



**Proposed Licence Modifications:
Licence to Act as SEM Operator granted to
SONI Limited**

Consultation Paper

SEM-16-072

04 November 2016

1. EXECUTIVE SUMMARY

This consultation paper relates to proposed changes to Annex 1, “Charging and Revenue Restriction”, of SONI Ltd’s Licence to act as SEM Operator (SONI MO Licence). The licence amendments¹ incorporate modifications to:

1. Ensure Annex 1 “Charging and Revenue Restriction” of the SONI MO Licence adequately codifies the Single Electricity Market Operator (SEMO) Price Control²;
2. Provide the Utility Regulator (UR) with the ability to approve SONI Market Operator (MO) annual tariffs.
3. Reflect the UR’s Decision Paper on “Modifications necessary due to the Gas and Electricity Licence Modification and Appeals Regulations (NI) 2015 (the ‘Regulations’)”³.

The SEM Committee (SEMC) periodically approve a single SEMO price control, with the current price control coming to an end on 30 September 2016 and being replaced by the recently published SEMO price control (SEM-16-043), which will apply from 1 October 2016 until 31 March 2019. Within the Republic of Ireland (ROI) price control decision papers represent a direction under the Electricity Regulation Act with tariff calculations made pursuant to the decision paper. However, in Northern Ireland (NI) the governance arrangements differ and at present there is no such legal framework for the SEMO price control and subsequent tariffs. Licence modifications are therefore required to address these shortfalls. The Regulations referred to in point three above facilitate the direct application of these modifications and also provide SONI with a clear appeal process should they wish to formally appeal the price control determination.

1. CODIFICATION OF PRICE CONTROL

The existing SONI MO Licence does not refer to or detail specific price control decisions and subsequently no specific modifications are required each time a new price control decision is made. Within the proposed Annex a specific reference to the price control decision is made in that the 'maximum allowed revenue' is the licensee's agreed specified proportion⁴ of the SEMO

¹ Attached as Appendix 2 to this Consultation Paper

² SEM-16-043 SEMO Price Control Decision Paper for period commencing 1 October 2016, published 3 August 2016

³ [http://www.uregni.gov.uk/uploads/news/150803_LMA_Decision_paper_\(final\).pdf](http://www.uregni.gov.uk/uploads/news/150803_LMA_Decision_paper_(final).pdf)

⁴ Market Operator Agreement between EirGrid and SONI. Parties agree to fund costs of SEMO in accordance with the specified proportions (75% EirGrid/25% SONI) with revenue from tariffs being reimbursed to each party on the basis of these agreed specified proportions [paragraph 5.1 Financial Matters].

price control decision. This specified proportion is 25% for SONI MO (the remaining 75% relates to EirGrid MO). This direct reference to the price control means the licence will have to be updated to reflect any subsequent price control decisions and this will provide the licensee with the appropriate right to appeal to any aspect of the price control as a result of the new Regulations.

2. TARIFF APPROVAL MECHANISM

The SONI MO Licence (Annex 1 paragraph 2) states "The Licensee shall, in setting its tariffs...use best endeavours to ensure that...revenue...shall not exceed the amount the Licensee determines is reasonable in all the circumstances for that relevant year."

Within the 2014/15 tariff setting process SEMO's tariff submission was higher than that provided within the relevant SEMO price control decision paper. The higher amount related solely to SONI's Parent Company Guarantee (PCG) allowance. The PCG is a specific licence requirement within the SONI MO Licence and SEMO sought to apply an annual value of €900k to tariffs rather than the €300k provided within the price control. Following UR senior management intervention a final agreement was reached in that the tariffs would reflect the price control allowances only.

The proposed modifications provide for a transparent tariff framework both when a price control is in place and in circumstances where a price control is absent. This provides the UR with a clear mechanism to avoid a similar situation to that experienced in the 2014/15 tariff setting process.

3. UPDATE TO REFLECT REGULATIONS

As a result of the Regulations a Licence Modifications and Appeals (LMA) workstream was set up within the UR to include a review of all electricity licences and the necessary changes required. The SONI MO Licence did not contain any consequential or expedient amendments as a result of the introduction of the Regulations and consequently was not included in the UR's Decision Paper on "Modifications necessary due to the Gas and Electricity Licence Modification and Appeals Regulations (NI) 2015"⁵. However, given that it is proposed to extensively modify Annex 1, the appeal provisions are now being included in the SONI MO Licence to afford SONI MO with the necessary right to appeal any licence amendments proposed by the UR.

⁵ [http://www.uregni.gov.uk/uploads/news/150803_LMA_Decision_paper_\(final\).pdf](http://www.uregni.gov.uk/uploads/news/150803_LMA_Decision_paper_(final).pdf)

Appendix 2 of this consultation paper contains Annex 1, as it currently stands, and the proposed Annex 1. The proposed licence modifications would be implemented under Article 14 of the Electricity Order 1992, as amended by the Regulations.

1.1 PROVISION OF COMMENTS

Comments are invited from industry and stakeholders, on the proposals within this consultation paper. All responses should be directed to Billy Walker at Billy.Walker@uregni.gov.uk, by 17:00 on Friday 2nd December 2016.

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Appendix 1 – Article 14 Licence Modification Notice

Appendix 2 – Current SONI SEM Operator Licence Annex 1 and Proposed SONI SEM Operator Licence Annex 1

3. INTRODUCTION

4.1 THE SINGLE ELECTRICITY MARKET

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 the transmission system operators, Eirgrid in ROI and SONI in NI. SEMO operates on a cross jurisdictional basis, with Eirgrid licensed as Market Operator in ROI and SONI in NI.

SEMO is licensed and regulated co-operatively by the Commission for Energy Regulation (CER), in ROI, and the UR in NI. To date, SEMO has been subject to a combined Regulatory Authority (RA) price control, approved by the SEM Committee (SEMC). The SEM is governed by the SEMC, which was set up by the Governments in ROI and NI. This Committee has representatives from both RAs, UR in NI and CER in ROI, together with an Independent Member.

The licence modifications proposed in this consultation paper relate solely to the SONI MO Licence and any amendments to the licence would be implemented under Article 14 of the Electricity Order 1992, as amended by the Regulations.

4.2 ROLE OF SEMO

SEMO's role in the market is explicitly defined in the SEM Trading and Settlement Code ("TSC")⁶, 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. Additionally, EirGrid and SONI must comply with the conditions within both their respective Market Operator (MO) licences.

SEMO's revenue requirement is determined on a combined basis for both Market Operators. Their operational and capital costs are recovered through MO tariffs and fees, which are levied on market participants. Tariffs are set on an all-island basis and recovered between Eirgrid and SONI in line with agreed proportions, which have regard to comparative levels of energy consumption in ROI and NI. The agreed current apportionment between EirGrid and SONI is 75% and 25% respectively.

⁶ <http://www.sem-o.com/MarketDevelopment/MarketRules/TSC.docx>

Both SONI and Eirgrid are party to the Market Operator Agreement⁷ which requires that each Market Operator works in conjunction with the other to ensure achievement of objectives on an all-island basis.

4.3 PURPOSE OF CONSULTATION

This consultation seeks stakeholder views on the proposed licence modifications contained in Appendix 2 of this paper.

4.4 HOW TO RESPOND

Comments are invited from industry and stakeholders, on the proposals within this consultation paper. All responses should be directed to Billy Walker at Billy.Walker@uregni.gov.uk, by 17:00 on Friday 2nd December 2016.

⁷ SONI Limited and Eirgrid PLC Market Operator Agreement, dated 03 July 2007

4. BACKGROUND

5.1 CURRENT ANNEX NOT FIT FOR PURPOSE

The SEMO Price Control, to cover the period from 1 October 2016 to 31 March 2019, was published on 3rd August 2016. As noted previously, the current SONI MO Licence does not provide for codification of this or any price control and does not provide the UR with the appropriate tariff approval powers. The need to ensure codification of the SEMO Price Control and an appropriate tariff approval mechanism was highlighted during the 2014/15 tariff setting process. The RAs and SEMO disputed the revenue amount needed to cover the SONI MO Licence requirement to have a PCG in place and the RAs had no suitable recourse under the SONI MO Licence as currently drafted.

Annex 1 of the SONI MO Licence currently states that, *“the revenue of the Market Operation Activity in each relevant year shall not exceed the amount the Licensee determines is reasonable in all the circumstances for that relevant year.”* Under an effective regulatory framework the licensee should not be accorded with the power to determine a reasonable level of revenue without the requirement for RA approval.

The UR have liaised extensively with external legal and SEMO, in respect of the licence modifications necessary to ensure that Annex 1 provides for codification of the SEMO Price Control, and an adequate tariff approval process. All parties involved agree that the Annex, as currently drafted, is not fit for purpose.

5.2 PROPOSED AMENDMENTS TO ENSURE ANNEX IS FIT FOR PURPOSE

The proposed Annex 1 aims to codify the SEMO Price Control, within the SONI MO Licence, through direct reference to it. As each new price control is instated this will be deemed to be a modification of the licence, providing the licensee with recourse under the new Regulations. Moreover, the updated Annex accords the UR with clear responsibility for approval of annual tariffs.

In terms of modifying the SONI MO Licence, complexity arises as SEMO’s revenue entitlement is determined on an all-island, cross jurisdictional basis. In order to ensure each Market Operator licence is operating within its jurisdictional vires, the total revenue entitlement, contained within the Price Control, must be split into an NI and an ROI portion. In order to reflect this, the proposed Annex incorporates the agreed current apportionment between Eirgrid and SONI and splits the total revenue entitlement, within the Price Control, on this basis. The agreed current apportionment is based on comparative levels of energy consumption in ROI and NI and

currently total revenue per the Price Control is split on a 75 (Eirgrid)/25 (SONI) basis. This 75/25 split reflects how the total allowed revenue, provided for within the Price Control, is recovered between both jurisdictions and this split is used throughout the SEMO Price Control, e.g. in relation to the WACC calculation where a blended WACC is derived from blending the WACCs applicable for Eirgrid and SONI in line with specified proportions. The RAs have carried out analysis confirming that this demand apportionment still reflects reality in terms of comparative levels of energy consumption on the island. This 75/25 break down is regularly used by both Eirgrid and SONI and is in line with the defined proportions in the Market Operator Agreement. Paragraph 13 of the proposed Annex accords the licensee with the ability to make an application to amend this 75/25 apportionment if they feel the split is no longer appropriate.

The RAs accept that not all elements of the SEMO Price Control are split on a 75/25 basis, with some costs being applicable solely to Eirgrid or solely to SONI. The RAs conducted analysis and concluded that the net effect of adjusting for these components is immaterial to tariffs and to SONI MO's revenue entitlement.

In order to reflect the all-island SEMO Price Control, within two separate licences, held in two different jurisdictions, some form of apportionment is required. The RAs wish to avoid the requirement for a dual tariff setting process within the SEM.

Q1 Respondents are asked to comment on the overall approach taken to modifying Annex 1 of the SONI Market Operator Licence to ensure it is fit for purpose.

5.3 THE REGULATIONS

On 6 February 2015, The Gas and Electricity Licence Modification and Appeals Regulations (Northern Ireland) 2015⁸ (Regulations) came into effect. The Regulations change the legislative procedure by which the UR can modify gas and electricity licences. The UR issued a Decision Paper on the "Modifications necessary due to the Gas and Electricity Licence Modification and Appeals Regulations (NI) 2015"⁹ (LMA Decision Paper) on 4th August 2015.

⁸ The Gas and Electricity Licence Modification and Appeals Regulations (Northern Ireland) 2015

⁹ [http://www.uregni.gov.uk/uploads/news/150803_LMA_Decision_paper_\(final\).pdf](http://www.uregni.gov.uk/uploads/news/150803_LMA_Decision_paper_(final).pdf)

The Regulations amend the procedures in the Gas and Electricity Orders so as to enable the UR to modify licence conditions without the requirement for consent from individual licensees or classes of licensees, but with a right for affected licence holders and other specified bodies, including the Consumer Council for Northern Ireland (CCNI), to appeal licence modifications to the Competition and Markets Authority (CMA).

As licence holders and the CCNI are permitted, under the new Regulations, to appeal directly to the CMA, it is no longer possible for the UR to refer matters to the CMA when licence holders do not agree with a UR decision. Prior to the UR's LMA Decision Paper, the majority of electricity licences relied upon the ability of the UR to refer matters to the CMA. As this is no longer possible under the Regulations, the licence conditions no longer worked in practice and modifications were necessary.

The UR decided to omit the SONI MO Licence from the LMA consultation and decision process as there were no requisite or expedient modifications necessary to the licence as a result of the Regulations coming into effect. However, given that it is being proposed to extensively modify Annex 1, the UR believes that the right of appeal should be inserted within the SONI MO Licence, in order to bring it into line with the SONI System Operator Licence, with minor adjustments where necessary.

Q2 Respondents are asked to comment on the overall approach taken to modifying Annex 1 of the SONI Market Operator Licence to reflect the new Regulations.