jan 08	Feb 08	Mar 08	Apr 08	May 08	Jun 08	Jul 08	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08
Euro Harmon	3.1	3.5	3.7	3.3	3.7	3.9	3.6	3.2	3.2	2.7	2.1	1.3
CPI	4.3	4.8	5	4.3	4.7	5	4.4	4.3	4.3	4	2.5	1.1
RPI	4.1	4.1	3.8	4.2	4.3	4.6	5	4.8	5	4.2	3	0.9
Belnded Rate	4.25	4.625	4.7	4.275	4.6	4.9	4.55	4.425	4.475	4.05	2.625	1.05
Date	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09						
Euro Harmon	1.1	0.1	-0.7	-0.7	-1.7	-2.2						
CPI	-0.1	-1.7	-2.6	-3.5	-4.7	-5.4						
RPI	0.1	0	-0.4	-1.2	-1.1	-1.6						
Belnded Rate	-0.05	-1.275	-2.05	-2.925	-3.8	-4.45						

INFLATION FORECAST

Find below the figures from the ERSI which supports the figure of -2.5% forecasted rate of inflation for the mid tariff 2009 -10 (March). This figure does not however take into account the blending of the UK RPI figure.

Inflation profile 2007-2010 - Republic of Ireland



	Jan 07	Feb 07	Mar 07	Apr 07	May 07	Jun 07	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
CPI Rolling Average	4.1	4.2	4.4	4.5	4.6	4.7	4.7	4.8	4.8	4.9	4.9	4.9
CPI Relative to 12 Months Ago	5.2	4.8	5.1	5.1	5.0	4.9	5.0	4.8	4.6	4.8	5.0	4.7
HICP Rolling Average	2.7	2.7	2.7	2.8	2.7	2.7	2.7	2.6	2.7	2.8	2.9	2.9
	Jan 08	Feb 08	Mar 08	Apr 08	May 08	Jun 08	Jul 08	Aug 08	Sep 08	Oct 08	Nov 08	Dec 08
CPI Rolling Average	4.8	4.8	4.8	4.8	4.7	4.7	4.7	4.7	4.6	4.6	4.4	4.1
CPI Relative to 12 Months Ago	4.3	4.8	5.0	4.3	4.7	5.0	4.4	4.3	4.3	4.0	2.5	1.1
HICP Rolling Average	2.9	3.0	3.0	3.1	3.1	3.2	3.3	3.4	3.4	3.4	3.3	3.1
	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09	Jul 09	Aug 09	Sep 09	Oct 09	Nov 09	Dec 09
CPI Rolling Average	3.7	3.1	2.5	1.8	1.1	0.2	-0.7	-1.6	-2.5	-3.4	-4.1	-4.6
CPI Relative to 12 Months Ago	-0.1	-1.7	-2.6	-3.5	-4.7	-5.4	-6.2	-6.4	-6.6	-6.6	-6.1	-5.0
HICP Rolling Average	2.9	2.7	2.3	1.9	1.5	1.0	0.4	0.0	-0.5	-0.9	-1.3	-1.6
	Jan 10	Feb 10	Mar 10	Apr 10	May 10	Jun 10	Jul 10	Aug 10	Sep 10	Oct 10	Nov 10	Dec 10
CPI Rolling Average	-5.0	-5.1	-5.1	-4.9	-4.6	-4.1	-3.5	-2.9	-2.2	-1.5	-0.9	-0.3
CPI Relative to 12 Months Ago	-4.1	-3.0	-2.5	-1.3	-0.6	0.3	0.7	0.9	1.2	1.5	1.8	2.0
HICP Rolling Average	-1.8	-1.9	-1.9	-1.9	-1.7	-1.5	-1.3	-1.0	-0.7	-0.4	-0.1	0.2