



Single Electricity Market Operator (SEMO) Revenue Requirement

Price control commencing 1 October 2013

Decision Paper

06 August 2013

SEM-13-054



1	EXECUTIVE SUMMARY	3
2	INTRODUCTION	6
3	REGULATORY PRINCIPLES	9
4	FORM, SCOPE & DURATION	10
5	INDEXATION	14
6	OPERATIONAL EXPENDITURE (OPEX)	15
7	CAPITAL EXPENDITURE (CAPEX).....	30
8	REGULATED ASSET BASE (RAB).....	37
9	WEIGHTED AVERAGE COST OF CAPITAL (WACC).....	38
10	DEPRECIATION	40
11	INCENTIVISATION	41
12	K FACTOR	46
13	MANAGING UNCERTAINTY AND RISK WITHIN AN ASSET LIGHT UTILITY	48
14	FORM AND MAGNITUDE OF CHARGES	50

1 EXECUTIVE SUMMARY

- 1.1 The All-Island Single Electricity Market (SEM) commenced operation on 1 November 2007 and is administered by the Single Electricity Market Operator (SEMO) formed through a contractual joint venture between EirGrid and SONI. SEMO recovers its operational and capital costs from market participants.
- 1.2 SEMO is licensed and regulated co-operatively by the Commission for Energy Regulation (CER) in the Republic of Ireland and the Utility Regulator in Northern Ireland. To date, SEMO has been subject to a combined Regulatory Authority (RA) price control approved by the SEM Committee (SEMC).
- 1.3 SEMO have now been operating for over five years as market operator to the SEM. During this period they have faced challenges, such as the implementation of the Intraday project in July 2012, but throughout they have successfully provided a reliable and robust service for market participants.
- 1.4 This paper includes decisions made by the SEM Committee on the form of SEMO regulation and the allowed revenue for SEMO for the period from 1 October 2013 to 30 September 2016. The RAs published a consultation paper¹ on the price control in April 2013. Unless stated otherwise, any proposals made in the consultation which were not subject to stakeholder responses have remained unchanged.
- 1.5 As outlined in the consultation paper, the SEM Committee took account of SEMO's performance against allowances during the 2010-2013 price control when forming views on the regulated allowance required for the new price control period. Since the consultation paper was published, the RAs have considered two responses received and met with SEMO on two occasions. SEMO have raised at length the view that the organisation is an 'asset-light' utility and therefore more akin to a business service provider. SEMO is of the view that the current traditional utility regulation model is inappropriate and needs to be addressed.
- 1.6 The SEM Committee have taken stakeholder views into account when deciding:
 - To provide an allowance of €29.98 million for operating expenditure (OPEX). This compares to SEMO's submission for €33.12 million and represents a reduction of 9.5%.

¹ http://www.allislandproject.org/en/smo_current_consultations.aspx?article=4b8da800-e911-48bb-8a14-a54137f9c287

- OPEX will be subject to a revenue-cap regime adjusted by RPI-X with an X of 0.3. This will provide an incentive for efficiency, as any savings within the allowed revenue can be kept by SEMO while no provision is made for over expenditure.
- The allowed revenue for capital expenditure (CAPEX) will be determined by SEMO's choice from a menu of regulatory options representing varying strengths of incentivisation. The options are structured so that SEMO will choose the option that matches most closely the outcome expenditure expected by them.
- A CAPEX baseline of €7.61 million has been determined in respect of approved CAPEX business cases. This compares to SEMO's submission of €8.81 million for the same approved business cases. The SEM Committee's baseline is set 13.6% below SEMO's submission which is based on an assessment of estimated outturn for the 2010-2013 price control.
- Greater emphasis has been placed on incentivising SEMO to focus on the importance of customer value and service delivery. This is evidenced by an increasing number of Key Performance Indicators (KPIs), which now include System Availability. In addition to this some existing KPIs have been strengthened together with the reward available increasing from 3% of OPEX to 4%.
- The SEM Committee acknowledge the licence requirement for contingent capital and have decided to remunerate SEMO a fair value for this, having been assured that neither EirGrid nor SONI are remunerated for such a provision in their respective price controls. An allowance of €0.900 million has been given which should not be taken as a binding precedent as a review of both the need for such a capital provision and quantum will be considered in more detail going forward.
- SEMO's revenue will be corrected year by year by the outturn rate of inflation. All figures in this decision paper are presented in March 2012 prices, unless stated otherwise.

1.7 The regulated entitlement determined by the SEM Committee excludes the impact of the European Market Integration Project (due to be implemented in 2016) for which the SEM Committee has published a European Market Integration Draft Decision Paper². The combination of a new European Target Model for electricity and corresponding market design has the potential to significantly change the current SEM design.

² http://www.allislandproject.org/en/TS_Current_Consultations.aspx?article=41f5681a-ef37-41ca-ab7d-7a1bdd7db385

1.8 The new SEMO price control will take effect from 1 October 2013. Licence modifications will be consulted on during August/September 2013. The price control will be in place until 30 September 2016 but the possibility of an extension to the duration may arise as a result of the implementation of market integration.

1.9 A summary of the allowances provided for in the 2013-2016 price control are outlined in Table 1.

SEMO Price Control Summary

	Totals	Totals		
	Current price control (Year 2012-13 x 3 years) € million	SEMO's Submission	RAS Consultation Paper	SEM Committee Decision
OPEX				
Total Payroll	15.54	16.99	14.91	15.38
Total IT & Communications	6.58	7.83	7.13	7.13
Total Facilities and Insurance	4.24	4.33	3.34	3.76
Total Professional Fees	1.82	1.71	1.69	1.69
Total General and Administrative	1.31	1.11	0.87	0.87
Total Corporate Services	0.54	1.15	1.15	1.15
Total	30.03	33.12	29.09	29.98
Cost of Capital³				
Depreciation (5 year)	20.78	15.16	14.18	14.48
WACC	2.97	2.10	1.87	1.92
Total	23.75	17.26	16.05	16.40
CAPEX recoverable via accelerated recovery	10.62			
Licence Requirement Allowance				0.90
Total Revenue Requirement	64.40	50.38	45.14	47.28
Total CAPEX allowance for RAB	10.30	9.37	6.72	7.61

Table 1: SEMO Price Control Summary

³Final depreciation and WACC figures will not be known until the menu selection is completed (and these figures will be used for tariff purposes)

2 INTRODUCTION

THE SINGLE ELECTRICITY MARKET

- 2.1 The Northern Irish and Irish Governments, the RAs and industry worked together to create an All-Island Energy Market, as outlined in the All-Island Energy Market Development Framework Paper⁴.
- 2.2 The first step in this process was the introduction of an All-Island wholesale electricity market. The Single Electricity Market (SEM) was implemented on 1 November 2007 when the market went live.
- 2.3 The SEM is a centralised or gross mandatory pool market, with electricity being bought and sold through the pool under a market clearing mechanism. Generators receive the System Marginal Price (SMP) for their scheduled dispatch quantities, capacity payments for their actual availability, and constraint payments for differences between the market schedule and actual dispatch due to system constraints. The SEM market rules are set out in the Trading and Settlement Code (TSC)⁵.

ROLE OF SEMO

- 2.4 The development of the SEM led to the requirement for a Single Electricity Market Operator (SEMO) to administer the market. With this in mind the SEM Committee approved the plans of EirGrid and SONI, the transmission system operators for Ireland and Northern Ireland respectively, to establish SEMO on a contractual joint venture basis.
- 2.5 SEMO's role in the market is explicitly defined in the SEM Trading and Settlement Code (TSC), which sets out the rules, procedures and terms and conditions which all parties, including SEMO, must adhere to in order to participate in the SEM. In addition both EirGrid and SONI must comply with the conditions imposed on this activity by their respective Market Operator (MO) licences⁶.

⁴ All-Island Energy Market: A Development Framework, November 2004, www.allislandproject.org
http://www.dcenr.gov.ie/NR/rdonlyres/BCF98EC4-7321-4E3F-8685-BFFCA2BF2DF4/0/All_island_Energy_Market_Development_Framework.pdf
http://www.detini.gov.uk/all-island_energy_market_development_framework.pdf

⁵ <http://www.sem-o.com/MarketDevelopment/MarketRules/TSC.docx>

⁶ <http://www.allislandproject.org/en/single-market-operator-overview.aspx?article=1fd2b5ff-ce2b-464e-8332-eafa06438ba2>

- 2.6 As defined in section 1.3 of the TSC, SEMO's role is to 'facilitate the efficient, economic and coordinated operation, administration and development of the Single Electricity Market in a financially secure manner'.

SEMO REVENUE & CHARGES

- 2.7 SEMO's operational and capital costs are recovered through Market Operator tariffs and fees, which are levied on market participants.
- 2.8 The RAs, in issuing a questionnaire, facilitated SEMO to submit proposals for revenue requirement on a combined basis for the two Market Operator licensees. The specified proportions agreed have regard to comparative levels of energy consumption in the Republic of Ireland and Northern Ireland. The agreed current apportionment between EirGrid MO and SONI MO is 75% and 25% respectively.
- 2.9 In addition to proposals for allowed revenue, SEMO must also present proposals on tariffs to recover imperfections costs. However, as indicated in our consultation, the RAs will hold a separate consultation on imperfection charges.

REGULATORY APPROVAL PROCESS

- 2.10 In order to determine an appropriate revenue entitlement for SEMO, the RAs analysed and reviewed SEMO's submission and associated supporting information. The RAs published a consultation paper⁷ on the basis of that review in April 2013. The objective of this was to solicit comments from stakeholders on the RAs proposals.
- 2.11 Two responses to the consultation were received. These have been published alongside this decision paper. Comments were received from:
- Electric Ireland
 - SEMO
- 2.12 The RAs met with SEMO on two occasions after SEMO's response had been received to discuss their views and obtain clarification on various issues raised by them. In addition to this, SEMO were offered the opportunity to provide the RAs with further evidence to justify the requests in their original submission.

DECISION PAPER

- 2.13 The SEM Committee is now publishing this decision paper in relation to the SEMO revenue and tariffs for the period from 1 October 2013 to 30 September 2016. The

⁷ http://www.allislandproject.org/en/smo_current_consultations.aspx?article=4b8da800-e911-48bb-8a14-a54137f9c287

decision takes into account comments received during the consultation process. Where no comment or response has been received on elements of the consultation, it has been assumed that this reflects agreement.

EXPECTATION OF SEMO IN THIS 2013-2016 PRICE CONTROL

- 2.14 In addition to SEMO's requirement to comply with the SEM Trading and Settlement Code and both Market Operator licences the SEM Committee also place importance on SEMO's overall performance. This includes the continuation and improvement of service delivery in meeting stakeholders' expectations.
- 2.15 The SEM Committee outline their expectations below for this price control in relation to performance and service, CAPEX and OPEX.
- 2.16 In recognising SEMO's generally good performance to date and the significant CAPEX programme approved for the 2010-2013 price control, stakeholders would expect SEMO to deliver exceptional service, improved functionality and greater reliability for the full duration of this 2013-2016 price control.
- 2.17 Monitoring Key Performance Indicators (KPIs) is one of a range of approaches the RAs use to measure the 'added value' to customer service. Quality of service provided by SEMO should not be compromised in achieving efficiency gains and therefore the SEM Committee would expect a strong KPI performance and clean market audit reports throughout the duration of the 2013-2016 price control.
- 2.18 To aid improved customer service the SEM Committee are proposing additional funding to facilitate further website development. SEMO intends to carry out a usability review of the website and restructure the underlying data to improve navigation and speed. This is expected to improve market accessibility and transparency of the SEM market information to all stakeholders.
- 2.19 The SEM Committee determine SEMO's capital refresh policy of three years in respect of critical servers to be too rigid and a more flexible refresh policy based on operational and available support options should be considered. This could substantially reduce ongoing replacement costs and such a change would also reduce the inherent risks in replacing and upgrading equipment.
- 2.20 The treatment of the OPEX and CAPEX allowances should be dealt with separately and are not interchangeable.
- 2.21 The above mentioned expectations are not exhaustive but highlight areas which the SEM Committee place importance on regarding delivery of customer service, transparency, consistency and improvement of performance.

3 REGULATORY PRINCIPLES

- 3.1 The principal objective of the SEM Committee is to protect the interests of consumers of electricity in Ireland and Northern Ireland and wherever appropriate to do so by promoting effective competition.
- 3.2 The SEM Committee, in carrying out their functions, have given regard to the principles underpinning regulatory activities⁸ to be:
- Transparent;
 - Accountable;
 - Proportionate;
 - Consistent; and
 - Targeted.
- 3.3 The SEM Committee's task essentially consists of creating a framework within which the regulated business receives a reasonable assurance of a revenue stream in future years that will cover its costs in return for providing monopoly services to an acceptable quality.

⁸ The Electricity (Single Wholesale Market) (Northern Ireland) Order 2007

4 FORM, SCOPE & DURATION

4.1 FORM

4.1.1 The SEMO business is unique in a number of aspects. SEMO's organisational structure is a contractual joint venture between the system operators and is therefore not a separate legal entity. Some aspects of the price control have to include consideration of factors affecting the parent companies e.g. financeability (Parent Company Guarantee), Weighted Average Cost of Capital (WACC) and recharges. Secondly, the all-island market operator is cross-jurisdictional and is governed by two Market Operator licences issued by the two RAs on the island.

4.1.2 A combined RA price control will apply for the Market Operator business as a whole.

4.1.3 OPEX

4.1.3.1 The SEM Committee have decided that OPEX should be subject to Revenue Cap (RPI-X) Regulation with an X of 0.3 applied. RPI-X regulation incentivises SEMO to reduce costs by increased efficiency of processes and lower input prices. Any efficiency and price savings are retained by SEMO; overspends must conversely be absorbed by them.

4.1.3.2 The SEM Committee recognise that SEMO is similar to a 'business service provider'. An assessment of an annual total factor productivity growth percentage was therefore determined with this in mind. A productivity growth rate of 0.3% was identified as being particularly relevant, for the forthcoming years, to a labour intensive business, such as SEMO⁹. Having established a productivity growth rate of 0.3%, consideration was then given to any impact of Real Price Effects (RPEs). CER commissioned CEPA to carry out a bottom up and benchmarking assessment of RPEs for the Bord Gais Transmission Network Control for 2012-2017. In their report¹⁰ CEPA pay particular attention to changes in general and specialised labour inflation in relation to the Irish Economy. CEPA concluded that a separate RPE allowance was not required for OPEX.

4.1.3.3 SEMO believe they have 'now largely reached the efficiency frontier in their operations'. The SEM Committee are of the view that there is scope for SEMO to operate more efficiently and benefit from reduced costs below the outturn inflation rate.

SEMC DECISION 1: OPEX TO BE REGULATED UNDER AN RPI-X REGIME. X FACTOR OF 0.3 TO BE APPLIED.

⁹<http://www.water.org.uk/home/policy/publications/archive/finance/retail-costs/waterretail.pdf>

¹⁰<http://www.cer.ie/en/gas-transmission-network-current-consultations.aspx?article=7c6755c1-140a-433b-b209-468b9e7f0ac1> CER12058a

4.1.4 CAPEX

- 4.1.4.1 In the consultation paper, the SEM Committee proposed that the revenue requirement for CAPEX should be recovered through rate of return regulation (i.e. a RAB, depreciation, WACC approach). 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 (currently 75% / 25% respectively).
- 4.1.4.2 As capital investment is longer term in nature the SEM Committee has had to be mindful of the likely market integration project changes in 2016. To that end the RAs indicated to SEMO that CAPEX would be assessed in terms of how critical the investment would be for the next 3-4 years.

SEMC DECISION 2: CAPEX TO BE REGULATED BY RATE OF RETURN REGULATION, INCENTIVISED THROUGH MENU REGULATION

4.1.5 TARIFFS

- 4.1.5.1 Tariffs will be calculated so that OPEX and CAPEX revenues are recovered based on forecasted market demand. This in turn requires the over or under recovery of revenue to be taken into account when finalising tariffs for the following year thus protecting SEMO from any revenue uncertainty arising from the difference from forecasted and actual market demand.

4.1.6 INCENTIVISATION

- 4.1.6.1 The SEM Committee will continue to incentivise SEMO's CAPEX. Based on approved business cases, a CAPEX 'baseline' allowance has been calculated. From this baseline a number of options (packages) have been prepared to create a form of menu regulation. The incentive for SEMO is to choose the option which best reflects their expected risk/reward profile. In summary, if SEMO choose a package less than the baseline and are in line with that level of expenditure, they would achieve greater reward i.e. the benefit between consumers and SEMO is split. However, should SEMO choose the baseline package or a package greater than the baseline they will receive less reward for efficiency saving.

4.1.7 NON-NETWORK UTILITY REGULATION

- 4.1.7.1 SEMO's price control submission raised concerns about the level of compensation they receive compared to the risks the business faces. SEMO gave particular focus to their relatively low asset base in comparison to other utility companies.
- 4.1.7.2 It should be noted that inflation risk, foreign exchange risk, market volume risk and a return on CAPEX is provided for in this price control either within year or as an end of year adjustment to tariffs.
- 4.1.7.3 In addition to this, the SEM Committee has determined that an allowance of €0.300 million per annum is appropriate remuneration for SEMO to facilitate their Parent Company Guarantee licence requirement.

4.2 SCOPE

- 4.2.1 The SEM has provided a platform for the wholesale trade of electricity in the Republic of Ireland and Northern Ireland since go-live in 2007. However, development towards European electricity market integration and compliance with the European 'target model' has the potential to significantly change the current SEM design. Due to the proposed implementation of the Market Integration project, it is necessary to define the scope of this 2013-2016 price control.
- 4.2.2 When the price control questionnaire was issued to SEMO in November 2012, the RAs requested that SEMO assume a '*Business as Usual*' approach to maintaining the current structure of the SEM. Any expenditure associated with Market Integration is considered outside the scope of the 2013-2016 price control. This 'Business as Usual' approach aligns with the SEM Committee commitment 'to maintain the current structure of SEM until 2016 where possible and will not approve material market changes between now and then'¹¹.

SEMC DECISION 3: THIS PRICE CONTROL IS BASED ON A 'BUSINESS AS USUAL' APPROACH WITH MARKET INTEGRATION CONSIDERED OUTSIDE THE SCOPE OF THE 2013-2016 PRICE CONTROL

4.3 DURATION

- 4.3.1 This price control is due to take effect from 1 October 2013 and will have a duration of three years, ending on 30 September 2016. The Market Integration Project is due to be implemented in 2016. The RAs consider that a roll forward of year three allowance on a

¹¹ European Market Integration Next Steps proposed decision paper

pro-rata basis may be required beyond 30 September 2016 to facilitate transition to the new market. This price control has been structured to facilitate this option. The SEM Committee will decide in 2015 whether a new price control is needed or if a roll forward is to be implemented.

SEMC DECISION 4: THE PRICE CONTROL WILL APPLY FROM 1 OCTOBER 2013 – 30 SEPTEMBER 2016. AN EXTENSION IS TO BE CONSIDERED IN 2015 TO FACILITATE MARKET INTEGRATION.

5 INDEXATION

- 5.1 At the request of the RAs, SEMO submitted their price control information using a mid- tariff (March 2012) price base.
- 5.2 MO tariffs will be adjusted for out-turn inflation up to March of each year and any further adjustment will be recognised in the end of year 'k' factor adjustment mechanism.
- 5.3 The indexation rate applicable is a blended rate of outturn CPI based on publication by the Central Statistics Office (Ireland) and RPI as detailed by the Office for National Statistics (UK). This is consistent with the current arrangements.
- 5.4 It is worth noting that the Office of National Statistics consulted recently in relation to the appropriateness of the Retail Price Index (RPI)¹². As a result of this a new index was created (RPIJ)¹³. The RAs will continue with the existing RPI measurement for the duration of this price control.

SEMC DECISION 5: SEMO'S ALLOWANCE TO BE CORRECTED BY THE BLENDED OUT-TURN INFLATION FIGURE

¹² <http://www.ons.gov.uk/ons/rel/mro/news-release/rpirecommendations/rpinewsrelease.html>

¹³ <http://www.ons.gov.uk/ons/rel/cpi/introducing-the-new-rpij-measure-of-consumer-price-inflation/1997-to-2012/index.html>

6 OPERATIONAL EXPENDITURE (OPEX)

6.1 TOTAL OPEX

6.1.1 SEMO requested a total of €33.123 million¹⁴ of OPEX during the 2013-2016 price control period. This compared to an actual expenditure during the 2010-2013 price control of €26.989 million¹⁵ and the SEM Committee's decision for the forthcoming period of €29.980 million.

6.1.2 SEMO's historic expenditure and OPEX Submission versus the SEM Committee's decision for the next three years is illustrated in Figure 1 as follows:

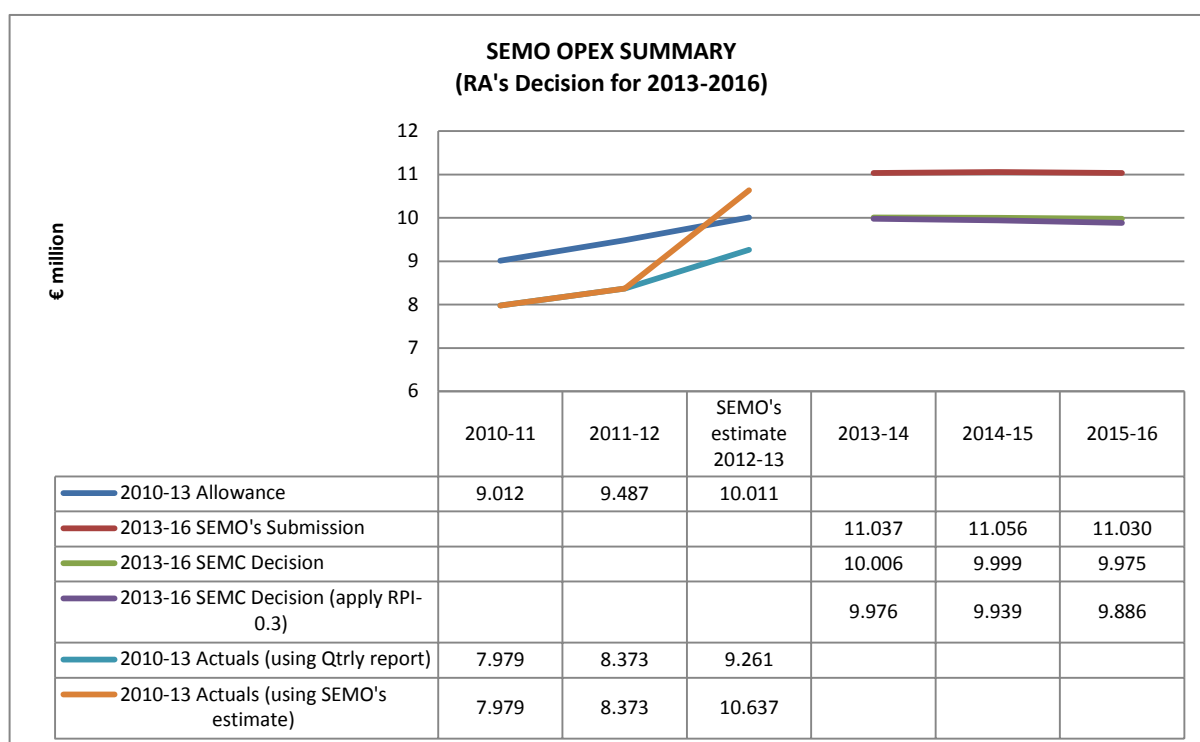


Figure 1: Summary of Actual OPEX Expenditure and SEM Committee Decision

6.1.3 In order to determine a suitable OPEX allowance for SEMO for the 2013-2016 price control, the RA's analysed SEMO's allowed and actual OPEX spend from 1 October 2010 to 30 September 2013 compared to its proposed future spend. Proposed OPEX includes payroll, IT & Communications, Facilities and Insurance, Professional fees, General and Administrative costs and costs associated with Corporate Services.

¹⁴ SEMO's original OPEX submission is for €32.908 million, but there were also additional IT support costs associated with the implementation of CAPEX projects (which total €0.215 million). SEMO included these in their CAPEX submission. For analysis purposes, the RAs have reviewed the IT support costs for CAPEX within this section of the consultation paper.

¹⁵ This 'actual' amount is based on two years of actuals, but the final year is SEMO's forecast

SEMO took a 'business as usual' approach to its OPEX submission, as requested by the RAs.

6.1.4 The RAs proposed OPEX allowance in the consultation paper was made up as follows:

OPEX Summary

	Totals		Totals	
	Current price control (Year 2012-13 x 3 years)	€ million	SEMO's Submission	RAS Consultation Paper
			€ million	
OPEX				
Total Payroll	15.543		16.994	14.913
Total IT & Communications	6.582		7.832	7.133
Total Facilities and Insurance	4.242		4.332	3.339
Total Professional Fees	1.815		1.706	1.688
Total General and Administrative	1.311		1.107	0.873
Total Corporate Services	0.540		1.152	1.152
Total	30.033		33.123	29.098

Table 2: Comparison of SEMO's Submission and RAs Consultation Proposals

6.2 MARKET PARTICIPANTS RESPONSES TO TOTAL OPEX AND SEMC COMMENTS

6.2.1 Electric Ireland were concerned that our proposed OPEX allowance increased from an actual OPEX outturn during the 2010-13 price control of €26.989 million to €29.098 million for an equivalent period commencing 1 October 2013.

6.2.2 **SEM Committee view:** The OPEX outturn for 2010-2013 price control was based on two years of actual data and one year of SEMO's forecast figures. The SEM Committee would like to emphasise that SEMO's actual costs incurred (from mid 2012) include the impact of costs which arose due to approved Intraday Trading arrangements. Because these did not occur until over half way through the 2010-2013 price control, comparing the total actuals with the 2013-2016 allowances is not on a like-for-like basis. The SEM Committee is of the view that it is more relative to compare the 2012-2013 SEMO's best estimate with the SEM Committee's decision for year 1 allowance of the 2013-2016 price control. This is shown in Table 3 below:

	SEMO's Estimates 2012-2013	SEM Committee Decision 2013-2014	Difference
	€ million	€ million	%
OPEX			
Total Payroll	5.262	5.125	-2.6%
Total IT & Communications	2.539	2.337	-8.0%
Total Facilities and Insurance	1.326	1.253	-5.5%
Total Professional Fees	0.739	0.616	-16.8%
Total General and Administrative	0.390	0.291	-25.4%
Total Corporate Services	0.381	0.384	0.8%
Total	10.637	10.006	-5.9%

Table 3: SEMO's estimate for 2012-2013 compared with SEM Committee's Decision for 2013-2014

6.2.3 Payroll and IT & Communications made up the most significant proportion of OPEX. Changes to the allowance for each cost line of OPEX since our consultation will now be discussed in turn.

6.3 SEMC PROPOSALS ON PAYROLL

6.3.1 Payroll is made up of salaries, employer's PRSI/National Insurance Contributions, ongoing pension contributions, performance related payments, overtime, contract staff and other allowances including car allowances.

6.3.2 For the 2013-2016 price control, SEMO have requested a three year allowance totalling €16.994 million for payroll. SEMO's submission is shown in the table below for each of the three years. The table shows an increase in the expected payroll cost of 9% from the allowance approved for 2012-2013 to the amount submitted for 2013-2014. This step change is predominantly due to additional revenue required to cover pension deficit repair and additional contract staff.

	Historical Information	SEMO's Submission		
	Allowed Revenue 2012-2013	2013-2014	2014-2015	2015-2016
	€ million	€ million		
Total Salaries/Pension etc	5.181	5.169	5.176	5.176
Pension Deficit	-	0.250	0.250	0.250
Additional Contractors	-	0.241	0.241	0.241
Total Payroll	5.181	5.660	5.667	5.667

Table 4: Summary of SEMO's 2012-2013 Approved Allowance and Submission for years 2013-2016

6.3.3 As stated in the consultation paper, the RAs relied on benchmarking evidence which was provided during the 2010-2013 price control review as an objective assessment of SEMO's payroll. The RAs proposed payroll allowance in the consultation paper

used the baseline, as quoted in the 2010 decision paper, as a starting point. This was commensurate with 56 staff.

- 6.3.4 The baseline stated in the 2010-2013 price control decision paper was €4.315 million (representing a 7% reduction on the approved allowance for year 1 of the three year 2010-2013 price control). This baseline amount was indexed to March 2012 prices which provided the RAs with a starting allowance of €4.585 million per annum.
- 6.3.5 During the 2010-2013 price control period, SEMO's scope expanded to include Intraday Trading (IDT) and Fuel Mix Disclosure (FMD) requirements. Intraday Trading was a significant project which went live in July 2012. The SEM Committee approved seven additional staff to resource the new requirements placed on SEMO. The payroll allowance approved for these resources was €0.524 million per annum based upon average payroll cost less efficiencies evident in payroll at the time the SEM Committee made their decision.
- 6.3.6 The RAs carried forward the payroll baseline of €4.585 million which was stipulated in the 2010-2013 price control. However, the RAs then applied a consistent approach to the allowance for Intraday and Fuel Mix Disclosure as had been decided during the 2010-2013 price control period, which in turn created a revised baseline of €5.109 million relating to 63 staff.
- 6.3.7 SEMO applied a foreign exchange adjustment to 25% of baseline payroll, which represented fluctuation in exchange rate between Sterling and the Euro. At the time of setting the 2010-2013 price control, the rate was 0.86p:€1. When SEMO prepared their submission for the 2013-2016 control, a rate of 0.81p:€1 applied. However, over recent months the exchange rate has been approximately c0.85p:€1. Based on this the RAs recognise a slight foreign exchange increase in allowance of €0.015 million per annum.
- 6.3.8 The RAs also proposed that one member of staff previously agreed should be removed due to reduced scope in the bi-annual releases. The RAs deducted €0.079 million from the baseline to account for this.
- 6.3.9 The SEM Committee has proposed to allow payroll (for salaries, PRSI/national insurance contributions, performance related payments, overtime and other staff costs) of €5.125 per annum equating to a price control allowance of €15.375 million for the three year period. The SEM Committee's proposals are detailed in the table below. Additional payroll submissions for contract staff and a pension scheme deficit are considered further below.

SEMO 2013-2016 Price Control Decision Paper

Payroll Summary € million	2010-2013 Payroll Decision			2013-2016 Consultation Paper	2013-2016 Decision Paper	
		7% reduction	Baseline from 2010- 2013 Price Control	Baseline	Decision	Headcount
	01/10/2010	30/09/2013		Indexed to March 2012	Indexed to March 2012	
2009-2010 Allowance	4.264	3.966	3.966	4.214	4.214	
Add: 2 heads approved Nov 2009	0.160	0.149	0.149	0.158	0.158	
Contractors	0.136	0.126	0.126	0.134	0.134	
Add: 1 head - Personal Assistant	0.080	0.074	0.074	0.079	0.079	
Total from price control	4.640	4.315	4.315	4.585	4.585	56
Intraday Trading and Fuel Mix Disclosure Decision Indexed				0.524	0.524	7
				5.109	5.109	63
Adjust foreign exchange base for both 2010-2013 baseline and Intraday baseline (Based on exchange rate of 0.86 updated to 0.85 (SEMO's submission used 0.81))				0.075	0.015	
Less: 1 head due to reduced scope of key activities				5.184	5.125	
				-0.079	-0.079	-1
Less: contractors included in 2010-2013 control				5.105	5.046	-1
				-0.134	-	
				4.971	5.046	62
Add: Guarantee of Origin Resource (ROI only; costs recharged out of Corporate Services)				-	0.079	1
Pension deficit repair allowance				-	-	
Additional Contractors for 2013-2016 price control				-	-	
Total Payroll Allowance				4.971	5.125	63

Table 5: Summary of SEM Committee's Decision in respect of Payroll

6.4 MARKET PARTICIPANTS RESPONSES TO PAYROLL AND SEMC COMMENTS

- 6.4.1 Electric Ireland raised particular concern to the scale of payroll increases. They reference the RAs proposed costs of €14.913 million for the period 2013-2016 against an estimated actual outcome of €13.408 million, representing a difference of €1.505 million (11.2%).
- 6.4.2 **SEM Committee view:** This differential can be explained due to the introduction of Intraday trading to the SEM in July 2012, and to a much lesser extent a resource for Fuel Mix Disclosure. An allowance of €0.524 million was approved per annum in recognition of the legal and regulatory requirement placed on SEMO to operate these additional requirements, particularly as Intraday trading introduced a complex integral aspect to the Central Market System. This additional allowance applied to all three years of the RAs proposal but was only reflected in one year of the estimated actual outcome figure due to the 'go live' date of July 2012.
- 6.4.3 Furthermore, a foreign exchange adjustment SEMO had applied to the 'rolling forward' of the baseline stipulated in the 2010-2013 price control in respect of the 25% relating to employees in Northern Ireland was included in the RAs proposals. This represented an increased allowance of €0.075 million per annum (€0.225 million over three years). The RAs have revised this adjustment to reflect an exchange rate experienced in recent months. Therefore the differential is significantly reduced to €0.015 million per annum (€0.045 million over 3 years). This is detailed in Table 5 above.

- 6.4.4 SEMO referred to inconsistencies in the amounts used as an average based on the 2010 decision.
- 6.4.5 **SEM Committee view:** SEMO's reference is partly due to a difference in approach in respect of the additional heads approved in July 2012 for both Intraday trading (IDT) and Fuel Mix Disclosure (FMD). In recognising the decisions made in both the 2010-2013 price control and for Intraday and FMD, the RAs rolled forward both allowances and applied indexation, before calculating an average headcount. SEMO's different approach was to take an average cost per head, which was calculated using only the price control decision and applying that average to the additional heads for Intraday and FMD.
- 6.4.6 Electric Ireland and SEMO both questioned the headcount analysis and requested further clarity.
- 6.4.7 **SEM Committee view:** SEMO's headcount is not straight forward as it includes resources that are reflected in payroll but recharged to EirGrid Group from Corporate Services. This is the case for two resources: a Reserve Constraint Unit Commitment (RCUC) resource recharged to the TSOs and more recently the introduction of a Guarantee of Origin (GOO) resource which is recharged to EirGrid TSO (as this function is for Ireland only). In summary, SEMO requested payroll commensurate with 64 resources including the above mentioned two recharged resources. The SEM Committee reduced headcount by one, leaving 63 heads remaining. 61 of these relate specifically to SEMO and two are included in payroll but recharged back to EirGrid Group via corporate charges. The breakdown provided in Table 5 provides additional clarity.

6.5 SEMC FINAL COMMENTS AND DECISION ON PAYROLL

- 6.5.1 SEMO submitted total payroll costs of €16.994 million including amounts for pension deficit and additional contract staff. The revised SEM Committee decision is to allow €15.375 million. Additional payroll submissions for contract staff and a pension scheme deficit are considered further below.
- 6.5.2 Considering SEMO's submission, historical expenditure and further information provided by SEMO, the SEM Committee decided that the allowance for payroll and separately, the headcount baseline, should be as follows:

SEMC DECISION 6: SEMO'S PAYROLL ALLOWANCE TO BE SET AT €5.125M PER ANNUM FOR YEARS 1, 2 AND 3 RESPECTIVELY.

SEMC DECISION 7: SEMO'S TOTAL HEADCOUNT BASELINE IS 63. THIS IS COMPRISED OF TWO HEADS WHICH ARE RECHARGED TO EIRGRID GROUP AND THE REMAINING 61 ARE SPECIFIC TO SEMO.

6.6 SEMC PROPOSALS ON CONTRACT STAFF

- 6.6.1 SEMO proposed in their submission an increase in their allowance for contract staff. The current annual allowance is €0.134 million; SEMO proposed an increase for the 2013-2016 price control period of €0.107 per annum bringing the total contract staff in SEMO's submission to €0.241 million per annum. This equates to €0.723 million for the three year period of the price control.
- 6.6.2 The RAs proposed that no allowance for contract staff should be given for the 2013-2016 period, so deducted the amount agreed at the 2010-2013 price control from the baseline. The reason for disallowing an amount for contract staff was that SEMO has now been in operation for over five years and has a structured plan for handling developments to the systems through a series of releases.

6.7 MARKET PARTICIPANTS RESPONSES TO CONTRACT STAFF AND SEMC COMMENTS

- 6.7.1 SEMO have suggested in their response to the consultation that the RAs should consider contract staff in two separate components. Firstly, the amount determined in 2010-2013 price control of €0.134 million per annum and secondly, SEMO's request for additional contract staff to the value of €0.107 million in each year of the 2013-2016 price control. SEMO insist on the €0.134 million previously agreed as part of the 2010-2013 baseline allowance being reinstated.
- 6.7.2 **SEM Committee view:** The SEM Committee are of the view that SEMO has reached a level of maturity where 'extra' contract staff on top of an organisation running at (almost) full capacity is no longer required. However, in recognising the benefits contract staff bring the SEM Committee have decided to provide an allowance for contract staff to align with the baseline agreed for the 2010-2013 price control of €0.134 million per annum.

6.8 SEMC FINAL COMMENTS AND DECISION ON PAYROLL

- 6.8.1 The SEM Committee accepts that contract staff offers flexibility in dealing with an unpredictable workload and in meeting the demands for specialist skills for a short term requirement. As SEMO have reached a level of maturity, there should be less need for contractors. The SEM Committee believe that adequate allowance is

provided for human resources elsewhere within total payroll and professional fees (for consultancy support).

SEMC DECISION 8: SEMO'S CONTRACT STAFF ALLOWANCE TO BE SET AT €0.134M, PER ANNUM IN YEARS 1, 2 AND 3.

6.9 SEMC PROPOSALS ON PENSION DEFICIT

6.9.1 In their submission, SEMO included a provision for pension deficit repair costs of €0.250 million per annum.

6.9.2 In the RAs consultation it was proposed to allow for ongoing pension costs, but not deficit recovery costs. The reason for this was that the revenue requirement for OPEX should be set at the level that would be possible for a new entrant to undertake SEMO's operational duties. Any costs in excess of that required by an efficient notional company should be borne by SEMO's shareholder.

6.10 MARKET PARTICIPANTS RESPONSES TO PENSION DEFICIT AND SEMC COMMENTS

6.10.1 SEMO's response states 'SEMO strongly believes the attributed cost of pension deficits should be provided as part of the revenue allowance. This is both as a general principle but particularly in the case of SEMO given that these largely relate to costs imposed upon it by legislative arrangements. To do otherwise imposes further impediment upon the SEMO balance sheet which it is not in a position to manage by virtue of the legislative constraints which are placed upon it. The revenue associated with the repair of pension deficit costs must be provided or at the very least the CER must provide clarity as to when, and on what basis, they will be assessed.'

6.10.2 **SEM Committee view:** The pension deficit of €0.250 million requested per annum relates solely to EirGrid. SEMO explain that the deficit is largely associated with the transfer of staff from ESB when EirGrid was formed in 2006. These historical liabilities were incurred before SEMO was established.

6.11 SEMC FINAL COMMENTS AND DECISION ON PAYROLL

6.11.1 The SEM Committee has decided that the treatment of EirGrid pension deficit will not be dealt with as part of this price control. This is consistent with the approach taken in EirGrid's current TSO current price control. EirGrid should liaise directly with CER on this issue.

SEMC DECISION 9: DISALLOW THE PROVISION FOR PENSION DEFICIT REPAIR

6.12 SEMC PROPOSALS ON IT & COMMUNICATIONS

6.12.1 Considering the complex IT systems deployed to support the SEM, IT & Communications is a significant OPEX area within SEMO's submission. This category makes up 24% of SEMO's OPEX proposals and the SEM Committee appreciate this is an area which is critical to the market. The cost components associated with IT and Communications are as follows:

- **Warrant Support & Maintenance: Market Systems** – these costs are largely made up of three elements: Support contracts for vendor maintenance, third party software and hardware items.
- **Warrant Support & Maintenance: Corporate Systems** – these costs cover requirements such as network and security IT services, website hosting, hardware support, Microsoft licences, Oracle licences and antivirus.
- **Other system maintenance** - This covers the costs associated with the support agreement for Dynamics AX, and other items such as Supportworks.
- **Telecoms Costs** – This covers the cost of operating the data links between the SEMO premises in Dublin and Belfast.

6.12.2 The table below outlines the RAs proposals in the consultation paper. The RAs carried out a detailed analysis of the IT support and maintenance cost in line with revenue cap regulation. The proposal takes into account efficiencies made in the 2010-2013 price control to date, followed by an upwards adjustment to recognise the renewal of key support contracts and increases for Oracle and Microsoft as specifically identified by SEMO. IT support costs for the new CAPEX projects have been revised to align with the approved CAPEX business cases only.

	SEMO's Submission				RAs Consultation Proposals			
	2013-2014	2014-2015	2015-2016	Total	2013-2014	2014-2015	2015-2016	Total
	€ millions				€ millions			
Telecommunications	0.227	0.227	0.227	0.681	0.227	0.227	0.227	0.681
IT Support & Maintenance	2.312	2.312	2.312	6.936	2.095	2.095	2.095	6.285
Total IT and Telecommunications	2.539	2.539	2.539	7.617	2.322	2.322	2.322	6.966
IT Support for CAPEX	0.025	0.080	0.110	0.215	0.015	0.061	0.091	0.167
TOTAL	2.564	2.619	2.649	7.832	2.337	2.383	2.413	7.133

Table 6: SEMO's Submission and RAs Proposals in respect of IT and Communications

6.13 MARKET PARTICIPANTS RESPONSES

6.13.1 The RAs did not receive any responses to the consultation paper specific to IT and Communication proposed. Therefore the SEM Committee is not minded to change their position from those proposed in the consultation.

6.14 SEMC FINAL COMMENTS AND DECISION ON IT & TELECOMMUNICATIONS

6.14.1 Considering the historical expenditure and SEMO's submission, the SEM Committee decided that the allowance for IT & Communications should be as follows:

SEMC DECISION 10: SEMO'S IT & COMMUNICATIONS ALLOWANCE TO BE SET AT €2.337M, €2.383M AND €2.413M IN YEARS 1, 2 AND 3 RESPECTIVELY.

6.15 SEMC PROPOSALS ON FACILITIES AND INSURANCE

6.15.1 SEMO has offices in both jurisdictions, i.e. Dublin and Belfast. SEMO will continue to co-locate on property provided by both parent companies and will be charged accordingly. Facilities costs cover all shared space and include rent, rates, insurance, utilities, cleaning services, maintenance, car parking, security, mail service, copy bureau, switch board catering and canteen services.

6.15.2 Facilities and insurance represents 13% of the overall proposed OPEX allowance requested by SEMO. The SEM Committee recognise these costs are predominantly a recharge from EirGrid Group based on headcount, and have therefore reviewed both the EirGrid TSO¹⁶ and SONI TSO¹⁷ price controls regarding decisions in place for facilities cost.

6.15.3 The table below shows historical information, SEMO's submission, and the RAs proposal as per the consultation paper.

	Historical Expenditure			SEMO's Proposal			RAs Consultation Proposal		
	Actuals 2011 - 2012 (indexed)	Allowance 2012-2013 (indexed)	SEMO's Estimate 2012-13	2013-2014	2014-2015	2015-2016	2013-2014	2014-2015	2015-2016
	€ millions			€ millions			€ millions		
Rent & Facilities- EirGrid				1.190	1.190	1.190	1.063	1.063	1.063
Facilities - SONI				0.193	0.202	0.202	n/a	n/a	n/a
Subtotal		1.360	1.276	1.383	1.392	1.392	1.063	1.063	1.063
General Insurance		0.053	0.050	0.055	0.055	0.055	0.050	0.050	0.050
Total Facilities including Insurance	1.136	1.413	1.326	1.438	1.447	1.447	1.113	1.113	1.113

Table 7: Facilities Table as per SEMO 2013-2016 Price Control Consultation Paper

¹⁶ Decision on TSO and TAO Transmission Revenue for 2011 to 2015 (page 123)

<http://www.cer.ie/en/electricity-transmission-network-current--consultations.aspx?article=163210c1-f11f-4713-bfc9-d3b1c2fb4df3&mode=author>

¹⁷ http://www.uregni.gov.uk/uploads/publications/SONI_Price_Control_decision_Paper_-_FINAL.pdf (page 23)

6.15.4 In arriving at the RAs consultation proposal the amounts, as determined in the current parent companies price controls, were indexed as appropriate.

6.15.5 The RAs recognise the majority of facility costs are fixed in the short term and therefore recommended the introduction of a fixed/variable apportionment. Our approach reflects that adopted for the SONI price control, with 55% of SEMO's facility costs being fixed and therefore 45% varying with future changes in headcount. This aligns with the decision in the SONI price control and is deemed appropriate when reviewing the breakdown of EirGrid Market Operator apportioned costs.

6.16 MARKET PARTICIPANTS RESPONSES TO FACILITIES AND SEMC COMMENTS

6.16.1 SEMO raised concerns in relation to a potential risk in changing the apportionment of costs to be applied to SEMO. SEMO confirmed that facilities are recharged from EirGrid Group based on a headcount apportionment.

6.16.2 **SEM Committee view:** Acknowledgment is made of the current apportionment being based on headcount. This is consistent with the treatment of facilities in both parent company price controls. Recognising the current facilities decisions are based on a headcount apportionment back in 2010, the RAs requested information on the updated apportionment which reflects the change in employee numbers in recent years. Having received this information, the decision made in this price control reflects the increased headcount apportionment of costs to SEMO on a consistent basis to that used in the parent companies price controls.

6.16.3 SEMO also responded specifically in relation to the RAs proposal on SONI market operator facility costs. They state 'In relation to costs associated with SEMO's facilities in Castlereagh House the Regulatory Authorities appear to have previously as part of the SONI control misinterpreted their own position and now appear to be proposing to continue with the perpetuation of this error going forward'. SEMO suggest 'an inaccurate statement in the SONI determination' is being upheld in this SEMO decision paper.

6.16.4 **SEM Committee view:** Having carried out a detailed assessment of the background information to SONI system operator decision in respect of facilities it has become clear that the headcount used was 98 for years 2013 to 2015. This aggregate headcount is determined in both SONI TSO price control and SEMO 2010 – 2013 price control as detailed in the table below.

Approved Headcount for SONI System Operator and Market Operator	2013	2014	2015	Comments
SONI SO Approved Headcount	84	84	84	Page 12 SONI decision paper
SEMO Headcount approved (NI proportion)	14	14	14	Based on 25% of 56 employees approved in 2010-13 price control
Total	98	98	98	Agrees with workings for SONI SO Facilities Decision

Table 8: Breakdown of Total Headcount as per SONI and SEMO Price Control Decisions

6.16.5 However, SONI's TSO price control determines 55% of facilities cost to be fixed (and therefore do not vary with headcount) with the remaining 45% flexing with changes in headcount. The fixed element relating to the SEMO employees based at Castlereagh House (SONI's offices) have already been included within the fixed proportion of facilities within SONI's TSO price control. However, the remaining variable proportion is due within this SEMO price control. Therefore this SEMO price control will include the facilities cost relating to the 45% variable element for **all** market operator employees based at Castlereagh House as determined by 25% of SEMO headcount detailed in this 2013-2016 price control.

6.16.6 The SEM Committee recognise from information received from SEMO following the consultation that the extension and refurbishment of Castlereagh House is likely to incur additional facility costs therefore the allowance sought by SEMO for this element has been included in this decision. This equates to €0.027 million total for the three year period.

6.16.7 Whilst the decision made specific to SONI market operator facilities is considerably less than the amount sought by SEMO, the SEM Committee is of the view that existing decisions made within both the EirGrid TSO and SONI TSO price controls have been correctly applied, indexed appropriately, and necessary adjustments made to reflect the current proportionate headcount. Furthermore, the RAs note a disparity in SONI system operator facility cost per head submission to that submitted by SEMO in respect of SONI market operator costs per head for the same building.

6.17 SEMC FINAL COMMENTS AND DECISION

6.17.1 The SEM Committee, having cross-checked the overall facilities decision with the actual outturn to date, are satisfied with their decision. This is evident from Table 9 below which details actual costs to date together with the allowance decision in this price control.

6.17.2 The revised allowance is set out in the table below:

	SEMO Historical Outturn				SEM Committee Decision			
	2010-2011	2011-2012	2012-2013 (based on 3 quarters)	Total	2013-2014	2014-2015	2015-2016	Total
	€ millions				€ millions			
Rent & Facilities - EirGrid					1.168	1.168	1.168	3.504
Facilities - SONI					0.035	0.035	0.035	0.105
Subtotal					1.203	1.203	1.203	3.609
General Insurance					0.050	0.050	0.050	0.150
Total Facilities including Insurance	1.123	1.136	1.211	3.470	1.253	1.253	1.253	3.759

Table 9: Summary of SEMO's Actual Costs and SEMC Decision in relation to Facilities

SEMC DECISION 11: SEMO'S FACILITIES ALLOWANCE TO BE SET AT €1.253M IN EACH YEAR OF THE PRICE CONTROL

SEMC DECISION 12: SEMO'S FACILITY COSTS TO BE SPLIT BETWEEN FIXED AND VARIABLE WITH 55% AND 45% PROPORTIONS, RESPECTIVELY

6.18 SEMC PROPOSALS ON OTHER OPEX

6.18.1 Other OPEX includes professional fees, general and administrative costs, and costs associated with corporate services. When combined these cost categories make up 12% of SEMO's OPEX submission for the 2013-2016 control period.

6.18.2 Professional fees cover SEMO's requirements for external professional services in respect of:

- General Consultant support
- Disputes
- Regulatory and Legal support
- Market Audit
- Corporate Audit
- Recruitment and Training
- Subscription and Membership Fees

6.18.3 General and Administration cover SEMO's requirement for the following:

- Travel and Expenses
- Committee Expenses including the Modification Committee Support
- Bank charges
- Meetings
- Stationery

6.18.4 Corporate Services cover an EirGrid Group recharge for services not directly undertaken by SEMO such as Human Resource Support, Payroll and Procurement.

Furthermore, a proportion of corporate overheads are recharged based on headcount. Corporate overheads relate to Boards, Chief Executive Officer, Chief Finance Officer, Group Finance, Group Regulation and Internal Audit. A recharge is also made for shared costs of senior staff (Information Services Director and General Manager). Corporate Services charges are reduced to reflect recharges from SEMO to Group in respect of the Reserve Constrained Unit Commitment (RCUC) payroll and IT costs which are only used by the System Operators. Furthermore, SEMO also recharge EirGrid TSO for the Guarantees of Origin payroll resource which is specific to Ireland only.

6.18.5 The table below presents SEMO's proposals and compares them with the historical expenditure.

	Historic data				SEMO's Submission			
	2010-11	2011-12	SEMO estimate 2012-13	Total	2013-2014	2014-2015	2015-2016	Total
Total Professional Fees	0.706	0.427	0.739	1.872	0.622	0.570	0.514	1.706
Total General and Administrative	0.236	0.336	0.390	0.962	0.369	0.369	0.369	1.107
Total Corporate Services	0.134	0.387	0.381	0.902	0.384	0.384	0.384	1.152
TOTAL OTHER OPEX	1.076	1.150	1.510	3.736	1.375	1.323	1.267	3.965

Table 10: Summary of Professional Fees, General & Administrative and Corporate Services

6.18.6 MARKET PARTICIPANTS RESPONSES

6.18.7 The RAs did not receive any responses to the consultation paper specific to professional fees, general and administrative costs and corporate services.

6.19 SEMC FINAL COMMENTS AND DECISION ON OTHER OPEX

6.19.1 SEMO has proposed an allowance of €3.965 million over three years. The SEM Committee has evaluated the future necessity and historical expenditure in arriving at their decision.

6.19.2 The proposed allowance in the consultation paper has been reviewed including those elements which flex with headcount. The SEM Committee has decided on a total allowance of €3.713 million for the three year period.

	SEMO's Submission				SEM Committee Decision			
	2013-2014	2014-2015	2015-2016	Total	2013-2014	2014-2015	2015-2016	Total
	€ millions				€ millions			
Total Professional Fees	0.622	0.570	0.514	1.706	0.616	0.563	0.509	1.688
Total General and Administrative	0.369	0.369	0.369	1.107	0.291	0.291	0.291	0.873
Total Corporate Services	0.384	0.384	0.384	1.152	0.384	0.384	0.384	1.152
TOTAL OTHER OPEX	1.375	1.323	1.267	3.965	1.291	1.238	1.184	3.713

Table 11: Summary of SEMO's Submission and SEM Committee Decision for Other OPEX

SEMC DECISION 13: SEMO'S ALLOWANCE IS TO BE SET AT €1.291M, €1.238M AND €1.184M FOR THE YEARS 1, 2 AND 3 RESPECTIVELY, AS SHOWN IN TABLE 11 ABOVE.

6.20 TOTAL OPEX

6.20.1 A summary of the OPEX decisions made for each cost category are compared with SEMO's submission and summarised in Table 12 below:

Total OPEX Summary	SEMO's Submission				SEM Committee Decision			
	2013-2014	2014-2015	2015-2016	Total	2013-2014	2014-2015	2015-2016	Total
	€ millions				€ millions			
Total Payroll	5.660	5.667	5.667	16.994	5.125	5.125	5.125	15.375
Total IT & Communications	2.564	2.619	2.649	7.832	2.337	2.383	2.413	7.133
Total Facilities and Insurance	1.438	1.447	1.447	4.332	1.253	1.253	1.253	3.759
Total Professional Fees	0.622	0.570	0.514	1.706	0.616	0.563	0.509	1.688
Total General and Administrative	0.369	0.369	0.369	1.107	0.291	0.291	0.291	0.873
Total Corporate Services	0.384	0.384	0.384	1.152	0.384	0.384	0.384	1.152
TOTAL OPEX	11.037	11.056	11.030	33.123	10.006	9.999	9.975	29.980

Table 12: Summary of Total OPEX decision

6.20.2 The SEM Committee decided to apply an annual RPI-0.3 to OPEX which will be adjusted to the above OPEX decision at the end of each year via the 'k' factor mechanism.

7 CAPITAL EXPENDITURE (CAPEX)

7.1 SEMC PROPOSALS ON CAPEX

7.1.1 The CAPEX allowance enables SEMO to recover the necessary financial resources to finance their capital investments from tariffs. The following five types of CAPEX have been identified as part of SEMO's submission:

1. Bi-annual IT Market Release CAPEX,
2. Bi-annual IT Market Release Support CAPEX,
3. Predictable Business CAPEX,
4. Unpredictable Business CAPEX,
5. Unknown Future Major Market Change CAPEX.

7.1.2 **Bi-annual IT Market Release CAPEX.** SEMO have recently entered into a new contract with a software vendor for six bi-annual releases over a period of three years, commencing with the October 2013 release until April 2016. The SEM Committee requires SEMO to manage the contract hours so as they are utilised in the best possible way over the three year period. An estimated amount of €3.300 million was included in SEMO's submission. SEMO have recently advised the final contract value to be €3.045 million.

7.1.3 In addition to the above funding for the main vendor contract SEMO proposes in their submission that each release would introduce a series of ancillary costs (to be incurred by SEMO) – **Bi-annual IT Market Release Support CAPEX.**

7.1.4 In its submission, SEMO has proposed an allowance for predictable capital expenditure. A **Predictable Business Capex** allowance enables SEMO to plan for hardware and software upgrades and the implementation of additional operational support systems as and when the need arises. The RAs have scrutinised SEMO's CAPEX proposals considering the costs and efficiency gains associated with each project.

7.1.5 SEMO proposes an allowance of €0.150 million per annum to cover unplanned spending to meet the day to day needs of SEMO on small investments such as software upgrades and availability of new products on the market that would deliver operational improvements i.e. **Unpredictable Business CAPEX.** The SEM Committee is of the view it is appropriate for SEMO to have an allowance for a level of unplanned expenditure in a given time period.

7.1.6 **Unknown Future Major Market Change CAPEX.** Finally, major CAPEX should be derived from major changes to the Trading and Settlement Code and supporting systems. The SEM Committee is of the view that major changes to the TSC will only occur in exceptional circumstances. For any major CAPEX, SEMO are required to

present their expenditure plans to the SEM Committee which in turn will determine the amounts and mechanisms for recovery of the required revenue.

- 7.1.7 Table 13 below presents the amounts involved in the determination of SEMO's CAPEX baseline (bi-annual release has been updated to reflect the actual contract value):

SEMO CAPEX Submission	2013-14	2014-15	2015-16	Total € million
Biannual IT Market Release CAPEX (revised)	1.218	1.218	0.609	3.045
Biannual IT Market Release Support CAPEX	0.408	0.408	0.200	1.016
Predictable Business CAPEX	2.377	1.528	0.700	4.605
Unpredictable Business CAPEX	0.150	0.150	0.150	0.450
Total	4.153	3.304	1.659	9.116

Table 13: SEMO's Revised CAPEX Submission

- 7.1.8 SEMO has a duty to minimise overall costs by efficiently and economically procuring and implementing services as required in both jurisdictional market operator licences. Therefore SEMO have an element of control over the expenditure, and utilisation of that expenditure, for each of the CAPEX items identified in their price control submission and summarised in Table 13 above.
- 7.1.9 The RAs commissioned Gemserv to carry out an objective assessment of SEMO's proposed business cases. The information provided by SEMO in their submission and subsequent responses to RAs requests, during the period when Gemserv were commissioned, had insufficient scope defined to carry out any objective benchmarking.
- 7.1.10 The key conclusion made in Gemserv's report is that SEMO's CAPEX proposals include many provisional sums in their cost lines. In aggregate, the provisional sums 'would seem to cover the majority of worst case scenarios relating to the scope they appear to support'.
- 7.1.11 SEMO proposed ten 'Predictable CAPEX' business cases which the SEM Committee approve with the exception of 'Participant Self Service Training Courses' and the introduction of 'two mobile apps' as part of the website infrastructure business case. These have been excluded from the allowance as the need for them had not been established and a cost benefit analysis had not been provided.
- 7.1.12 As Gemserv were unable to carry out any form of benchmarking of the CAPEX budgets proposed by SEMO the RAs have reviewed the historical performance to date in the 2010–2013 price control as a basis to apply to the present SEMO proposals. The baseline decision now reflects the overall expected outturn on total CAPEX, a saving, in relative terms, of 13.6%. This aligns with Gemserv's

recommendation 'to set the baseline at a level that is comparable, in relative performance terms, to the CAPEX outturn of the present price control compared with the approved budget.' Therefore the SEM Committee determines that the baseline for CAPEX is to be set at **€7.608 million**.

- 7.1.13 It should be noted, in assessing the total CAPEX saving, the allowance previously approved for new communications links of €1.9 million was excluded as this project is 'delayed until further notice due to insufficient need at the moment (March 2013)¹⁸. This €1.9 million will be returned via the 'k' factor mechanism. SEMO have re-submitted this business case at a value of €0.5 million in the 2013-2016 price control submission. This highlights the challenges for SEMO in achieving accurate forecasts.
- 7.1.14 In terms of CAPEX incentivisation the SEM Committee will continue with the application of menu regulation as introduced in the previous price control. Menu regulation presents SEMO with a menu of regulatory options embodying varying strengths of incentives. Following the revision of the CAPEX baseline, the menu options have been modified so as they are structured so that SEMO has an incentive to choose the option that matches most closely their expected outcome expenditure.
- 7.1.15 Menu regulation has the potential to deliver benefits for all stakeholders in the SEM by promoting greater control and accountability and delivering value for customers through revealing and promoting efficiency.

7.2 MARKET PARTICIPANT RESPONSES AND SEMC COMMENTS ON CAPEX

- 7.2.1 SEMO raised concerns regarding the CAPEX allowance proposed and stated 'the RAs have proposed an across the board 35% cut without substantiation other than by reference to previous expenditure against capital project forecasts prepared on an entirely different basis'.
- 7.2.2 **SEM Committee view:** In the absence of sufficient scope and cost detail in the submission for a benchmarking exercise to be carried out, the RAs have reviewed SEMO's historical performance. The RAs consulted on this method having regard for only the predictable and release support CAPEX outturn expected for the 2010–2013 price control when comparing the indexed approved allowance. The baseline decision of €7.608 million now reflects the overall expected outturn on total CAPEX, a saving, in relative terms, of 13.6%. With regard to the basis for preparing capital project forecasts SEMO had indicated that proposed CAPEX is built on whatever empirical data was available during the budget development from a range of sources

¹⁸ Market Systems Development Plan 5 published by SEMO

with varying degrees of confidence. It is difficult to understand how this would be an 'entirely different basis' from the previous price control.

- 7.2.3 SEMO were allowed visibility of the Gemserv Report, as commissioned by the RAs, on a confidential basis. In their response to the consultation, SEMO emphasised Gemserv's further recommendation that an 'up to allowance' be set at 95% of SEMO's submission (less any items which require further cost benefit).
- 7.2.4 **SEM Committee view:** Gemserv recommended two separate baselines. The first baseline was an amount which represented 95% of SEMO's submission. This was recommended as an 'up to allowance'. However a further recommendation was made that a second baseline be set at a level that is comparable, in relative performance terms, to the CAPEX outturn of the present price control compared with the approved budget. On this basis the SEM Committee has arrived at an overall CAPEX allowance of €7.608 million. The purpose of this was to apply stronger incentives around the SEM Committee's expected outturn for the price control period. Both baselines recommended in Gemserv's report are reflected in the menu regulation packages.
- 7.2.5 SEMO's response states 'the reality of the allowance proposed is that SEMO is unlikely to be in a position to carry out any of the projects.'
- 7.2.6 **SEM Committee view:** The SEM Committee's CAPEX allowance reflects a consideration of responses and additional information. This revised allowance is viewed by the SEM Committee as being a reasonable CAPEX allowance to facilitate the approved business cases. The SEM Committee is of the view that savings opportunities should emerge throughout the procurement process. With the continuation of menu regulation, SEMO has freedom to choose a different package from the SEM Committee's expectation. However a higher value package means that SEMO would receive diminished rewards for under-spend.
- 7.2.7 SEMO highlighted concerns in relation to the rules specified in the consultation paper. They suggest that the rules would hinder SEMO's position to carry out any of the CAPEX projects. SEMO refer specifically to the RAs reference to claw back benefits gained by SEMO which, following the RAs assessment, are deemed material forecast errors rather than efficiency gains.
- 7.2.8 **SEM Committee view:** The SEM Committee is concerned with the lack of visibility for the RAs to check ex-post the actual outcome for each business case. Therefore, to improve the 'observability' aspect of CAPEX, the mechanisms to monitor the budget and delivery of the projects, are detailed in section 7.4 'Regulatory Approach to Monitoring the Delivery of CAPEX Items'. There is one exception, from the consultation paper, which is the removal of the following mechanism:

- Where the SEM Committee deems that benefits gains have been as a result of forecast error rather than efficiency gains, benefits will be clawed back.

7.2.9 SEMO disagreed with the RAs proposal in which no provision was being made for unpredictable CAPEX. SEMO argue this is not a contingency against predictable CAPEX items but rather an amount to deal with unforeseen capital requirements which may/will arise in the course of any control.

7.2.10 **SEM Committee view:** SEMO have provided additional information in relation to the nature and costs of expenditure incurred during the 2010 – 2013 price control. The SEM Committee therefore includes an allowance for unpredictable CAPEX.

7.3 SEMC FINAL COMMENTS AND DECISION

7.3.1 The SEM Committee is of the view that the proposed set of rewards and penalties are sufficient to incentivise SEMO to act economically and efficiently. Table 14 below lists (in the green row) eight different packages which will be offered to SEMO. The dark blue column lists the possible outturn expenditure over three years. Across the table is the reward or penalty associated with each choice of package. SEMO would maximise their reward by selecting the package which matches with their ‘true’ or ‘best estimate’ expenditure expectations for the outturn figure (Dark Blue Column). The figures in Table 14 are in real values and should be indexed in accordance with the expenditure profile for each year of the price control.

7.3.2 In Table 14, Package 8 represents SEMO’s proposal in respect of the business cases which the SEM Committee has approved. Furthermore, package 8 is shown as the highest allowance available based on the analysis carried out on SEMO’s submission. The SEM Committee’s baseline (Package 5) reflects Gemserv’s further recommendation to set the allowance at a level that is comparable, in relative performance terms, to the CAPEX outturn of the 2010-2013 price control. SEMO are requested to notify the RAs as to which package they have chosen within one month of publication of this decision paper.

		Allowed Expenditure (Menu Choices in €'000)							
		80%	85%	90%	95%	100%	105%	110%	116%
Outturn Expenditure		Package 1	Package 2	Package 3	Package 4	Package 5	Package 6	Package 7	Package 8
		6,086	6,467	6,847	7,228	7,608	7,988	8,369	8,807
80%	6,086	784	780	768	749	723	689	647	589
85%	6,467	639	643	639	628	609	582	548	499
90%	6,847	495	506	510	506	495	476	449	409
95%	7,228	350	369	380	384	380	369	350	319
100%	7,608	205	232	251	262	266	262	251	229
105%	7,988	61	95	122	141	152	156	152	138
110%	8,369	-84	-42	-8	19	38	49	53	48
116%	8,807	-250	-199	-156	-121	-93	-73	-61	-56

Table 14: Menu Regulation Table for 2013 – 2016 Price Control

7.3.3 Some worked examples are provided to illustrate the incentive to SEMO to choose the package that reflects their expectations on the outturn CAPEX.

- **Example 1:** Suppose SEMO chooses package 5 (100% of the SEMC baseline). It can be seen from the table that SEMO would be rewarded with €0.266 million for spending €7.608 million. This reward is a premium for keeping the capital expenditure exactly equal to the SEM Committee's expectation.
- **Example 2:** Suppose SEMO chooses package 8, €8.807 million and the outturn expenditure on CAPEX by the end of the three years is €7.228 million (which represents 95% of the baseline). SEMO would receive a reward of €0.319 million. Given the outturn figure of €7.228 million SEMO would be better off if they chose package 4. In this case the reward would be €0.384 million rather than €0.319 million.

7.3.4 In addition to the rewards and penalties outlined in the menu:

- Any under-spend in relation to the chosen package will be clawed back by the regulatory authorities via the 'k' factor.
- Any over-spend in relation to the chosen package will be provided for via the k factor, limited to a cap of €8.807 million. Above this limit, SEMO will absorb the deficit.
- The maximum reward and maximum penalty will not exceed those defined in Table 14 above.

7.3.5 The ex-post adjustment derived from the package choice will be determined by the following formula.

$$CAPEX\ k = (\min(\text{€}8.807m, \text{Outturn CAPEX}) - \text{CAPEX Tariff Revenue}) + (\text{Reward} : \text{Penalty})$$

7.4 REGULATORY APPROACH TO MONITORING THE DELIVERY OF CAPEX ITEMS

7.4.1 The following general bullets outline the responsibility of SEMO and the approach the RAs will take in monitoring the delivery of each CAPEX business case:

- Timely notice should be given by SEMO of their intention to no longer take forward any capital business cases approved for the price control period;
- In the event of any of the projects submitted being cancelled by SEMO during the price control period, the RAs would revise the baseline and the revenue requirement

downward. The same incentive scheme would apply. This mechanism would prevent SEMO being rewarded simply by not implementing projects;

- SEMO would require the RAs approval in order to make any substitution to the list of projects submitted;
- The RAs will monitor the delivery of all projects composing the RAs baseline.

7.4.2 To enhance the 'observability' aspect of menu regulation the RAs must continue to receive an annual capital update in the form of an End of Year Capital Report already produced by SEMO. The RAs expect the following information (in addition to the information identified above) to be made available to the RAs:

- Each business case must be assigned an accounting cost centre within the Microsoft Dynamics software. This allows for a summary of actual outturn corresponding to each business case approved. This would significantly improve the visibility of CAPEX outturn.
- The End of Year Capital Report should summarise any projects which are no longer deemed necessary within the price control period or where alternative expenditure would be more appropriate. Such projects would have already been brought to the RAs attention on a timely basis.
- The End of Year Capital Report should confirm the following (where appropriate):
 - That no project has been withdrawn or is likely to be withdrawn;
 - That no substitution has taken place or is likely to take place.
- This report should be submitted to the RAs by 31 January of each year.
- An estimated timeframe should continue to be incorporated into the End of Year Capital Report.

7.4.3 There will be no intersection between the CAPEX and OPEX allowances. SEMO has auditable accounts for these two categories of expenditure and they are not interchangeable.

7.4.4 SEMO will provide a review at the end of the price control which will be reviewed and the necessary adjustments will be made to the subsequent tariff 'k' factor.

SEMC DECISION 14: MENU REGULATION WILL BE EMPLOYED TO DETERMINE SEMO'S CAPEX ALLOWANCE.

8 REGULATED ASSET BASE (RAB)

8.1.1 The value of SEMO's RAB at the start of this price control on 1 October 2013 is estimated at €13.951 million.

8.1.2 During the 2010-2013 price control, additional assets were added to the SEMO RAB at an estimated value of €16,781,936 (the final value has yet to be agreed with the RA's). As a result, SEMO has used this value in calculations for the price control submission.

8.1.3 The value of SEMO's RAB in October 2013 is outlined in the table below:

Summary	RAB Value at 01 October 2013
	€ millions
Day 1+	0.819
Other Assets Capitalised in 2009-10	0.829
Additions in 2010-2013 (IT Releases)	4.541
Intraday Trading Asset	7.762
Opening RAB Value October 2010	13.951

Table 15: Status of SEMO's RAB

SEMC DECISION 15: ALL CAPEX DURING THE NEW PRICE CONTROL PERIOD WILL BE INCORPORATED INTO THE EXISTING RAB USING THE HISTORICAL COST METHOD.

9 WEIGHTED AVERAGE COST OF CAPITAL (WACC)

9.1 SEMC PROPOSALS ON WACC

9.1.1 The application of a Weighted Average Cost of Capital (WACC) to a Regulated Asset Base (RAB) is a form of remuneration for the exposure to systematic risk.

9.1.2 The SEM Committee will continue to determine SEMO's WACC in accordance with the WACC of SEMO's parent companies (EirGrid and SONI). The current ratio of 3:1 will remain, with the weighting based on funding for SEMO being supplied in this ratio from EirGrid and SONI respectively.

9.1.3 Table 16 below shows the WACC applicable in the existing price controls for both SONI and EirGrid system operators which were set in 2010. The figures in Table 16 have been updated to reflect the most up-to-date corporation tax rate.

	Specified Proportion	WACC 2013/14	WACC 2014/15	Estimated WACC 2015/16
Eirgrid Transmission System Operator	75%	5.95% ¹⁹	5.95%	5.95%
SONI Transmission System Operator	25%	5.44% ²⁰	5.44%	5.44%
Blended Rate for SEMO WACC		5.82%	5.82%	5.82%

Table 16: SEMO's Blended WACC

9.1.4 The table below shows SEMO's estimations of the cost of capital for the next three years.

SEMO's Proposed WACC	2013-14	2014-15	2015-16	Total € millions
Total WACC	0.794	0.726	0.575	2.095

Table 17: SEMO's Proposed WACC

9.1.5 The table below shows the SEM Committee's estimation of the cost of capital for the next three years based on additional assets of €7.608 million during the three years and the blended WACC rate updated with the appropriate tax rate.

WACC Revenue Allowance	2013-14	2014-15	2015-16	Total € millions
Total WACC	0.758	0.659	0.504	1.921

Table 18: SEM Committee WACC Allowance

¹⁹ Real Pre-tax WACC as defined in Decision on EirGrid TSO Transmission Revenue for 2011 to 2015

²⁰ Real Pre-tax WACC as defined in SONI Price Control 2010 – 2015 Decision Paper

9.2 SEMC FINAL COMMENTS AND DECISION

9.2.1 Both parent companies (EirGrid and SONI) are due to have their next price controls implemented during SEMO's 2015-2016 price control year. Therefore SEMO's WACC will be adjusted in line with the WACC decisions reached by CER and the Utility Regulator in the forthcoming EirGrid and SONI price controls. Essentially SEMO's WACC will track the prevailing WACC of their parent companies.

SEMC DECISION 16: USE THE PREVAILING BLENDED WACC FROM EIRGRID AND SONI WITH THE CURRENT BLEND RATE OF 3:1 TO BE APPLIED.

10 DEPRECIATION

10.1 SEMC PROPOSALS ON DEPRECIATION

10.1.1 The depreciation charge forms one of the two largest components of SEMO's revenue request. The SEM Establishment project has now been fully depreciated and this has resulted in a substantial fall in the depreciation charge for 2012-2013 onwards.

10.1.2 SEMO proposed to continue to depreciate its assets subject to straight-line depreciation over a five year period. This methodology appears reasonable. Straight-line depreciation is often used by regulators, and five years is a reasonable asset life for IT and related assets. Continuing with a five year period is consistent with previous SEMO price controls.

10.1.3 SEMO's depreciation allowance includes amounts both for depreciation on its existing RAB and for depreciation associated with its proposed CAPEX. The table below shows SEMO's proposed depreciation figures.

Summary	2013-14	2014-15	2015-16	Total
	€ millions			
Depreciation Charge	5.284	5.045	4.829	15.158

Table 19: SEMO's Proposed Depreciation Charge

10.1.4 However, the SEM Committee's depreciation allowance based upon an expected CAPEX of €7.608 million is as follows²¹:

Summary	2013-14	2014-15	2015-16	Total
	€ millions			
Depreciation Charge	5.183	4.795	4.498	14.475

Table 20: SEM Committee's Depreciation Allowance

SEMC DECISION 17: DEPRECIATE ASSETS ON A STRAIGHT LINE BASIS OVER FIVE YEARS

²¹ Final depreciation and WACC figures will not be known until the menu selection is completed (and these figures will be used for tariff purposes)

11 INCENTIVISATION

11.1 SEMC PROPOSALS ON KEY PERFORMANCE INDICATORS

- 11.1.1 Incentives should encourage improved performance and are an effective mechanism to encourage benefit to stakeholders with better quality and service. They also benefit the regulated company by recognising the 'value add' of the overall business by offering a monetary reward. The reward should reflect consumers' willingness to pay for an improvement in performance standards. It is imperative that the incentives evolve with the organisation and represent a challenging target which is attainable with the utilisation of resources provided.
- 11.1.2 In the 2010-2013 price control the SEM Committee decided that a reward mechanism equivalent to three per cent of total OPEX allowance would be available for out-performing targets for six key performance indicators (KPIs). In its 2013-2016 price control submission SEMO has proposed a reward mechanism of six per cent of total OPEX allowance together with the introduction of two additional KPIs.
- 11.1.3 SEMO also proposed that in terms of assessing the KPIs, a measure be taken at the end of each month using the average value of each KPI over that period. This proposed approach represents a further relaxation of the prevailing quarterly criteria.
- 11.1.4 An underlying assumption in assessing the KPIs is the understanding that external factors outside of the Market Operators direct control are excluded e.g. Limited Communication failure by Market Participant, late provision of data by System Operators or the Meter Data Provider, Government policy changes, Regulatory Authorities policy changes etc.
- 11.1.5 The RAs agree that in recognition of higher performance gained from the value added by management and the investment strategy, incentives should evolve as the business matures. The RAs proposed increasing the incentive pot from 3% to 4% of OPEX revenue while also revising the target levels where appropriate. This recognises the greater experience gained over the years in managing the market operator business. The RAs also recommended maintaining the quarterly assessment, based on an average value of each KPI over that period. The RAs believe this incentivises SEMO to maintain good performance over a longer period to the benefit of participants in the form of a consistent good service.

11.1.6 SEMO has proposed lower targets than those currently in place for most of the existing KPIs and has proposed two new KPIs. SEMO’s submission and the RAs proposals are summarised in the table below. The new KPIs proposed by SEMO are Central Market System availability and Customer Training/Stakeholder Engagement.

	Weighting			Target			Upper Bound		
	Current	SEMO Proposed	RAs Proposal	Current	SEMO Proposed	RAs Proposal	Current	SEMO Proposed	RAs Proposal
Ex-ante pricing report	0.2	0.1	0.1	99%	97%	99%	100%	100%	100%
Ex-post initial pricing report	0.1	0.1	0.1	99%	97%	99%	100%	100%	100%
Invoicing	0.2	0.2	0.2	95%	95%	97%	100%	100%	97%
Credit Cover Increase Notices	0.2	0.1	0.1	99%	98%	99%	100%	100%	100%
SEMO related Resettlement queries	0.2	0.15	0.2	<15	<30	<9	10	10	5
General Queries	0.1	0.15	0.15	97% - 20 days	97% - 30 days	99% - 20 days	99% - 20 days	99% - 30 days	100% - 20 days
Central Market System Availability (7am 5pm Mon-Sun)		0.1	0.15		97%	99.90%		99%	100%
Customer Training/Stakeholder Engagement		0.1			1 Market Training Programme for market participants per annum and 6 individual customer meetings per quarter				

Table 21: SEMO and RAs proposals for KPI incentive scheme

11.1.7 System availability would be assessed against availability excluding planned outages. An assessment carried out on behalf of the SEM Committee in relation to system availability concluded that the Market Operator systems have high levels of resilience and mainly ‘hot’ standby facilities in line with the expectation for a high availability market critical system. With the systems and infrastructure in place, participants would not expect the systems to have unplanned outages for more than eight hours per year. This implies an availability target of approximately 99.9%.

11.1.8 Customer training and stakeholder engagement are important aspects of the SEMO business. This current centralised training arrangement benefits SEMO and participants in terms of reduced errors and good understanding held by participants. The RAs believe this KPI is difficult to measure particularly in respect of the customer/stakeholders perception of the quality of this engagement. Therefore the RAs, in the consultation paper, proposed not to include this as a new KPI.

11.2 MARKET PARTICIPANTS RESPONSES AND SEMC COMMENTS ON KPIS

11.2.1 SEMO suggest the proposed performance targets are too stringent and refer to SEMO’s historical performance, particularly since performance levels dropped from 82% (2010-2011) to 68% (2011-2012).

11.2.2 **SEM Committee view:** The RAs investigated this drop in performance and identified concerns in respect of the General Queries KPI. In 2011-2012, SEMO failed to meet the target in three quarters and obtained a partial reward for quarter 3 (April to June) 2012. The RAs requested information for quarter 1 of 2012-2013 (October to December 2012) which shows an improved actual performance of 97.66%. This

performance is above the 97% target and reflects SEMO's efforts to restore performance in this area. The SEM Committee proposes that the targets and upper bounds remain unchanged except for the following:

- General Queries KPI – reduce proposed target from 99% (20 days) to 97% (20 days)
- System availability target - reduced from 99.9% to 99.5% with the upper bound set to 99.9%.

11.2.3 SEMO believe they now run a real risk of incurring penalties which they can ill afford if the RAs introduce their proposal to penalise poor performance levels.

11.2.4 **SEM Committee view:** The possibility of introducing symmetrical KPIs was considered by the SEM Committee. The SEM Committee has decided to revise the targets for some KPIs and not to introduce penalties to the KPIs at this stage. It is hoped SEMO would gain rewards for high performance, however the worst possible scenario is no reward for targets not being met, on average, throughout each quarter.

11.2.5 SEMO suggest that in some cases the incentive offered doesn't compensate sufficiently for the effort required to deliver the KPI. SEMO then refer specifically to the General Query KPI which has a weighting of 10%.

11.2.6 **SEM Committee view:** The SEM Committee has considered this response and the summary of the Customer Satisfaction Survey provided by SEMO which identifies customer service as an area which could be improved. Therefore the SEM Committee has revised the weighting for General Queries from 10% to 15%, as proposed by SEMO, and reduced the proposed target to 97% (20 days) to make this KPI more attainable and reflect the cost/benefit associated with delivering this KPI on target.

11.2.7 SEMO mention there is no incentive for SEMO to maintain performance over a quarter if the KPI is missed early in the Quarter.

11.2.8 **SEM Committee view:** The SEM Committee revised the assessment period from annual to quarterly in a previous price control and therefore do not intend reducing this further to monthly, as suggested by SEMO. With SEMO's focus on customer service together with the average performance for the quarter being assessed, the SEM Committee is of the view there is sufficient incentive on SEMO in respect of their performance.

11.3 SEMC FINAL COMMENTS AND DECISION ON KPIS

11.3.1 The SEM Committee's view is that the SEMO's consultation response in relation to incentivisation of Key Performance Indicators was not encouraging. SEMO in

acknowledging the statement that ‘The reward should reflect the consumers’ willingness to pay for an improvement in performance standards’ focused on the corollary ‘the reward should be sufficient for the company to invest in service improvements’. The response did not reflect a customer focus, and the response to the RAs request for information relating to recent customer surveys was noted as limited. Whilst a number of targets have been revisited and the incentive increased from 3% (response quotes 4%) to 4%, the RAs intend considering how customer satisfaction regarding the services provided by SEMO can be transparently assessed and reported.

11.3.2 SEM Committee Final Considerations: Taking into account market participants’ responses, the SEM Committee determines SEMO should be incentivised for the achievement of the following KPI targets:

	Weighting		Target		Upper bound	
	Current	Decided	Current	Decided	Current	Decided
Ex-ante pricing report	0.2	0.15	99%	99%	100%	100%
Ex-post initial pricing report	0.1	0.1	99%	99%	100%	100%
Invoicing	0.2	0.2	95%	97%	100%	100%
Credit Cover Increase Notices	0.2	0.1	99%	99%	100%	100%
SEMO related Resettlement queries	0.2	0.2	<15	<9¹	10	<5²
General Queries	0.1	0.15	97%	97%³	99%	99%⁴
System Availability (7am to 5pm Mon - Sun)	-	0.1	-	99.5%⁵	-	99.9%⁶

1. 9 or less upheld queries incidents per quarter
2. 5 upheld queries incidents per quarter
3. 97% of Queries answered within 20 Business days
4. 99% of Queries answered within 20 Business days
5. 99.5% System availability between 7am and 5pm Monday - Sunday excluding planned outages
5. 99.9% System availability between 7am and 5pm Monday - Sunday excluding planned outages

Table 22: SEM Committee’s Decision on KPIs

11.3.3 The following conditions will apply:

- The metric is delivered within one hour of the targeted time;
- External factors which are demonstrably outside of the Market Operator’s direct control are to be excluded e.g. Limited Communication failure by Market Participant, late provision of data by System Operators or the Meter Data Provider, Government policy changes, Regulatory Authorities’ policy changes etc.;
- In terms of assessing the KPIs, a measure is to be taken at the end of each quarter using the average value of each KPI over that period;

- KPI incentive pot to be set at 4% of the total OPEX revenue for each year. The increase (from 3%) is justified by the fact that the SEM Committee has increased the targets of several KPIs.

SEMC DECISION 18: SEM COMMITTEE PROPOSALS FOR KEY PERFORMANCE INDICATORS TO BE ADOPTED AS DEFINED IN TABLE 22 ABOVE

12 K FACTOR

12.1 SEMC PROPOSALS FOR K FACTOR

12.1.1 An annual adjustment to the revenue allowance is necessary when setting the market operator tariffs for the forthcoming tariff year. Such an adjustment is referred to as a 'k factor adjustment' and is a mechanism which manages specific areas of SEMO's business which are exposed to risk. Therefore this adjustment factor reduces SEMO's overall risk profile.

12.1.2 The SEM Committee has proposed that the 'k' factor should apply an adjustment to reflect the actual cost of the annual market audit fee.

12.2 MARKET PARTICIPANTS RESPONSES

12.2.1 The RAs did not receive any responses to the consultation paper specific to the RAs proposals in respect of the application of the 'k' factor.

12.3 SEMC FINAL COMMENTS AND DECISION ON K FACTOR

12.3.1 The SEM Committee has decided to continue with the arrangements as outlined below.

12.3.2 Uncertain costs that cannot be reasonably foreseen by SEMO should be dealt on a cost pass-through basis via 'k' factor adjustment. These costs could include:

- Changes in legislation or regulation that impose unforeseen costs to SEMO's operations and capital investments;
- Restructuring costs driven by changes in legislation.

12.3.3 In addition, the 'k' factor adjustment should cater for the following:

- Adjustment to allow revenues to reflect any over or under recovery of revenue in comparison with the revenue allowance (ie adjust for market demand);
- Foreign exchange gains or losses catered on a cost pass through basis;
- Interest on funding from the parent company, EirGrid Group;
- Interest received on surplus funds;
- Market audit adjustment to reflect actual expense;

- Any capital underspend/overspend in relation to the chosen menu package. The 'k' factor is limited for capital overspend;
- Depreciation and WACC will require a separate 'k' factor adjustment. This specific treatment is required given that the timing of the CAPEX could deviate from the initial expectations and therefore will have a resulting impact on the depreciation and WACC costs;
- KPI reward and CAPEX menu regulation reward/penalty will be recovered through an adjustment of the 'k' factor;
- Any actual net outturn tax loss relating to accelerated recovery of CAPEX and any other adjustments necessary, specific to accelerated CAPEX recovery applied in the 2010-2013 price control.

12.3.4 The RAs would continue to expect an ex-post review report outlining separately the market operator tariff adjustments with detail provided on a line-by-line analysis. This report will continue to be provided in May each year to facilitate the annual tariff process. This report will detail the 'k' factor for the most recent year end September.

12.3.5 On receipt of this report the RAs will carry out a review and engage with SEMO to discuss any areas requiring clarification. Once all issues are closed, the RAs will seek approval from the SEM Committee for the 'k' factor adjustments as part of the overall market operator tariff approval process.

SEMC DECISION 19: K-FACTOR TO INCLUDE THE COMPONENTS REFERRED TO IN SECTION 12.3 ABOVE.

13 MANAGING UNCERTAINTY AND RISK WITHIN AN ASSET LIGHT UTILITY

13.1 MANAGING UNCERTAINTY AND RISK

13.1.1 As with any business there is an element of inherent business risk. The SEMO business is unique in that it is a contractual joint venture between the system operator in Ireland (EirGrid) and the system operator for Northern Ireland (SONI). SEMO also have a licence requirement to have in place a parent company guarantee from EirGrid plc (the legal and beneficial owner). This includes a requirement to ensure that the licensee has, at all times, adequate financial and non-financial resources to perform its obligations. Some aspects of the price control take consideration of these arrangements e.g. financeability, Weighted Average Cost of Capital (WACC) and recharges. This is consistent with the arrangements for the current price control.

13.1.2 However as a regulated business, the exposure to risk is mitigated to a large extent with a 'k' factor mechanism which provides for specific items, should they arise, to be addressed through a 'k' factor adjustment. The 'k' factor mechanism for this price control is consistent to that applied in the 2010-2013 price control and mitigates company risk by allowing an adjustment for under recovery of revenues; for foreign exchange rate losses; and for interest on funding from the parent company. Other measures are also included in the 'k' factor mechanisms to protect consumers.

13.1.3 The RAs acknowledge that SEMO have been proactive in mitigating risks and this has been evident in the current price control, with their day to day operation of the market and the implementation of various projects.

13.2 CONSIDERATION OF SEMO AS AN ASSET LIGHT UTILITY

13.2.1 In SEMO's consultation response they placed considerable emphasis on not being a typical utility but rather a business service provider operating in the utility sector. To this end they highlight the need to have appropriate incentives to deliver customer value and service to market participants.

13.2.2 Their response goes on to state that the declining RAB of the SEMO business means that it is more highly operationally geared and therefore exposed to greater liquidity and credit/revenue risk than in the case of previous controls. While acknowledging that the RAB has decreased, the SEM Committee note that SEMO's OPEX to RAB ratio is little different than that for SONI System Operator and higher than EirGrid's

System Operator ratio thereby concluding that the blended WACC applied is appropriate.

13.2.3 Reference was made to the existing licence requirement for a Parent Company Guarantee and the need to be remunerated for its provision.

13.2.4 The SEM Committee has considered this in detail and recognise contingent capital has a lower cost than actual capital. The SEM Committee has decided to remunerate SEMO for this, having been assured that neither EirGrid nor SONI are remunerated for such provision in their respective price controls.

13.2.5 The SEM Committee determined that an allowance of €0.300 million per annum as being appropriate remuneration for SEMO to facilitate their licence requirements in this regard. This amount has been determined based on an assessment of the fair value of the requirement to have in place the Parent Company Guarantee and the likely cost of procuring such a facility for contingent capital.

13.2.6 Whilst providing such an allowance for the provision of the current licence requirement, we consider it appropriate to review both the need for such provision and the quantum currently required. We also wish to state that the allowance provided within this price control should not be taken as a binding precedent as the RAs intend to look at this issue in more detail going forward.

13.2.7 This price control has been prepared by considering each cost area to arrive at an overall allowance. As with all price controls following acceptance of the price control determination, the management of costs is a matter for SEMO unless specifically identified as a 'k' factor adjustment item.

SEMC DECISION 20: SEMO TO BE ALLOWED A €0.300 MILLION ALLOWANCE PER ANNUM TO FACILITATE THEIR LICENCE REQUIREMENTS IN THIS REGARD

14 FORM AND MAGNITUDE OF CHARGES

14.1 As part of its role in the administration of the market there are charges which SEMO must levy in order to recover its own allowed costs and allowed market related costs.

These charges consist of:

- the accession fee;
- the participation fee;
- the market operator charges.

14.1.1 In order to be sustainable and cost-effective, the tariffs should seek to accurately recover the costs identified in a broadly cost-reflective way and to reflect an optimal regulatory approach.

14.1.2 For SEMO's costs, the TSC and Agreed Procedures allow for allocation of costs to a number of fees and charges. In respect of the Accession and Participation Fees, they should continue to reflect the costs of accession and registration.

14.2 ACCESSION FEES

14.2.1 The TSC states that the accession fee will be a fee paid to SEMO by each applicant for accession to the TSC, to cover SEMO's costs incurred in assessing the application. The SEM Committee has fixed this fee at €1,044 for the 2013-2016 price control period.

14.2.2 Currently these fees are simply netted off overall SEMO costs. The workload in SEMO for processing a Party Registration is approximately **4 days** work. With an estimate cost of €261 per day (which is based on this revenue decision paper and a weighted average cost per resource of €57,397 divided by 220 working days) the average cost is €1,044 per party registration.

14.3 PARTICIPATION FEES

14.3.1 In the TSC the participation fee is defined as 'the fee payable with an application to register and become a participant in respect of any unit'. The SEM Committee has fixed this fee at €2,610 for this price control period.

Currently these fees are simply netted off overall SEMO costs. The workload in SEMO for processing a Party Registration is approximately **10 days** work. With an estimate cost of €261 per day (based on this revenue decision paper and a weighted average cost per resource of €57,397 divided by 220 working days) the average cost is €2,610 per party registration.

14.4 MARKET OPERATOR CHARGES

14.4.1 The TSC states that the Market Operator Charge shall comprise of:

- a Fixed Market Operator Generator Charge, which may be different for each Generator Unit;
- a Fixed Market Operator Supplier Charge, which may be different for each Supplier Unit; and
- a Variable Market Operator Charge applicable to all Participants in respect of their Supplier Units, expressed in €/MWh.

14.4.2 During the new tariff period, these charges will recover SEMO's operational costs, the appropriate amount of depreciation associated with the SEM related capital costs incurred by EirGrid Market Operator and SONI Market Operator, the appropriate blended WACC and the 'k' factor adjustment.

14.4.3 The RAs propose that 95% of costs will be recovered through the Variable Charge. It is proposed that the fixed charges to Generators and Suppliers will recover the remaining 5% of all costs.

14.4.4 The final values of the 2013-2014 Market Operator tariffs will be published following this price control determination. Licence modifications will be consulted and finalised for implementation as soon as possible thereafter.

14.5 PROVISIONAL MARKET OPERATOR CHARGES

14.5.1 Provision tariffs are provided in Table 23 below based on decisions contained within this decision paper. It should be noted a final assessment of the 'k' factor is to be carried out together with updated parameters and confirmation from SEMO regarding the CAPEX menu package chosen before the final tariffs are announced.

	Current 2012-2013	SEMO's 2013-2014	SEM Committee 2013-2014
Costs to be Recovered by SEMO	€24.176 million	€20.759 million	€19.891 million
Recovery via Fixed Charge	€1.209 million	€1.038 million	€0.995 million
Recovery via Variable Charge	€22.967 million	€19.721 million	€18.896 million
Fixed Generator Charge (perMW)	€100	€86	€82
Fixed Supplier Charge (per Unit)	€366	€314	€301
Variable Supplier Charge (per MWh)	€0.698	€0.594	€0.569
Accession Fee	€1,115	€1,115	€1,044
Participation Fee	€2,788	€2,788	€2,610

Table 23: Provisional 2013-2014 Tariff compared to Current Tariff Period 2012-2013